UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 8-K/A

CURRENT REPORT
Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

Date of report (Date of earliest event reported): October 30, 2023

Aileron Therapeutics, Inc.
(Exact Name of Registrant as Specified in Charter)

Delaware	**001-38130**	**13-4196017**
(State or Other Jurisdiction of Incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

738 Main Street #398 **Waltham, MA**	**02451**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant's telephone number, including area code: (617) 995-0900

(Former Name or Former Address, if Changed Since Last Report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (*see* General Instruction A.2. below):

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.001 par value per share	ALRN	The Nasdaq Capital Market

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Explanatory Note

On October 31, 2023, Aileron Therapeutics, Inc., a Delaware corporation ("Aileron" or the "Company") filed with the Securities and Exchange Commission a Current Report on Form 8-K (the "Original Report") to report that, among other things, the Company acquired Lung Therapeutics, Inc., a Texas corporation ("Lung"), pursuant to that certain Agreement and Plan of Merger, dated October 31, 2023 (the "Merger Agreement"), by and among Aileron, AT Merger Sub I, Inc., a Delaware corporation and a wholly owned subsidiary of Aileron ("First Merger Sub"), AT Merger Sub II, LLC, a Delaware limited liability company and wholly owned subsidiary of Aileron ("Second Merger Sub"), and Lung. Pursuant to the Merger Agreement, First Merger Sub merged with and into Lung, pursuant to which Lung was the surviving entity and became a wholly owned subsidiary of Aileron (the "First Merger"). Immediately following the First Merger, Lung merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity (the "Second Merger," together with the First Merger, the "Merger").

This Current Report on Form 8-K/A is being filed by the Company to amend the Original Report solely to provide the financial statement and financial information required by Item 9.01 of Form 8-K that were not filed with the Original Report.

Except as provided herein, the disclosures contained in this Current Report on Form 8-K/A have not been updated to reflect events, results or developments that have occurred since the filing of the Original Report. This Current Report on Form 8-K/A should be read in conjunction with the Original Report, which provides a more complete description of the Merger.

Item 9.01 Financial Statements and Exhibits

(a) Financial statements of businesses or funds acquired.

The financial statements required by Item 9.01(a) and the notes related thereto are filed as Exhibits 99.1 and 99.2 to this Current Report on Form 8-K/A.

(b) Pro forma financial information.

The pro forma financial information required by Item 9.01(b) and the notes related thereto are filed as Exhibit 99.3 to this Current Report on Form 8-K/A.

(d) Exhibits

Exhibit No.	Description
23.1	Consent of Deloitte LLP
99.1	Audited Consolidated Financial Statements of Lung Therapeutics, Inc. for the years ended December 31, 2022 and 2021
99.2	Unaudited Condensed Consolidated Financial Statements of Lung Therapeutics, Inc. for the nine months ended September 30, 2023 and 2022
99.3	Unaudited Pro Forma Condensed Combined Financial Information of Aileron Therapeutics, Inc. and Lung Therapeutics, Inc. as of September 30, 2023 and for the nine months ended September 30 2023 and for the year ended December 31, 2022
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AILERON THERAPEUTICS, INC.

Date: January 11, 2024

By: /s/ Manuel C. Alves-Aivado, M.D., Ph.D.
Manuel C. Alves-Aivado, M.D., Ph.D.
Chief Executive Officer

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in Registration Statement on Form S-3 (File No. 333-265470), Registration Statement on Form S-3 (File No. 333-252587), Registration Statement on Form S-3 (File No. 333-244367), Registration Statement on Form S-8 (File No. 333-258717), Registration Statement on Form S-8 (File No. 333-254659), Registration Statement on Form S-8 (File No. 333-237480), Registration Statement on Form S-8 (File No. 333-230592), Registration Statement on Form S-8 (File No. 333-224785) and Registration Statement on Form S-8 (File No. 333-219158) of Aileron Therapeutics, Inc. of our report dated May 25, 2023, relating to the financial statements of Lung Therapeutics, Inc. appearing in this Current Report on Form 8-K/A dated January 11, 2024 and included in Annex A of the Definitive Proxy Statement on Schedule 14A of Aileron Therapeutics, Inc.

/s/ Deloitte & Touche LLP

Morristown, NJ

January 11, 2024

Exhibit 99.1

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITOR'S REPORT

To the stockholders and Board of Directors of Lung Therapeutics, Inc.

Opinion

We have audited the consolidated financial statements of Lung Therapeutics, Inc. and subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2022 and 2021, the related consolidated statements of operations and comprehensive loss, convertible preferred stock and stockholder's deficit, and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Substantial Doubt About the Company's Ability to Continue as a Going Concern

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses from operations that raise substantial doubt exists about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

/s/ Deloitte & Touche LLP

Morristown, New Jersey
May 25, 2023

LUNG THERAPEUTICS, INC.

Consolidated Balance Sheets
(in thousands, except share and per share amounts)

	As of December 31, 2022	As of December 31, 2021
Assets		
Current assets:		
Cash and cash equivalents	$ 11,881	$ 11,483
Prepaid expenses and other current assets	2,714	8,073
Total current assets	14,595	19,556
Property and equipment, net	5	10
Operating lease right-of-use assets	221	—
Deferred financing costs	—	1,032
Other assets	27	27
Total assets	$ 14,848	$ 20,625
Liabilities, Convertible Preferred Stock and Stockholders' Deficit		
Current liabilities:		
Simple agreements for future equity	$ 13,435	$ —
Accounts payable	860	428
Deferred revenue	352	1,591
Operating lease liabilities, current	184	—
Accrued expenses and other current liabilities	1,753	2,306
Total current liabilities	16,584	4,325
Deferred revenue, net of current portion	2,515	1,964
Operating lease liabilities, net of current portion	48	—
Total liabilities	19,147	6,289
Commitments and contingencies (Note 10)		
Series A convertible preferred stock, par value $0.0001 per share; 10,888,283 shares authorized, issued and outstanding as of December 31, 2022 and 2021, respectively	2,874	2,874
Series B convertible preferred stock, par value $0.0001 per share; 23,152,737 shares authorized, issued and outstanding as of December 31, 2022 and 2021, respectively	14,293	14,293
Series C convertible preferred stock, par value $0.0001 per share; 41,076,061 and 44,162,774 shares authorized as of December 31, 2022 and 2021, respectively; 41,076,061 shares issued and outstanding as of December 31, 2022 and 2021, respectively	39,858	39,858
Stockholders' deficit:		
Common stock, par value $0.0001 per share; 106,000,000 shares authorized as of December 31, 2022 and 2021, respectively; 9,245,103 and 9,150,208 shares issued and outstanding as of December 31, 2022 and 2021, respectively	1	1
Additional paid-in capital	2,119	1,713
Accumulated deficit	(63,444)	(44,403)
Total stockholders' deficit	(61,324)	(42,689)
Total liabilities, convertible preferred stock and stockholders' deficit	$ 14,848	$ 20,625

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

LUNG THERAPEUTICS, INC.

Consolidated Statements of Operations and Comprehensive Loss
(in thousands)

	For the Year Ended December 31,	
	2022	**2021**
Licensing revenue	$ 688	$ 556
Operating expenses:		
Research and development	(22,465)	(15,397)
General and administrative	(6,763)	(4,720)
Total operating expenses	(29,228)	(20,117)
Loss from operations before gains from affiliate	(28,540)	(19,561)
Gain from sale of equity securities in TFF	9,400	9,373
Loss from operations	(19,140)	(10,188)
Other income, net:		
Interest income	99	30
Gain on extinguishment of PPP loan	—	253
Other income, net	—	2
Total other income, net	99	285
Net loss and comprehensive loss	$(19,041)	$ (9,903)

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

LUNG THERAPEUTICS, INC.

Consolidated Statements of Convertible Preferred Stock and Stockholders' Deficit
(in thousands, except share amounts)

	Convertible preferred stock										
	$0.0001 Par Value Series A		$0.0001 Par Value Series B		$0.0001 Par Value Series C		Common stock $0.0001 Par Value		Additional paid-in capital	Accumulated deficit	Total stockholders' deficit
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance, January 1, 2021	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,150,208	$ 1	$ 1,461	$ (34,500)	$ (33,038)
Stock-based compensation	—	—	—	—	—	—	—	—	252	—	252
Net loss	—	—	—	—	—	—	—	—	—	(9,903)	(9,903)
Balance, December 31, 2021	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,150,208	$ 1	$ 1,713	$ (44,403)	$ (42,689)
Stock-based compensation	—	—	—	—	—	—	—	—	393	—	393
Exercise of common stock warrants	—	—	—	—	—	—	75,000	—	9	—	9
Exercise of common stock options	—	—	—	—	—	—	19,895	—	4	—	4
Net loss	—	—	—	—	—	—	—	—	—	(19,041)	(19,041)
Balance, December 31, 2022	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,245,103	$ 1	$ 2,119	$ (63,444)	$ (61,324)

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

LUNG THERAPEUTICS, INC.

Consolidated Statements of Cash Flows
(in thousands)

	For the Year Ended December 31,	
	2022	**2021**
Cash flows from operating activities		
Net loss	$(19,041)	$ (9,903)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	5	6
Amortization of operating lease right-of-use assets	163	—
Deferred financing costs written off	1,032	—
Gain from sale of equity securities in TFF	(9,400)	(9,373)
Stock-based compensation expense	393	252
Gain on extinguishment of PPP loan	—	(253)
Changes in operating assets and liabilities:		
Due from licensing partner	—	5,000
Prepaid expenses and other current assets	5,359	(6,414)
Other assets	—	(15)
Accounts payable	1,113	(296)
Deferred revenue	(688)	(556)
Operating lease liability	(152)	—
Accrued expenses and other current liabilities	(553)	877
Net cash flows used in operating activities	(21,769)	(20,675)
Cash flows from investing activities		
Proceeds from sale of equity securities in TFF, net of commissions and other transaction costs of $0 and $637, respectively	9,400	9,373
Purchase of property and equipment	—	(5)
Net cash flows provided by investing activities	9,400	9,368
Cash flows from financing activities		
Proceeds from issuance of simple agreements for future equity, net of issuance costs	13,435	—
Proceeds from exercise of common stock options and warrants	13	—
Deferred financing costs	(681)	(351)
Net cash flows provided by (used in) financing activities	12,767	(351)
Net increase (decrease) in cash and cash equivalents	398	(11,658)
Cash and cash equivalents, beginning of year	11,483	23,141
Cash and cash equivalents, end of year	$ 11,881	$ 11,483
Non-cash financing activities:		
Recognition of right-of-use asset and operating lease liability	$ 384	$ —
Deferred financing costs included in accounts payable and accrued expenses	$ —	$ 681

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

Note 1. Description of Business

Lung Therapeutics, Inc. ("Lung Therapeutics" or the "Company"), was incorporated in November 2012 under the laws of the state of Texas. Its principal offices are in Austin, Texas. The Company's focus is developing novel therapeutics for orphan pulmonary and fibrosis indications with the potential to greatly improve patient outcomes over currently available treatments.

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned, non-operating subsidiaries, Lung Therapeutics Australia Pty Ltd ("Lung Therapeutics Australia") and Lung Therapeutics Limited, which is an Irish entity.

The Company is subject to risks and uncertainties common to clinical-stage companies in the biotechnology industry, including, but not limited to the risk that the Company never achieves profitability, the need for substantial additional financing, the risk of relying on third parties, risks of clinical trial failures, dependence on key personnel, protection of proprietary technology, and compliance with government regulations. The Company's lead product candidate, LTI-03, is being developed for the treatment of Idiopathic Pulmonary Fibrosis ("IPF") and has completed a healthy volunteer Phase 1a clinical trial. LTI-03 is currently in a Phase 1b clinical trial in IPF patients. The Company's second product candidate, LTI-01, is in development for loculated pleural effusion ("LPE"). The Company has completed Phase 1 and Phase 2 clinical trials in LPE patients.

Liquidity and Going Concern

In accordance with Accounting Standards Codification ("ASC") 205-40, *Going Concern* ("ASC 205-40"), the Company has evaluated whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date the accompanying consolidated financial statements were issued.

As an emerging growth entity, the Company has devoted substantially all of its resources since inception to its research and development efforts relating to its product candidates, including activities to manufacture product candidates, conduct clinical studies of its product candidates and perform preclinical research to identify new product candidates. As a result, the Company has incurred significant operating losses and negative cash flows from operations since its inception and anticipates such losses and negative cash flows will continue for the foreseeable future. To date, the Company has financed its operations primarily through private placements of convertible preferred stock, an upfront payment received from a licensing agreement, and sales of marketable equity securities in TFF Pharmaceuticals, Inc. ("TFF").

As of December 31, 2022, the Company had $11.9 million of cash and cash equivalents to fund its operations. Notwithstanding the amounts on hand, the Company anticipates it will need to secure additional funding through public or private convertible preferred financings, debt financings, and/or collaboration agreements or government grants over the next twelve months in order to continue to fund the Company's operations. Given the lack of a finalized plan to secure additional funding that would be considered probable of occurrence under ASC 205-40 as of the date of issuance of the accompanying consolidated financial statements, the Company can provide no assurance that additional funding will be obtained on acceptable terms, or at all. If the Company is unable to secure additional funding to continue to fund its operations over the next twelve months, the Company would need to pursue other alternatives, such as a scale back in its operating plan by deferring or limiting some or all of its research, development or clinical projects, further reductions to its workforce, and/or seek other strategic investment alternatives. Management has concluded the uncertainty surrounding the Company's ability to secure additional funding over the next twelve months raises substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that may result from the outcome of this uncertainty.

Note 2. Summary of Significant Accounting Policies

Basis of presentation

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Any reference in these notes to applicable guidance is meant to refer to the authoritative GAAP as found in the ASC and as amended by Accounting Standards Updates ("ASUs") of the Financial Accounting Standards Board ("FASB").

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Lung Therapeutics Australia Pty Ltd and Lung Therapeutics Limited. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates and assumptions reflected in these financial statements include, but are not limited to, the accrual for research and development expenses, the valuation of simple agreements for future equity ("SAFEs"), the valuation of warrants, and the valuation of common stock. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. Changes in estimates are recorded in the period in which they become known. Actual results could differ from those estimates.

Foreign Currency Transactions

The functional currency for the Company's wholly owned foreign subsidiary, Lung Therapeutics Australia Ltd., is the United States dollar. All foreign currency transaction gains and losses are recognized in the consolidated statements of operations and comprehensive loss.

Revenue Recognition

In accordance with ASC *Topic 606, Revenue from Contracts with Customers* ("ASC 606"), the Company recognizes revenue when the Company's customer obtains control of promised goods or services, in an amount that reflects the consideration which the Company expects to receive in exchange for those goods and services. To determine revenue recognition for arrangements within the scope of ASC 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when or as the Company satisfies a performance obligation.

At contract inception, once the contract is determined to be within the scope of ASC 606, the Company identifies the performance obligations in the contract by assessing whether the goods or services promised within each contract are distinct. The Company then recognizes revenue for the amount of the transaction price that is allocated to the respective performance obligation when, or as, the performance obligation is satisfied.

Licensing revenue

On November 12, 2020, the Company entered into a license agreement (the "License Agreement") with Taiho Pharmaceutical Co., Ltd ("Taiho"). This agreement is discussed further in Note 8 of Notes to Consolidated Financial Statements. The Company's license arrangements may include the transfer of intellectual property rights in the form of licenses, obligations to provide research and development services and products, and obligations to participate on certain development committees with licensing partners.

The terms of such license arrangements generally include payment to the Company of one or more of the following: nonrefundable upfront fees, payments for the supply of clinical products, payment for research and development services, payments related to milestone payments and royalties on net sales of licensed products. The Company assesses whether the promises in these agreements are considered distinct performance obligations that should be accounted for separately. Judgment is required to determine whether the license to the Company's intellectual property is distinct from the research and development services or participation on development committees.

The transaction price in each agreement is allocated to the identified performance obligations based on the standalone selling price, or SSP, of each distinct performance obligation as applicable. Judgment is required to determine SSP. Due to the early stage of the Company's licensed technology, the license of such technology is typically combined with the research and development services and committee participation as one performance obligation.

Revenue associated with nonrefundable upfront license fees where the license fees and research and development services cannot be accounted for as separate performance obligations is deferred and recognized as revenue over the expected period of performance using a cost-based input methodology. The Company utilizes judgment to assess the pattern of delivery of the performance obligation.

At the inception of each agreement that includes milestone payments, the Company evaluates whether the milestones are considered probable of being reached and estimates the amount to be included in the transaction price by using the most likely amount method. If it is probable that a significant reversal of cumulative revenue would not occur, the associated milestone value is included in the transaction price. Milestone payments that are not within the control of the Company or the licensee, such as regulatory approvals, are not considered probable of being achieved until those approvals are received or the underlying activity has been completed. The transaction price is then allocated to each performance obligation in the agreement based on relative SSP. At the end of each subsequent reporting period, the Company re-evaluates the probability of achievement of each such milestone and any related constraint, and if necessary, adjusts its estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect revenues and earnings in the period of adjustment.

Concentration of Credit Risk and Off-Balance Sheet Risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash and cash equivalents. Periodically, the Company maintains balances in operating accounts above federally insured limits. The Company deposits its cash in financial institutions that it believes have high credit quality. The Company has not experienced any losses on such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Investment in TFF

The Company applies the equity method of accounting to investments when it has significant influence, but not controlling interest in the investee. In assessing whether it can exercise significant influence, the Company considers key factors such as ownership interest, representation on the board of directors, participation in policy-making decisions and material intercompany transactions. Under the equity method of accounting, the Company records in its consolidated statements of operations and comprehensive loss its share of income or loss of the other company. If its share of losses exceeds the carrying value of its investment, the Company will suspend the recognition of additional losses. Pursuant to a contribution agreement executed on January 24, 2018, the Company's wholly-owned subsidiary, TFF, was spun out into a separate company, whereby the Company received 4,000,000 shares of TFF's common stock in exchange for providing TFF with certain intellectual property assets licensed by the Company from the University of Texas. The Company had previously concluded that it had the ability to exercise significant influence over the operating and financial policies of TFF. Consequently, during 2019 the Company had concluded that its share of TFF's net losses under the equity method was greater than the carrying value of its investment and as a result, had written down the investment in TFF to $0 and suspended the recognition of any additional losses by TFF.

In January 2022, the Company entered into a variable price forward sales contract with Jefferies LLC to sell 962,000 shares of TFF common stock based upon the daily volume-weighted average price during the three-month period ended March 31, 2022 plus a premium applied over the term of the contract. On April 1, 2022, the contract was consummated and as a result, the Company received total cash proceeds of $6.2 million from the sale of these shares. In April 2022, the Company sold 500,000 additional shares of TFF common stock to Bios Special Opportunity Fund, LP at a price of $6.43 per share, generating net proceeds of $3.2 million. Aaron G.L. Fletcher, a Board member of the Company and Managing Partner of Bios Partners, a shareholder of the Company, is the General Partner of Bios Special Opportunity Fund, LP.

In March 2021, the Company sold 715,000 shares of common stock of TFF at an average price of $14.00 per share, generating proceeds of $9.4 million, net of commissions and other direct selling expenses.

The Company recorded gains from the sale of these shares of $9.4 million and $9.4 million that are reflected under Gain from sale of equity securities in TFF on its consolidated statements of operations and comprehensive loss for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022, the Company's remaining ownership of TFF common stock amounted to 773,000 shares.

Fair Value Measurements

Certain assets and liabilities of the Company are carried at fair value under GAAP. 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 must maximize the use of observable inputs and minimize the use of unobservable inputs. Financial assets and liabilities carried at fair value are to be classified and disclosed in one of the following three levels of the fair value hierarchy, of which the first two are considered observable and the last is considered unobservable:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs (other than Level 1 quoted prices), such as quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities, including pricing models, discounted cash flow methodologies and similar techniques.

To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

An entity may choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings.

Simple Agreement for Future Equity - SAFE

The Company accounts for SAFEs at fair value in accordance with ASC 480, *Distinguishing Liabilities from Equity* ("ASC 480"). The SAFEs are subject to revaluation at the end of each reporting period, with changes in fair value recognized in the Company's consolidated statements of operations and comprehensive loss.

Cash and Cash Equivalents

Cash and cash equivalents consist of standard checking accounts and money market funds. The Company considers all highly liquid investments with an original maturity of 90 days or less at the date of purchase to be cash equivalents. The Company's cash equivalents are comprised of funds held in money market accounts and are measured at fair value on a recurring basis. As of December 31, 2022 and 2021, the fair value of cash equivalents was $11.8 million and $11.2 million, respectively.

Deferred Financing Costs

The Company capitalizes certain legal, professional accounting and other third-party fees that are directly associated with in-process equity financings as deferred financing costs until such financings are consummated. The deferred financing costs are initially recorded as a long-term asset on the balance sheet. After consummation of the equity financing, these costs are reclassified and recorded as a reduction to the carrying value of convertible preferred stock or of stockholders' deficit through a reduction of additional paid-in capital generated as a result of such offering. Should an in-process equity financing be aborted, the deferred financing costs will be expensed immediately as a charge to general and administrative expenses in the consolidated statements of operations and comprehensive loss.

As of December 31, 2022 and 2021, deferred financing costs amounted to $0 and $1.03 million, respectively. The deferred financing costs of $1.03 million as of December 31, 2021 were written off as a charge to general and administrative expenses during 2022, following the Company's decision to abort its plan to pursue an initial public offering.

Convertible Preferred Stock

The Company has classified convertible preferred stock, referred to as preferred stock, as temporary equity in the accompanying consolidated balance sheets due to terms that allow for redemption of the shares in cash upon certain change in control events that are outside of the Company's control, including sale or transfer of control of the Company as holders of the preferred stock could cause redemption of the shares in these situations. The Company did not accrete the carrying values of the preferred stock to the redemption values since a liquidation event was not considered probable as of December 31, 2022. Subsequent adjustments of the carrying values to the ultimate redemption values will be made only when it becomes probable that such a liquidation event will occur**.**

Income Taxes

The Company accounts for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the financial statements or the Company's tax returns. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities using the enacted statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Recognition of deferred tax assets is limited to amounts for which, in the opinion of management, realization is considered more likely than not in future periods.

Research and Development Expenses

Research and development costs are expensed as incurred. Research and development expenses are comprised of costs incurred in performing research and development activities, including stock-based compensation and benefits, facilities costs, costs of clinical trials, sponsored research, manufacturing, and external costs of outside vendors engaged to conduct preclinical development activities and trials.

Costs incurred in obtaining technology licenses are recognized as research and development expense as incurred if the technology licensed has not reached technological feasibility and has no alternative future uses.

The Company has entered into various research and development and other agreements with commercial firms, researchers, universities, and others for provisions of goods and services. These agreements are generally cancelable, and the related costs are recorded as research and development expenses as incurred. Research and development expenses include costs for salaries, employee benefits, subcontractors, facility-related expenses, depreciation and amortization, stock-based compensation, laboratory supplies, and external costs of outside vendors engaged to conduct discovery, preclinical and clinical development activities, and clinical trials as well as to manufacture clinical trial materials, and other costs. The Company records accruals for estimated ongoing research and development costs. When evaluating the adequacy of the accrued liabilities, the Company analyzes progress of the studies or clinical trials, including the phase or completion of events, invoices received and contracted costs. Significant judgments and estimates are made in determining the accrued balances at the end of any reporting period. Actual results could differ materially from the Company's estimates. Nonrefundable advance payments for goods or services to be received in the future for use in research and development activities are recorded as prepaid expenses. Such prepaid expenses are recognized as an expense when the goods have been delivered or the related services have been performed, or when it is no longer expected that the goods will be delivered, or the services rendered.

Upfront payments, milestone payments and annual maintenance fees under license agreements are expensed in the period in which they are incurred.

Patent Costs

All patent-related costs incurred in connection with filing and prosecuting patent applications are expensed as incurred due to the uncertainty about the recovery of the expenditure. Amounts incurred are classified as general and administrative expenses.

Leases

At inception of a contract, the Company determines whether an arrangement is or contains a lease. For all leases, the Company determines the classification as either operating leases or financing leases. Operating leases are included in Operating lease right-of-use assets and Operating lease liabilities in the Company's consolidated balance sheets.

Lease recognition occurs at the commencement date and lease liability amounts are based on the present value of lease payments over the lease term. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. If a lease does not provide information to determine an implicit interest rate, the Company uses its incremental borrowing rate in determining the present value of lease payments. Right-of-use ("ROU") assets represent the Company's right to use an underlying asset for the lease term, and lease liabilities represent the Company's obligation to make lease payments under the lease. ROU assets also include any lease payments made prior to the commencement date and exclude lease incentives received. Operating lease payments are expensed using the straight-line method as a general and administrative expense over the lease term. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. The Company has elected to apply the practical short-term expedient to leases with a lease term of 12 months or less, which does not subject the leases to capitalization.

Stock-Based Compensation

The Company's stock-based compensation expense stems from granted awards that may include stock options, restricted stock awards, restricted stock units, and other stock-based awards. The fair values of stock option grants are estimated as of the date of grant using a Black-Scholes option valuation model. The estimated fair values of the awards are expensed over the requisite service period, which is generally the vesting period of the award. The Company accounts for forfeitures as they occur. For performance-based awards, the Company does not recognize expense until the underlying vesting conditions are deemed to be probable of occurrence.

The Company utilizes significant estimates and assumptions in determining the fair value of its common stock. The Company has utilized various valuation methodologies in accordance with the framework of the American Institute of Certified Public Accountants Technical Practice Aid, *Valuation of Privately-Held Company Equity Securities Issued as Compensation* (the "Practice Aid"), to estimate the fair value of its common stock. Each valuation methodology includes estimates and assumptions that require the Company's judgment. These estimates and assumptions include a number of objective and subjective factors, including external market conditions, the superior rights and preferences of securities senior to the Company's common stock at the time of, and the likelihood of, achieving a liquidity event, such as an initial public offering or sale. Significant changes to the key assumptions used in the valuations could result in different fair values of common stock at each valuation date.

The Company historically has been a private company and lacks company-specific historical and implied volatility information for its stock. Therefore, it estimates its expected stock price volatility based on the historical volatility of publicly traded peer companies and expects to continue to do so until such time that it has adequate historical data regarding the volatility of its own traded stock price. The expected term of the Company's stock options granted to employees was determined utilizing the "simplified" method for awards that qualify as "plain-vanilla" options. The expected term of stock options granted to non-employee consultants is equal to the contractual term of the option award. The risk-free interest rate is determined by reference to the U.S. Treasury yield curve in effect at the time of grant of the award for time periods approximately equal to the expected term of the award. Expected dividend yield is based on the fact that the Company has never paid cash dividends on common stock and does not expect to pay any cash dividends in the foreseeable future.

Comprehensive Income or Loss

Comprehensive income or loss consists of net income or loss and changes in equity during a period from transactions and other equity and circumstances generated from non-owner sources. For the years ended December 31, 2022 and 2021, the Company's net loss equals comprehensive loss.

Recently Issued Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies and are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its financial position or results of operations upon adoption.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* ("ASU 2016-02"), which requires lessees to recognize ROU assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. In July 2018, the FASB issued ASU No. 2018-10, *Codification Improvements to Topic 842, Leases* and ASU No. 2018-11, *Leases (Topic 842): Targeted Improvements*, which offered a practical expedient for transitioning at the adoption date. ASU No. 2018-11 provides registrants with an option to not restate comparative periods presented in the financial statements.

The Company adopted the new standard on January 1, 2022 using the effective date as the date of initial application. Consequently, prior period amounts were not adjusted and will continue to be reported in accordance with historical accounting policies under ASC 840*, Leases (Topic 840)*. The Company elected the package of practical expedients under which the Company did not reassess prior conclusions about lease identification, lease classification and initial direct costs. Additionally, the Company made a policy election to not recognize ROU assets and lease liabilities related to short-term leases that have a term of twelve months or less.

The largest impact upon adoption of this new standard was the recognition of ROU assets and lease liabilities on the consolidated balance sheet, as the Company's lease portfolio primarily consists of an operating lease for its corporate headquarters in Austin, Texas. The Company recognized ROU assets and corresponding lease liabilities of $384,000 at the date of adoption, determined based on the present value of the remaining minimum rental payments under current leasing standards for the existing operating lease. The Company's results of operations and cash flows were not materially impacted by the adoption of this new standard.

Note 3. Fair Value Measurements

The following tables present information about the Company's assets measured at fair value on a recurring basis and indicate the level of the fair value hierarchy utilized to determine such fair values (in thousands):

	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As of December 31, 2022				
Assets:				
Money market funds	$11,763	$11,763	$ —	$ —
SAFEs	13,435	—	—	13,435
Total	$25,198	$11,763	$ —	$ 13,435
As of December 31, 2021				
Assets:				
Money market funds	$11,204	$11,204	$ —	$ —
Total	$11,204	$11,204	$ —	$ —

The fair value of the SAFEs is based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy.

There were no transfers between fair value levels during the years ended December 31, 2022 and 2021. The carrying values of other current assets, accounts payable and accrued expenses approximate their fair values due to the short-term nature of these assets and liabilities.

Simple Agreement for Future Equity - SAFE

In March and April 2022, the Company executed a series of SAFE arrangements primarily with new investors, pursuant to which the Company received net proceeds in an aggregate amount equal to $13.4 million. The fair value of the SAFEs on the date of issuance was determined to equal the proceeds received by the Company. The SAFE arrangements provide investors with future equity by conversion of the SAFE amounts into preferred stock at the Company's subsequent equity financing event, to the extent that the Company receives aggregate gross proceeds of at least $20,000,000 and provided that such equity financing event occurs prior to December 31, 2022, the date of maturity of the SAFE. The initial discount for the SAFE was 90%, but if, prior to the subsequent equity financing event, the Company has supplied to any potential third-party investor the results of its Phase II data with respect to its drug candidate LTI-01, the discount is reduced to 80%. If there is no equity financing prior to December 31, 2022 that yields aggregate gross proceeds of at least $20,000,000, or if a liquidity or dissolution event of the Company does not occur, each SAFE will automatically convert into the Company's Series C Preferred Stock at the original issuance price of such Series C shares.

The SAFEs are not mandatorily redeemable, nor do they require the Company to repurchase a fixed number of shares. The Company determined that the SAFEs contain a liquidity event provision that embodies an obligation indexed to the fair value of the Company's preferred shares and could require the Company to settle the SAFE obligation by transferring assets or cash. For this reason, the Company records the SAFEs as a liability under ASC 480 and re-measures the fair value at the end of each reporting period, with changes in fair value reported in earnings. As of December 31, 2022, the fair value of the SAFEs was determined to be $0.98, the price at which they will convert into shares of Series C Preferred Stock. Accordingly, the Company did not record any fair value changes associated with the SAFEs during the year ended December 31, 2022.

The following table sets forth a summary of the activities of the SAFE arrangements which represents a recurring measurement that is classified within Level 3 of the fair value hierarchy wherein fair value is estimated using significant unobservable inputs (in thousands):

	Amount
Balance as of December 31, 2021	$ —
Issuance of SAFEs	13,435
Change in fair value	—
Balance as of December 31, 2022	$13,435

Non-Recurring Fair Value Measurements

The Company issued warrants to purchase common stock in 2014, 2015, 2018, and 2019, pursuant to its convertible preferred stock issuances (See Note 11 of Notes to Consolidated Financial Statements) and its license agreement with Vivarta Therapeutics LLC (See Note 9 of Notes to Consolidated Financial Statements). All warrants were determined to be equity-classified and recorded as part of additional paid in capital at fair value using the Black-Scholes option pricing model. The warrants are not subsequently remeasured.

Preferred Stock Warrants

Prior to 2020, the Company had issued to its preferred shareholders a total of 7,096,828 warrants to purchase shares of common stock. Of these warrants, 3,043,184 were granted in connection with Series A and Series B convertible preferred stock ("Series A" and "Series B") issuances and 4,053,644 were granted in conjunction with the issuance of the Company's convertible Series C preferred stock ("Series C") (See Note 11 of Notes to Consolidated Financial Statements). In November 2021, the Company issued an additional 122,045 warrants to purchase shares of common stock. No additional warrants to purchase shares were issued in 2022. The Company had determined the fair value of these warrants using the following inputs: fair value of common stock at the time of issuance, exercise price, the contractual period, risk free rate, volatility, and dividend yield. These warrants to purchase a total of 7,218,873 shares of the Company's common stock remained outstanding as of December 31, 2022 and 2021, and none have been exercised to date.

Vivarta Therapeutics LLC Warrants

In March 2018, the Company had issued warrants to purchase 75,000 shares of common stock to Vivarta Therapeutics LLC ("Vivarta"). The Company determined the fair value of the warrants using the fair value of the common stock at the time of issuance, the exercise price, contractual period, volatility, and dividend yield. These warrants to purchase 75,000 shares of common stock were wholly exercised by Vivarta during the year ended December 31, 2022 at a price of $0.12 per share.

Note 4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	As of December 31,	
	2022	2021
Prepaid research and development	$2,544	$7,946
Other	170	127
Total prepaid and other current assets	$2,714	$8,073

Note 5. Property and Equipment, net

Property and equipment, net consisted of the following (in thousands):

	As of December 31,	
	2022	2021
Property and equipment:		
Furniture and equipment	$ 53	$ 53
Total property and equipment	53	53
Less: accumulated depreciation	(48)	(43)
Property and equipment, net	$ 5	$ 10

Depreciation expense was $5,000 and $6,000 for the years ended December 31, 2022 and 2021, respectively.

Note 6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	As of December 31,	
	2022	2021
Accrued compensation and benefits	$ 904	$ 847
Clinical and development costs	657	628
Deferred financing costs	—	626
Other	192	205
Total accrued expenses and other current liabilities	$1,753	$2,306

Note 7. Notes Payable

On April 15, 2020, the Company obtained a loan from Ciera Bank in the aggregate amount of $251,000 (the "PPP Loan") pursuant to the Small Business Administration Paycheck Protection Program under the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act").

The PPP Loan, which was in the form of a promissory note dated April 15, 2020, had a maturity date of April 15, 2022 and bore interest at a rate of 1% per annum. No payments had been made under the loan, although interest continued to accrue during the deferment period. Under the terms of the CARES Act, PPP Loan participants could apply for and be granted forgiveness for all or a portion of loans if proceeds were used for qualifying expenses, including payroll, benefits, rent and utilities, and provided that participants maintain their payroll levels.

The Company applied for forgiveness of the loan and was notified by the lender in May 2021 that an aggregate amount of $253,000, including accrued interest on the loan, had been approved for forgiveness in accordance with PPP guidelines. The forgiveness of the loan was recorded as a gain on extinguishment of debt in the Company's consolidated financial statements during the second quarter of 2021.

Note 8. Licensing Arrangement with Taiho

On November 12, 2020, the Company entered into a License Agreement with Taiho pursuant to which the Company is collaborating with Taiho regarding the development and potential commercialization of the Company's lead product candidate, LTI-01. Under the License Agreement, the Company granted Taiho an exclusive, royalty-bearing license to develop, seek regulatory approval for, and commercialize LTI-01 in Japan. The Company is obligated to conduct all development activities for LTI-01 through regulatory approval in the United States or other markets worldwide, except Japan. The Company will retain the right to commercialize LTI-01 in all markets worldwide except Japan. Under the terms of the License Agreement, the Company, in part through its participation in a joint development committee with Taiho, will participate in overseeing the development and commercialization of LTI-01 in Japan.

In consideration for the exclusive, royalty-bearing license and other rights contained in the License Agreement, Taiho agreed to make a non-refundable, non-creditable payment to the Company of $5.0 million. This up-front payment, deemed a partial reimbursement of past and future development costs for LTI-01, was received by the Company in February 2021. The License Agreement also provides that the Company is eligible to receive an additional milestone payment of $10.0 million.

In addition, the Company will receive royalties on net sales of LTI-01 in Japan. Royalties will be payable during the period commencing on the first commercial sale of LTI-01 in Japan and ending upon the later of: (a) ten years from the date of first commercial sale of LTI-01 in Japan; and (b) expiration of the last-to-expire valid claim of the Company's patents covering the manufacture, use or sale or exploitation of LTI-01 in Japan.

The Company evaluated the License Agreement under ASC 606 and determined that there is one combined performance obligation that consists of the license and data transfer, the research and development services in which the Company will use commercially reasonable efforts to further the development of LTI-01, including execution of the necessary clinical trials, and supply of all clinical products during the term of the Agreement. These deliverables are non-contingent in nature.

The Company's assessment of the transaction price included an analysis of amounts it expected to receive, which at contract inception consisted of the non-refundable, upfront payment of $5.0 million that was received by the Company in February 2021. The Company considered this non-refundable fee of $5.0 million to be the initial transaction price.

The Company determined that the combined performance obligation is satisfied over time. The Company concluded that it will utilize a cost-based input method to measure its progress toward completion of its performance obligation and to calculate the corresponding amount of revenue to recognize each period. The Company believes this is the best measure of progress because other measures do not reflect how the Company transfers its performance obligation to Taiho. In applying the cost-based input method of revenue recognition, the Company uses actual clinical study enrollment figures as well as actual costs incurred relative to budgeted costs expected to be incurred for the combined performance obligation. These costs consist primarily of third-party contract costs relative to the level of patient enrollment in the studies. Revenue will be recognized based on the level of costs incurred relative to the total budgeted costs for the performance obligations. A cost-based input method of revenue recognition requires management to make estimates of costs to complete the Company's performance obligation. In making such estimates, significant judgment is required to evaluate assumptions related to cost estimates. The cumulative effect of revisions to estimated costs to complete the Company's performance obligation will be recorded in the period in which changes are identified and amounts can be reasonably estimated. A significant change in these assumptions and estimates could have a material impact on the timing and amount of revenue recognized in future periods.

The Company also determined that the milestone payment of $10.0 million under the License Agreement is variable consideration under Topic 606 which needs to be added to the transaction price when it is probable that a significant revenue reversal will not occur. Based on the nature of milestones, such as the regulatory approvals which are generally not within the Company's control, the Company will not consider achievement of this milestone to be probable until the uncertainty associated with such milestone has been resolved. When it is probable that a significant reversal of revenue will not occur, the milestone payment will be added to the transaction price for which the Company recognizes revenue. As of December 31, 2022 and 2021, no milestones had been achieved under the License Agreement.

The Company will recognize royalty revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied). As of December 31, 2022 and 2021, no royalty revenue has been recognized.

For the years ended December 31, 2022 and 2021, the Company recognized revenue totaling $688,000 and $556,000, respectively, from its agreement with Taiho. As of December 31, 2022 and 2021, the Company recorded current deferred revenue of $0.35 million and $1.59 million, and noncurrent deferred revenue of $2.52 million and $1.96 million, respectively, on its consolidated balance sheets.

Note 9. License Agreements

Agreements with the Board of Regents of the University of Texas System ("UT System")

In June 2013, May 2014 and May 2015, the Company entered into three license agreements with affiliates of the Board of Regents of the University of Texas (collectively, the "UT Agreements"). These three affiliated entities (collectively, the "UT entities") are as follows: University of Texas Health Science Center at Tyler ("UTHSCT"), University of Texas Horizon Fund ("UT Horizon Fund") and University of Texas at Austin ("UT Austin"). The UT Agreements were accounted for as asset acquisitions and do not meet the definition of a business under ASU 2017-01, *Business Combinations—Clarifying the definition of a business* ("ASC 805").

Pursuant to the UT Agreements, the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the UT intellectual property, which includes future rights to royalties on licensed products. The UT Agreements also provide for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms within the UT Agreements. The UT Agreements can be terminated at-will by the Company with 90 days' notice, or by the UT entities in the event of a material breach of terms. Under the UT Agreements, the Company is responsible for the following payments, which are made to the indicated parties:

- *License Fees* – The Company is required to make annual payments of $10,000 for license fees under the UT Austin agreement until the agreement is terminated. Under the UT Austin agreement, the Company made a license fee payment of $10,000 during each of the years ended December 31, 2022 and 2021.
- *Sublicensing fees* – The Company will pay a percentage of non-royalty sublicensing consideration for the UT Agreements, with varying rates that will depend on when the sublicensing agreement is executed.
- *Assignment fee* – The Company will pay the greater of 10% of the consideration received or $100,000, if any of the UT Agreements are assigned to a third party.

- *Royalties* – The Company will pay tiered royalties that are in the low-to-mid single-digit percentages, based on net sales of all products licensed under the UT Agreements.
- *Milestones* – The Company will make milestone payments to UT Austin of up to $395,000 if specified regulatory and clinical development milestone events occur. There were no milestone payments made during each of the years ended December 31, 2022 and 2021.

The Company's expense associated with annual license fees and milestone payments under the UT Agreements was $10,000 for each of the years ended December 31, 2022 and 2021, respectively. All license fee and milestone payments are recorded as general and administrative expenses in the consolidated statements of operations and comprehensive loss.

In addition to the UT Agreements, the Company previously conducted sponsored research programs with and retained the UT entities to provide certain research-related services. The Company's expense associated with these sponsored research and other services was $34,000 for the year ended December 31, 2021. No such expense was incurred during the year ended December 31, 2022. Payments for these sponsored research and other services were recorded as research and development expenses in the consolidated statements of operations and comprehensive loss. As of December 31, 2022 and 2021, no amounts were payable to the UT entities for sponsored research and other services rendered to the Company.

Agreement with Medical University of South Carolina ("MUSC")

In March 2016, the Company entered into a license agreement with MUSC (the "MUSC Agreement"), pursuant to which the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The MUSC Agreement was accounted for as an asset acquisition and does not meet the definition of a business under ASC 805.

The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the MUSC intellectual property, which includes future rights to royalties on licensed products. The MUSC Agreement also provided for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms in the MUSC Agreement. The MUSC Agreement can be terminated at-will by the Company with 90 days' notice, or by MUSC only in the event of a material breach of terms. Under the MUSC Agreement, the Company is responsible for the following payments:

- *License Fee* – The Company was obligated to and paid a one-time, nonrefundable license fee of $10,000 at the execution of the MUSC Agreement.
- *Sublicensing fees* – The Company will pay sublicensing fees, which vary from 15-30% of total consideration based on the Company's progression through each phase of development.
- *Transaction fee* – The Company will pay the lesser of $2.5 million or 1% of total consideration in the event of a liquidation.
- *Royalties* – The Company will pay a running royalty rate in the low single digits on all net sales and is also required to pay annual minimum royalties of $10,000 on the third, fourth, and fifth anniversaries of the execution date and $25,000 on the sixth anniversary of the execution date and all years thereafter. Under this agreement, the Company made minimum royalty payments of $25,000 and $10,000 for each of the years ended December 31, 2022 and 2021, respectively.
- *Milestones* – The Company will make milestone payments to MUSC of up to $300,000 if specified regulatory and clinical development milestone events occur. There were no milestone payments made during the years ended December 31, 2022 and 2021.

The Company's expense associated with minimum royalty and milestone payments under the MUSC Agreement was $25,000 and $10,000 for the years ended December 31, 2022 and 2021, respectively. All minimum royalty and milestone payments are recorded as general and administrative expenses in the consolidated statements of operations and comprehensive loss.

Agreement with Vivarta Therapeutics LLC ("Vivarta")

In March 2018, the Company entered into a license agreement with Vivarta (the "Vivarta Agreement"), pursuant to which the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The Vivarta Agreement was accounted for as an asset acquisition and does not meet the definition of a business under ASC 805.

The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the Vivarta intellectual property, which includes future rights to royalties on licensed products. The Vivarta Agreement also provided for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms in the Vivarta Agreement. The Vivarta Agreement can be terminated at-will by the Company with 90 days' notice, or by Vivarta only in the event of a material breach of terms. Under the Vivarta Agreement, the Company is responsible for the following payments:

- *License Fee* – The Company was obligated to and paid one-time, nonrefundable license fees of $10,000 due upon the execution of the Vivarta Agreement and $40,000 due upon receipt by the Company of a positive freedom to operate analysis.
- *Sublicensing fees* – The Company will pay sublicensing fees, which vary from 5-40% of total consideration based on the Company's progression through each phase of development.
- *Royalties* – The Company will pay a running royalty rate in the low single digits on all net sales.
- *Milestones* – The Company will make milestone payments to Vivarta of up to $6.83 million if specified research, regulatory and clinical development milestone events occur. A milestone payment in the amount of $50,000 was made to Vivarta during the year ended December 31, 2022 following the attainment of a research and development milestone. No milestone payments were made to Vivarta during the year ended December 31, 2021.

Pursuant to the Vivarta Agreement, the Company issued warrants to Vivarta to purchase 75,000 shares of common stock at an exercise price of $0.12 per share in 2018 (See Note 3 of Notes to Consolidated Financial Statements). These warrants were wholly exercised by Vivarta during the year ended December 31, 2022.

The Company's expense associated with license fees and milestones under the Vivarta Agreement amounted to $50,000 and $0 in each of the years ended December 31, 2022 and 2021, respectively. Any license fee and milestone payments are recorded as general and administrative expenses in the consolidated statements of operations and comprehensive loss.

Note 10. Commitments and Contingencies

Lease Agreements

On August 16, 2021, the Company entered into an operating lease agreement to rent approximately 6,455 square feet of office space for its corporate headquarters in Austin, Texas, beginning on October 1, 2021. The lease agreement is for a 30-month term that ends on March 31, 2024 and includes a rent escalation clause and a rent holiday. Rent expense during the year ended December 31, 2021 for this lease agreement was recognized on a straight-line basis over the lease term. In addition to the base rent, the Company was also responsible for its share of operating expenses, electricity and real estate taxes, in accordance with the terms of the lease agreement.

In May 2019, the Company entered into an operating lease agreement to rent approximately 2,560 square feet of office space for its corporate headquarters in Austin, Texas. The lease agreement was for a 28-month term that ended on October 31, 2021 and had included a rent escalation clause which resulted in average cash rental payments of $51,000 per year. Rent expense during the year ended December 31, 2021 for this lease agreement was recognized on a straight-line basis over the lease term. In addition to the base rent, the Company was also responsible for its share of operating expenses, electricity and real estate taxes, in accordance with the terms of the lease agreement.

Amounts reported in the Company's consolidated balance sheet as of December 31, 2022 for the existing operating lease were as follows, in thousands:

Assets	
Operating lease right-of-use assets	$221
Total operating lease right-of-use assets	$221
Liabilities	
Current	
Operating lease liabilities	$184
Noncurrent	
Operating lease liabilities, net of current	48
Total operating lease liabilities	$232

Operating lease costs for the year ended December 31, 2022 amounted to $184,000. Rent expense was $88,000 for the year ended December 31, 2021.

The maturities of the operating lease liabilities and minimum lease payments as of December 31, 2022 were as follows, in thousands:

For the Years Ending December 31,	Operating Lease
2023	$ 193
2024	48
Total undiscounted lease payments	241
Less: Imputed interest	(9)
Present value of operating lease liabilities	$ 232

The following table summarizes the lease term and discount rate as of December 31, 2022:

	As of December 31, 2022
Remaining lease term (years)	
Operating lease	1.25
Discount rate	
Operating lease	6.6%

Operating cash flows used for the operating lease during the year ended December 31, 2022 amounted to $172,000.

License Agreements

The Company is required to make certain payments under its license agreements, related to patent expenses, license fees, and assignment fees, as well as milestone and royalty payments upon the achievement of certain development and sales-based events (See Note 9 of Notes to Consolidated Financial Statements).

Legal Proceedings

The Company may from time to time be party to litigation arising in the ordinary course of business. As of December 31, 2022 and 2021, the Company was not party to any legal proceedings and no material legal proceedings are currently pending or, to the best of the Company's knowledge, threatened.

Note 11. Convertible Preferred Stock

The Company has issued Series A convertible preferred stock ("Series A"), Series B convertible preferred stock ("Series B") and Series C convertible preferred stock ("Series C"), collectively referred to as Preferred Stock.

As of December 31, 2022 and 2021, the authorized shares of Preferred Stock consisted of the following:

	As of December 31, 2022	As of December 31, 2021
Series A	10,888,283	10,888,283
Series B	23,152,737	23,152,737
Series C	41,076,061	44,162,774
	75,117,081	78,203,794

As of December 31, 2022 and 2021, the issued and outstanding shares of Preferred Stock consisted of the following (in thousands, except amounts):

	Preferred stock issued and outstanding	Carrying value	Liquidation value	Common stock issuable upon conversion
Series A	10,888,283	$ 2,874	$ 2,931	10,888,283
Series B	23,152,737	14,293	14,307	23,152,737
Series C	41,076,061	39,858	39,911	41,076,061
	75,117,081	$57,025	$ 57,149	75,117,081

The Company recorded all issued shares of Preferred Stock at fair value on the date of issuance, net of issuance costs. All Preferred Stock has a par value of $0.0001 per share. The rights, privileges, and preferences of the Preferred Stock are discussed below.

Voting

On any matter presented to the stockholders of the Company for their action or consideration at any meeting of stockholders of the Company (or by written consent of stockholders in lieu of meeting), each holder of outstanding shares of Preferred Stock shall be entitled to cast the number of votes equal to the number of whole shares of common stock into which the shares of Preferred Stock held by such holder are convertible as of the record date for determining stockholders entitled to vote on such matter. Except as provided by law or by the other provisions of the Company's articles of incorporation, holders of Preferred Stock shall vote together with the holders of common stock as a single class.

The holders of outstanding shares of Preferred Stock shall be entitled to elect one member of the Board of Directors (the "Board").

Dividends

The holders of Preferred Stock are entitled to an 8% non-cumulative dividend. Dividends are payable only when and if declared by the Board. No dividends are payable to the common stockholders unless a dividend is also paid to preferred stockholders equal to at least the amount that would be received if the shares of Preferred Stock were converted into common stock. To date, the Company has not declared or paid any dividends.

Liquidation Preference

In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the Company, holders of shares of Preferred Stock then outstanding shall be entitled to receive an amount per share equal to the Preferred Stock original issue price, plus any dividends declared but unpaid thereon, prior to any distribution to the common shareholders.

Note that in relation to the above, no series of the Preferred Stock has a higher liquidation preference than another, but the Preferred Stock as a whole has a higher liquidation preference than the common stock.

Redemption

The Company's certificate of incorporation, as amended and restated, does not provide redemption rights to the holders of Preferred Stock.

Conversion

Each share of Preferred Stock shall be convertible into shares of common stock on a one-for-one basis at the option of the stockholder, at any time, and without the payment of additional consideration by dividing the Preferred Stock original issue price by the conversion price. The conversion price may be adjusted for issuance of additional shares of Common Stock, for stock splits, for stock combinations, for certain dividends and distributions, and for mergers and reorganizations.

Note 12. Stockholders' Deficit

Common Stock

As of December 31, 2022, the Company had 106,000,000 shares of common stock authorized, of which 9,245,103 were issued and outstanding.

The holders of the Company's common stock are entitled to one vote for each share of common stock held at all meetings of stockholders and written action in lieu of meetings; there is no cumulative voting. The holders of outstanding shares of common stock shall be entitled to elect one member of the Board.

After payment to the holders of shares of Preferred Stock of their liquidation preferences, the remaining assets of the Company are distributed to the holders of the Company's common stock.

Shares of common stock reserved for future issuance were as follows:

	As of December 31,	
	2022	2021
Preferred Stock issued and outstanding	75,117,081	75,117,081
Warrants to issue shares of common stock	7,218,873	7,293,873
Stock options outstanding	11,611,674	11,261,257
Shares available for future grants under the Plan	2,407,145	2,777,457
	96,354,773	96,449,668

Warrants

As of December 31, 2022, a total of 7,218,873 warrants to purchase the Company's common stock were outstanding. All of the Company's outstanding warrants are non-tradeable and equity-classified because they meet the derivative scope exception under ASC Topic 815-40, *Derivatives and Hedging—Contracts in Entity's Own Equity* ("ASC 815-40").

Note 13. Stock-Based Compensation

In October 2013, the Company's board of directors approved the 2013 Long-Term Incentive Plan (the "Plan") to provide long-term incentives for its employees, non-employee directors and certain consultants. As of December 31, 2022, the Company was authorized to issue a total of 14,188,922 shares of common stock under the Plan and as of that date, a total of 2,407,145 shares remained available for future issuance.

The Plan is administered by the board of directors or, at the discretion of the board of directors, by a committee of the board of directors. The exercise prices, vesting and other restrictions are determined at the discretion of the board of directors, or its committee if so delegated, except that the exercise price per share of stock options may not be less than 100% of the fair market value of the share of common stock on the date of grant and the term of stock option may not be greater than ten years. The vesting periods for equity awards are determined by the Board, but generally are four years. The contractual term for stock option awards is ten years.

A summary of the stock option activity for the year ended December 31, 2022 is as follows:

	Year Ended December 31, 2022	
	Shares	Weighted Average Exercise Price
Outstanding, beginning of year	11,261,257	$ 0.16
Granted	430,000	0.79
Exercised	(19,895)	0.24
Cancelled or forfeited	(59,688)	0.31
Expired	—	—
Outstanding, end of year	11,611,674	$ 0.21
Vested and expected to vest, end of year	11,611,674	$ 0.21
Exercisable, end of year	7,986,566	
Weighted-average fair value of options granted during the year	$ 0.62	

As of December 31, 2022, the aggregate intrinsic value of all outstanding stock options was $6.7 million and for exercisable stock options was $4.8 million. A total of 19,895 stock options were exercised during the fiscal year ended December 31, 2022 at a weighted average exercise price of $0.24. The intrinsic value per option at December 31, 2022 is calculated as the difference between the exercise price of the underlying option and the estimated fair value of the Company's common stock on that date, which was $0.79 per share. The total fair value of options that vested during the fiscal year ended December 31, 2022 was $372,000.

Unrecognized compensation expense related to non-vested employee stock options amounted to $554,000 as of December 31, 2022. Such compensation expense is expected to be recognized over a weighted-average period of 1.76 years.

Stock-based compensation expense amounted to $393,000 and $252,000 for the years ended December 31, 2022 and 2021, respectively. The table below shows the allocation of this stock-based compensation expense (in thousands):

	Year Ended December 31	
	2022	2021
General and administrative	$ 307	$ 211
Research and development	86	41
Total	$ 393	$ 252

Stock-based compensation expense recognized in the statement of operations and comprehensive loss for the years ended December 31, 2022 and 2021 does not reflect tax related effects on stock-based compensation given the Company's historical and anticipated operating losses.

The fair value of each option granted by the Company is estimated on the grant date using the Black-Scholes stock option pricing model. For the options granted during the years ended December 31, 2022 and 2021, the following assumptions were made in estimating fair value:

	Year Ended December 31	
	2022	2021
Dividend yield	—%	—%
Expected term (in years)	5.00 - 6.08	5.50 - 6.08
Risk-free interest rate	1.6% to 3.0%	0.4% to 1.2%
Expected volatility	96.1% - 99.0%	84.3% - 95.3%

Note 14. Income Taxes

For each of the years ended December 31, 2022 and 2021, the Company did not record a current or deferred income tax expense or benefit. The components of the current and deferred income tax expense or benefit consisted of the following (in thousands):

	Year Ended December 31,	
	2022	2021
Current income tax expense:		
Federal	$ —	$ —
State	—	—
Total income tax expense	$ —	$ —
Deferred income tax (benefit) expense:		
Federal	$ (5,876)	$ (4,161)
State	(24)	(32)
Foreign	17	54
Change in valuation allowance	5,883	4,139
Total income tax expense	$ —	$ —

A reconciliation of the U.S. federal statutory income tax rate to the Company's effective income tax rate was as follows:

	Year Ended December 31,	
	2022	2021
Federal income tax (benefit) at statutory rate	21%	21%
Permanent differences	—	—
Research and development credits	10	21
State income tax, net of federal benefit	—	—
Change in valuation allowance	(31)	(42)
Effective tax rate	—%	—%

Coronavirus Aid, Relief and Economic Security Act

In response to the COVID-19 pandemic, the CARES Act was signed into law in the U.S. in March 2020. The CARES Act adjusted a number of provisions of the tax code, including the calculation and eligibility of certain deductions and the treatment of net operating losses and tax credits. The enactment of the CARES Act did not result in any material adjustments to the Company's income tax provision for the years ended December 31, 2022 and 2021 or to its net deferred tax assets as of December 31, 2022 and 2021.

Tax Cuts and Jobs Act

Enacted in 2017, the Tax Cuts and Jobs Act ("TCJA") included significant changes in tax law including a change to Internal Revenue Code section 174 ("Section 174") regarding the deductibility of research and experimentation expenses ("R&E expenses"). The section 174 tax law change had a delayed effective date and became effective for the Company in 2022. The new Section 174 requires that companies capitalize and amortize R&E expenses performed in the U.S. over five years and further provides for a fifteen-year amortization period for R&E expenses incurred outside the U.S. The Company has factored any impact of section 174 in its consolidated financial statements and related disclosures.

Net deferred tax assets as of December 31, 2022 and 2021 consisted of the following (in thousands):

	Year Ended December 31,	
	2022	2021
Deferred tax assets:		
Net operating loss	$ 8,759	$ 9,906
Research and development credits	6,850	4,992
Section 174 costs	4,512	—
Deferred revenue	610	—
Other	130	69
Total deferred tax assets	20,861	14,967
Deferred tax liabilities:		
Prepaid assets	(33)	(22)
Property and equipment	(1)	(2)
Other	(2)	—
Total deferred tax liabilities	(36)	(24)
Deferred tax asset valuation allowance	(20,825)	(14,943)
Net deferred tax assets (liabilities)	$ —	$ —

As of December 31, 2022, the Company had U.S. federal and state net operating losses ("NOLs"), research and development ("R&D) tax credit, and capitalized R&D expense carryforwards of $37.2 million, $6.9 million and $4.5 million, respectively. The NOLs begin to expire in 2024.

Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets, which are comprised principally of NOLs, R&D credits, and R&E expenses capitalized per Section 174. Under the applicable accounting standards, management has considered the Company's history of losses and concluded that it is more likely than not that the Company will not recognize the benefits of federal and state deferred tax assets. Accordingly, a full valuation allowance was maintained as of December 31, 2022. An increase in the Company's valuation allowance in the amount of $5.9 million was recorded in 2022, due primarily to the increase in net deferred tax assets.

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations for both federal taxes and the many states in which it operates or does business in. A tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, on the basis of the technical merits.

The Company records tax positions as liabilities and adjusts these liabilities when its judgement changes as a result of the evaluation of new information not previously available. Because of the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from the Company's current estimate of the recognized tax benefit liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which new information is available. As of December 31, 2022, the Company has not recorded any uncertain tax positions in its consolidated financial statements.

The Company recognizes interest and penalties related to unrecognized tax benefits on the income tax expense line in the accompanying consolidated statement of operations. As of December 31, 2022, the Company had no accrued interest or penalties related to uncertain tax positions and no amounts have been recognized in the Company's consolidated statements of operations and comprehensive loss for either of the years ended December 31, 2022 and 2021.

The Company files tax returns as prescribed by the tax laws of the jurisdictions in which it operates. In the normal course of business, the Company is subject to examination by federal and state jurisdictions, where applicable. All of the Company's tax years from inception are still open as the Company has tax attribute carryforwards. Accordingly, the tax years in which these tax attributes were generated may still be adjusted upon examination by the Internal Revenue Service and state tax authorities to the extent utilized in a future period. There are currently no pending income tax examinations.

Note 15. Related Party Transactions

The Company analyzed its transactions with related parties for the years ended December 31, 2022 and 2021 and determined that other than the sponsored research and other services provided by the UT entities (See Note 9 of Notes to Consolidated Financial Statements) and the sale of 500,000 shares of TFF common stock to Bios Special Opportunity Fund, LP (See Note 2 of Notes to Consolidated Financial Statements), all other transactions related to compensation-based consulting arrangements with certain investors. As such, the Company did not have any material related party transactions in 2022 and 2021 other than the sponsored research and other services provided by the UT entities and the sale of TFF common stock to Bios Special Opportunity Fund, LP as noted above.

Note 16. Subsequent Events

For its consolidated financial statements as of December 31, 2022 and for the year then ended, the Company evaluated subsequent events through May 25, 2023, the date on which these financial statements are issued. No subsequent events have been identified for disclosure.

Exhibit 99.2

INDEX TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS OF LUNG THERAPEUTICS, INC.

LUNG THERAPEUTICS, INC.

Condensed Consolidated Balance Sheets
(in thousands, except share and per share amounts)
(unaudited)

	September 30, 2023	December 31, 2022
Assets		
Current assets:		
Cash and cash equivalents	$ 20	$ 11,881
Prepaid expenses and other current assets	2,147	2,714
Total current assets	2,167	14,595
Property and equipment, net	3	5
Operating lease right-of-use assets	91	221
Other assets	27	27
Total assets	$ 2,288	$ 14,848
Liabilities, Convertible Preferred Stock and Stockholders' Deficit		
Current liabilities:		
Simple agreements for future equity	$ —	$ 13,435
Loan from related party	720	—
Accounts payable	2,436	860
Deferred revenue	—	352
Operating lease liabilities, current	96	184
Accrued expenses and other current liabilities	2,110	1,753
Total current liabilities	5,362	16,584
Deferred revenue, net of current portion	2,714	2,515
Operating lease liabilities, net of current portion	—	48
Total liabilities	8,076	19,147
Commitments and contingencies (Note 9)		
Series A convertible preferred stock, par value $0.0001 per share; 10,888,283 shares authorized, issued and outstanding as of September 30, 2023 and December 31, 2022, respectively	2,874	2,874
Series B convertible preferred stock, par value $0.0001 per share; 23,152,737 shares authorized, issued and outstanding as of September 30, 2023 and December 31, 2022, respectively	14,293	14,293
Series C convertible preferred stock, par value $0.0001 per share; 56,176,061 and 41,076,061 shares authorized as of September 30, 2023 and December 31, 2022, respectively; 56,139,878 and 41,076,061 shares issued and outstanding as of September 30, 2023 and December 31, 2022, respectively	53,293	39,858
Stockholders' deficit:		
Common stock, par value $0.0001 per share; 121,000,000 and 106,000,000 shares authorized as of September 30, 2023 and December 31, 2022, respectively; 9,245,103 shares issued and outstanding as of September 30, 2023 and December 31, 2022, respectively	1	1
Additional paid-in capital	2,352	2,119
Accumulated deficit	(78,601)	(63,444)
Total stockholders' deficit	(76,248)	(61,324)
Total liabilities, convertible preferred stock and stockholders' deficit	$ 2,288	$ 14,848

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

LUNG THERAPEUTICS, INC.

Condensed Consolidated Statements of Operations and Comprehensive Loss
(in thousands)
(unaudited)

	For the Nine Months Ended September 30,	
	2023	2022
Licensing revenue	$ 153	$ 766
Operating expenses:		
Research and development	(10,861)	(16,105)
General and administrative	(4,525)	(5,287)
Total operating expenses	(15,386)	(21,392)
Loss from operations before gains from affiliate	(15,233)	(20,626)
Gain from sale of equity securities in TFF	—	9,400
Loss from operations	(15,233)	(11,226)
Other income, net:		
Interest income	76	42
Total other income, net	76	42
Net loss and comprehensive loss	$ (15,157)	$ (11,184)

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

LUNG THERAPEUTICS, INC.

Condensed Consolidated Statements of Convertible Preferred Stock and Stockholders' Deficit
(in thousands, except share amounts)
(unaudited)

	Convertible preferred stock						Common stock				
	$0.0001 Par Value Series A		$0.0001 Par Value Series B		$0.0001 Par Value Series C		$0.0001 Par Value		Additional paid-in capital	Accumulated deficit	Total stockholders' deficit
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance, January 1, 2023	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,245,103	$ 1	$ 2,119	$ (63,444)	$ (61,324)
Stock-based compensation	—	—	—	—	—	—	—	—	233	—	233
Conversion of SAFEs into Series C convertible preferred stock	—	—	—	—	15,063,817	13,435	—	—	—	—	—
Net loss	—	—	—	—	—	—	—	—	—	(15,157)	(15,157)
Balance, September 30, 2023	10,888,283	$ 2,874	23,152,737	$ 14,293	56,139,878	$ 53,293	9,245,103	$ 1	$ 2,352	$ (78,601)	$ (76,248)

	Convertible preferred stock						Common stock				
	$0.0001 Par Value Series A		$0.0001 Par Value Series B		$0.0001 Par Value Series C		$0.0001 Par Value		Additional paid-in capital	Accumulated deficit	Total stockholders' deficit
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance, January 1, 2022	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,150,208	$ 1	$ 1,713	$ (44,403)	$ (42,689)
Stock-based compensation	—	—	—	—	—	—	—	—	304	—	304
Exercise of common stock options	—	—	—	—	—	—	17,812	—	4	—	4
Net loss	—	—	—	—	—	—	—	—	—	(11,184)	(11,184)
Balance, September 30, 2022	10,888,283	$ 2,874	23,152,737	$ 14,293	41,076,061	$ 39,858	9,168,020	$ 1	$ 2,021	$ (55,587)	$ (53,565)

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

LUNG THERAPEUTICS, INC.

Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	For the Nine Months Ended September 30,	
	2023	**2022**
Cash flows from operating activities		
Net loss	$ (15,157)	$ (11,184)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	132	124
Gain from sale of equity securities in TFF	—	(9,400)
Stock-based compensation expense	233	304
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	567	4,224
Accounts payable	1,576	657
Deferred revenue	(153)	(767)
Accrued expenses and other current liabilities	221	(1,313)
Net cash flows used in operating activities	(12,581)	(17,355)
Cash flows from investing activities		
Proceeds from sale of equity securities in TFF, net	—	9,400
Net cash flows provided by investing activities	—	9,400
Cash flows from financing activities		
Proceeds from issuance of simple agreements for future equity, net of issuance costs	—	13,435
Proceeds from exercise of common stock options	—	4
Proceeds from a related party loan	720	—
Net cash flows provided by (used in) financing activities	720	13,439
Net increase (decrease) in cash and cash equivalents	(11,861)	5,484
Cash and cash equivalents, beginning of year	11,881	11,483
Cash and cash equivalents, end of year	$ 20	$ 16,967
Non-cash financing activities:		
Recognition of right-of-use asset and operating lease liability	$ —	$ 384

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

Note 1. Description of Business

These unaudited condensed consolidated financial statements have not been audited or reviewed by an independent accountant.

Lung Therapeutics, Inc. ("Lung Therapeutics" or the "Company"), was incorporated in November 2012 under the laws of the state of Texas. Its principal offices are in Austin, Texas. The Company's focus is developing novel therapeutics for orphan pulmonary and fibrosis indications with the potential to greatly improve patient outcomes over currently available treatments.

The accompanying unaudited interim condensed consolidated financial statements include the accounts of the Company and its wholly owned, non-operating subsidiaries, Lung Therapeutics Australia Pty Ltd ("Lung Therapeutics Australia") and Lung Therapeutics Limited, which is an Irish entity.

The Company is subject to risks and uncertainties common to clinical-stage companies in the biotechnology industry, including, but not limited to the risk that the Company never achieves profitability, the need for substantial additional financing, the risk of relying on third parties, risks of clinical trial failures, dependence on key personnel, protection of proprietary technology, and compliance with government regulations. The Company's lead product candidate, LTI-03, is being developed for the treatment of idiopathic pulmonary fibrosis ("IPF") and has completed a healthy volunteer Phase 1a clinical trial. LTI-03 is currently in a Phase 1b clinical trial in IPF patients. The Company's second product candidate, LTI-01, is in development for loculated pleural effusion ("LPE"). The Company has completed Phase 1b and Phase 2a clinical trials of LTI-01 in LPE patients.

On October 31, 2023, Aileron Therapeutics, Inc., a publicly traded Delaware corporation ("Aileron") listed on The Nasdaq Capital Market, acquired the Company pursuant to an Agreement and Plan of Merger (the "Merger Agreement"), by and among Aileron, AT Merger Sub I, Inc., a Delaware corporation and a wholly owned subsidiary of Aileron ("First Merger Sub"), AT Merger Sub II, LLC, a Delaware limited liability company and wholly owned subsidiary of Aileron ("Second Merger Sub), and the Company. Pursuant to the Merger Agreement, among other matters, First Merger Sub merged with and into the Company, with the Company surviving as a wholly owned subsidiary of Aileron (the "First Merger"), and, immediately following the First Merger, the Company merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity (together with the First Merger, the "Merger"). Following the completion of the Merger, the business conducted by the Company became primarily the business conducted by Aileron, which is developing novel therapies for the treatment of orphan pulmonary and fibrosis indications that have no approved or limited effective treatments. The Merger was intended to qualify for U.S. federal income tax purposes as a tax-free reorganization under the provision of Sections 368(a) of the Internal Revenue Code (the "Code"). (See Note 14 of Notes to unaudited condensed consolidated financial statements).

Liquidity and Going Concern

In accordance with Accounting Standards Codification ("ASC") 205-40, *Going Concern* ("ASC 205-40"), the Company has evaluated whether there are conditions and events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern within one year after the date the accompanying consolidated financial statements were issued.

As an emerging growth entity, the Company has devoted substantially all of its resources since inception to its research and development efforts relating to its product candidates, including activities to manufacture product candidates, conduct clinical studies of its product candidates and perform preclinical research to identify new product candidates. As a result, the Company has incurred significant operating losses and negative cash flows from operations since its inception and anticipates such losses and negative cash flows will continue for the foreseeable future. To date, the Company has financed its operations primarily through private placements of convertible preferred stock, an upfront payment received from a license agreement, and sales of marketable equity securities in TFF Pharmaceuticals, Inc. ("TFF").

During the nine months ended September 30, 2023 and 2022, the Company incurred net losses of $15.2 million and $11.2 million, respectively. As of September 30, 2023, the Company had an accumulated deficit of $78.6 million and expects to continue incurring losses for the foreseeable future. Recently, the Company has been highly dependent on financing from its controlling shareholder, for which it has a convertible promissory note payable in the principal amount of $0.7 million as of September 30, 2023 (See Note 13 of Notes to unaudited condensed consolidated financial statements). The Company does not expect to generate any revenue in the near future and accordingly, will need to secure additional funding through public or private convertible preferred financings, debt financings, and/or collaboration agreements or government grants over the next twelve months in order to continue to fund the Company's operations. Given the lack of a finalized plan to secure additional funding that would be considered probable of occurrence under ASC 205-40, the Company can provide no assurance that additional funding will be obtained on acceptable terms, or at all. If the Company is unable to secure additional funding to continue to fund its operations over the next twelve months, the

Company would need to pursue other alternatives, such as a scale back in its operating plan by deferring or limiting some or all of its research, development or clinical projects, further reductions to its workforce, and/or seek other strategic investment alternatives. Management has concluded the uncertainty surrounding the Company's ability to secure additional funding over the next twelve months raises substantial doubt about the Company's ability to continue as a going concern. The accompanying unaudited condensed consolidated financial statements do not include any adjustments that may result from the outcome of this uncertainty.

Note 2. Summary of Significant Accounting Policies

Basis of presentation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Any reference in these notes to applicable guidance is meant to refer to the authoritative U.S. GAAP as found in the ASC and as amended by Accounting Standards Updates ("ASUs") of the Financial Accounting Standards Board ("FASB").

Unaudited Condensed Financial Statements

The condensed consolidated balance sheet as of September 30, 2023, and the condensed consolidated statements of operations and comprehensive loss, convertible preferred stock and stockholders' deficit, and cash flows for the nine months ended September 30, 2023 and 2022 are unaudited. The unaudited condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and reflect, in the opinion of management, all adjustments of a normal and recurring nature that are necessary for the fair statement of the Company's financial position as of September 30, 2023 and its results of operations and cash flows for the nine months ended September 30, 2023 and 2022. The financial data and the other financial information disclosed in these notes to the condensed consolidated financial statements related to the nine-month periods are also unaudited. The results of operations for the nine months ended September 30, 2023 are not necessarily indicative of the results to be expected for the year ended December 31, 2023, or for any other future annual or interim period. The consolidated balance sheet as of December 31, 2022, included herein was derived from the audited financial statements as of that date, but does not contain all of the footnote disclosures from those audited annual financial statements.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Lung Therapeutics Australia and Lung Therapeutics Limited. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Significant estimates and assumptions reflected in these condensed financial statements include, but are not limited to, the accrual for research and development expenses, the valuation of simple agreements for future equity ("SAFEs"), the valuation of warrants, and the valuation of common stock. Estimates are periodically reviewed in light of changes in circumstances, facts and experience. Changes in estimates are recorded in the period in which they become known. Actual results could differ from those estimates.

Foreign Currency Transactions

The functional currency for the Company's wholly owned foreign subsidiary, Lung Therapeutics Australia, is the United States dollar. All foreign currency transaction gains and losses are recognized in the condensed consolidated statements of operations and comprehensive loss.

Revenue Recognition

In accordance with ASC *Topic 606, Revenue from Contracts with Customers* ("ASC 606"), the Company recognizes revenue when the Company's customer obtains control of promised goods or services, in an amount that reflects the consideration which the Company expects to receive in exchange for those goods and services. To determine revenue recognition for arrangements within the scope of ASC 606, the Company performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when or as the Company satisfies a performance obligation.

At contract inception, once the contract is determined to be within the scope of ASC 606, the Company identifies the performance obligations in the contract by assessing whether the goods or services promised within each contract are distinct. The Company then recognizes revenue for the amount of the transaction price that is allocated to the respective performance obligation when, or as, the performance obligation is satisfied.

Licensing revenue

On November 12, 2020, the Company entered into a license agreement (the "License Agreement") with Taiho Pharmaceutical Co., Ltd ("Taiho"). The License Agreement is discussed further in Note 7 of Notes to unaudited condensed consolidated financial statements. The Company's license arrangements may include the transfer of intellectual property rights in the form of licenses, obligations to provide research and development services and products, and obligations to participate on certain development committees with licensing partners.

The terms of such license arrangements generally include payment to the Company of one or more of the following: nonrefundable upfront fees, payments for the supply of clinical products, payment for research and development services, payments related to milestone payments and royalties on net sales of licensed products. The Company assesses whether the promises in these agreements are considered distinct performance obligations that should be accounted for separately. Judgment is required to determine whether the license to the Company's intellectual property is distinct from the research and development services or participation on development committees.

The transaction price in each agreement is allocated to the identified performance obligations based on the standalone selling price ("SSP") of each distinct performance obligation as applicable. Judgment is required to determine SSP. Due to the early stage of the Company's licensed technology, the license of such technology is typically combined with the research and development services and committee participation as one performance obligation.

Revenue associated with nonrefundable upfront license fees where the license fees and research and development services cannot be accounted for as separate performance obligations is deferred and recognized as revenue over the expected period of performance using a cost-based input methodology. The Company utilizes judgment to assess the pattern of delivery of the performance obligation.

At the inception of each agreement that includes milestone payments, the Company evaluates whether the milestones are considered probable of being reached and estimates the amount to be included in the transaction price by using the most likely amount method. If it is probable that a significant reversal of cumulative revenue would not occur, the associated milestone value is included in the transaction price. Milestone payments that are not within the control of the Company or the licensee, such as regulatory approvals, are not considered probable of being achieved until those approvals are received or the underlying activity has been completed. The transaction price is then allocated to each performance obligation in the agreement based on relative SSP. At the end of each subsequent reporting period, the Company re-evaluates the probability of achievement of each such milestone and any related constraint, and if necessary, adjusts its estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect revenues and earnings in the period of adjustment.

Concentration of Credit Risk and Off-Balance Sheet Risk

Financial instruments that potentially expose the Company to concentrations of credit risk consist principally of cash and cash equivalents. Periodically, the Company maintains balances in operating accounts above federally insured limits. The Company deposits its cash in financial institutions that it believes have high credit quality. The Company has not experienced any losses on such accounts and does not believe it is exposed to any significant credit risk on cash and cash equivalents.

Investment in TFF

Pursuant to a contribution agreement executed on January 24, 2018, the Company's wholly owned subsidiary, TFF, was spun out into a separate company, whereby the Company received 4,000,000 shares of TFF's common stock in exchange for providing TFF with certain intellectual property assets licensed by the Company from the University of Texas. The Company applies the equity method of accounting to its investment in TFF as the Company determined that it continues to exercise significant influence over the operating and financial policies of TFF. Based on TFF's history of losses, the Company had previously concluded that its share of TFF's net losses under the equity method was greater than the carrying value of the investment. As a result, in 2019 the Company wrote down its investment in TFF to $0 and suspended further recognition of its share of losses incurred by TFF. In 2020 and 2021, the Company sold 1,765,000 shares of common stock of TFF generating proceeds of $23.4 million. In January 2022, the Company entered into a variable price forward sales contract with Jefferies LLC to sell 962,000 shares of common stock of TFF based upon the daily volume-weighted average price during the three-month period ended March 31, 2022 plus a premium applied over the term of the contract. In April 2022, the contract was consummated and as a result, the Company received total cash proceeds of $6.2 million from the sale of these shares. In April 2022, the Company sold 500,000 additional shares of common stock of TFF to Bios Special Opportunity Fund, LP, a related party, at a price of $6.43 per share, generating net proceeds of $3.2 million.

The Company recorded gains from the sale of these shares of $9.4 million that are reflected under Gain from sale of equity securities in TFF on its condensed consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2022. As of September 30, 2023, the Company's remaining ownership of TFF common stock amounted to 773,000 shares of common stock of TFF.

Fair Value Measurements

Certain assets and liabilities of the Company are carried at fair value under U.S. GAAP. 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 must maximize the use of observable inputs and minimize the use of unobservable inputs. Financial assets and liabilities carried at fair value are to be classified and disclosed in one of the following three levels of the fair value hierarchy, of which the first two are considered observable and the last is considered unobservable:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs (other than Level 1 quoted prices), such as quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities, including pricing models, discounted cash flow methodologies and similar techniques.

To the extent that the valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised by the Company in determining fair value is greatest for instruments categorized in Level 3. A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

An entity may choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings.

Simple Agreement for Future Equity - SAFE

The Company accounts for SAFEs at fair value in accordance with ASC 480, *Distinguishing Liabilities from Equity* ("ASC 480"). The SAFEs are subject to revaluation at the end of each reporting period, with changes in fair value recognized in the Company's consolidated statements of operations and comprehensive loss.

Cash and Cash Equivalents

Cash and cash equivalents consist of standard checking accounts and money market funds. The Company considers all highly liquid investments with an original maturity of 90 days or less at the date of purchase to be cash equivalents. The Company's cash equivalents are comprised of funds held in money market accounts and are measured at fair value on a recurring basis.

Convertible Preferred Stock

The Company has classified convertible preferred stock, referred to as preferred stock, as temporary equity in the accompanying condensed consolidated balance sheets due to terms that allow for redemption of the shares in cash upon certain change in control events that are outside of the Company's control, including sale or transfer of control of the Company as holders of the preferred stock could cause redemption of the shares in these situations. The Company did not accrete the carrying values of the preferred stock to the redemption values since a liquidation event was not considered probable as of September 30, 2023. Subsequent adjustments of the carrying values to the ultimate redemption values will be made only when it becomes probable that such a liquidation event will occur**.**

Income Taxes

The Company accounts for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the financial statements or the Company's tax returns. Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of assets and liabilities using the enacted statutory tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Recognition of deferred tax assets is limited to amounts for which, in the opinion of management, realization is considered more likely than not in future periods.

For the nine months ended September 30, 2023 and 2022, the Company recorded no current or deferred income tax expenses or benefits as it has incurred losses since inception and has historically provided a full valuation allowance against its deferred tax assets.

In assessing the realizability of the net deferred tax assets, management considers all relevant positive and negative evidence in determining whether it is more likely than not that some portion or all the deferred income tax assets will not be realized. The realization of the gross deferred tax assets is dependent on several factors, including the generation of sufficient taxable income prior to the expiration of the net operating loss carryforwards. Management believes that it is more likely than not that the Company's deferred income tax assets will not be realized.

The Company has not recorded any liabilities for unrecognized tax benefits as of September 30, 2023, and 2022. The Company will recognize interest and penalties related to uncertain tax positions, if any, in income tax expense. As of September 30, 2023 and 2022, the Company had no accrued interest or penalties related to uncertain tax positions.

Research and Development Expenses

Research and development costs are expensed as incurred. Research and development expenses are comprised of costs incurred in performing research and development activities, including stock-based compensation and benefits, facilities costs, costs of clinical trials, sponsored research, manufacturing, and external costs of outside vendors engaged to conduct preclinical development activities and trials.

Costs incurred in obtaining technology licenses are immediately recognized as research and development expense if the technology licensed has not reached technological feasibility and has no alternative future uses.

The Company has entered into various research and development and other agreements with commercial firms, researchers, universities, and others for provisions of goods and services. These agreements are generally cancelable, and the related costs are recorded as research and development expenses as incurred. Research and development expenses include costs for salaries, employee benefits, subcontractors, facility-related expenses, depreciation and amortization, stock-based compensation, laboratory supplies, and external costs of outside vendors engaged to conduct discovery, preclinical and clinical development activities, and clinical trials as well as to manufacture clinical trial materials, and other costs. The Company records accruals for estimated ongoing research and development costs. When evaluating the adequacy of the accrued liabilities, the Company analyzes progress of the studies or clinical trials, including the phase or completion of events, invoices received and contracted costs. Significant judgments and estimates are made in determining the accrued balances at the end of any reporting period. Actual results could differ materially from the Company's estimates. Nonrefundable advance payments for goods or services to be received in the future for use in research and development activities are recorded as prepaid expenses. Such prepaid expenses are recognized as an expense when the goods have been delivered or the related services have been performed, or when it is no longer expected that the goods will be delivered, or the services rendered.

Upfront payments, milestone payments and annual maintenance fees under license agreements are expensed in the period in which they are incurred.

Patent Costs

All patent-related costs incurred in connection with filing and prosecuting patent applications are expensed as incurred due to the uncertainty about the recovery of the expenditure. Amounts incurred are classified as general and administrative expenses.

Leases

At inception of a contract, the Company determines whether an arrangement is or contains a lease. For all leases, the Company determines the classification as either operating leases or financing leases. Operating leases are included in Operating lease right-of-use assets and Operating lease liabilities in the Company's condensed consolidated balance sheets.

Lease recognition occurs at the commencement date and lease liability amounts are based on the present value of lease payments over the lease term. The lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. If a lease does not provide information to determine an implicit interest rate, the Company uses its incremental borrowing rate in determining the present value of lease payments. Right-of-use ("ROU") assets represent the Company's right to use an underlying asset for the lease term, and lease liabilities represent the Company's obligation to make lease payments under the lease. ROU assets also include any lease payments made prior to the commencement date and exclude lease incentives received. Operating lease payments are expensed using the straight-line method as a general and administrative expense over the lease term. The depreciable life of assets and leasehold improvements are limited by the expected lease term, unless there is a transfer of title or purchase option reasonably certain of exercise. The Company has elected to apply the practical short-term expedient to leases with a lease term of 12 months or less, which does not subject the leases to capitalization.

Stock-Based Compensation

The Company's stock-based compensation expense stems from granted awards that may include stock options, restricted stock awards, restricted stock units, and other stock-based awards. The fair values of stock option grants are estimated as of the date of grant using a Black-Scholes option valuation model. The estimated fair values of the awards are expensed over the requisite service period, which is generally the vesting period of the award. The Company accounts for forfeitures as they occur. For performance-based awards, the Company does not recognize expense until the underlying vesting conditions are deemed to be probable of occurrence.

In determining the fair value of its common stock, the Company utilizes significant estimates and assumptions that require the Company's judgment. These estimates and assumptions include a number of objective and subjective factors, including external market conditions, the superior rights and preferences of securities senior to the Company's common stock at the time of, and the likelihood of, achieving a liquidity event, such as an initial public offering or sale. Significant changes to the key assumptions used in the valuations could result in different fair values of common stock at each valuation date.

The Company historically has been a private company and lacks company-specific historical and implied volatility information for its stock. Therefore, it estimates its expected stock price volatility based on the historical volatility of publicly traded peer companies and expects to continue to do so until such time that it has adequate historical data regarding the volatility of its own traded stock price. The expected term of the Company's stock options granted to employees was determined utilizing the "simplified" method for awards that qualify as "plain-vanilla" options. The expected term of stock options granted to non-employee consultants is equal to the contractual term of the option award. The risk-free interest rate is determined by reference to the U.S. Treasury yield curve in effect at the time of grant of the award for time periods approximately equal to the expected term of the award. Expected dividend yield is based on the fact that the Company has never paid cash dividends on common stock and does not expect to pay any cash dividends in the foreseeable future.

Comprehensive Income or Loss

Comprehensive income or loss consists of net income or loss and changes in equity during a period from transactions and other equity and circumstances generated from non-owner sources. For each of the nine-month periods ended September 30, 2023 and 2022, the Company's net loss equals comprehensive loss.

Recently Issued Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies and are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of recently issued standards that are not yet effective will not have a material impact on its financial position or results of operations upon adoption.

Note 3. Fair Value Measurements

The following tables present information about the Company's assets measured at fair value on a recurring basis and indicate the level of the fair value hierarchy utilized to determine such fair values (in thousands):

	Total	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As of September 30, 2023				
Assets:				
Money market funds	$ 11	$ 11	$ —	$ —
SAFEs	—	—	—	—
Total	$ 11	$ 11	$ —	$ —
As of December 31, 2022				
Assets:				
Money market funds	$11,763	$11,763	$ —	$ —
SAFEs	13,435	—	—	13,435
Total	$25,198	$11,763	$ —	$ 13,435

The fair value of the SAFEs is based on significant inputs not observable in the market, which represents a Level 3 measurement within the fair value hierarchy.

There were no transfers between fair value levels during the nine-month periods ended September 30, 2023 and 2022. The carrying values of other current assets, accounts payable and accrued expenses approximate their fair values due to the short-term nature of these assets and liabilities.

Simple Agreement for Future Equity - SAFE

In March and April 2022, the Company executed a series of SAFEs primarily with new investors, pursuant to which the Company received net proceeds in an aggregate amount equal to $13.4 million. The fair value of the SAFEs on the date of issuance was determined to equal the proceeds received by the Company. The SAFEs provided investors with potential future equity by conversion of the SAFEs into preferred stock at the Company's subsequent equity financing event, to the extent that the Company received aggregate gross proceeds of at least $20.0 million and provided that such equity financing event occurs prior to December 31, 2022, the date of maturity of the SAFEs. The initial discount for the SAFEs was 90%, but if, prior to the subsequent equity financing event, the Company has supplied to any potential third-party investor the results of its Phase 2a clinical trial with respect to its drug candidate LTI-01, the discount is reduced to 80%. If there is no equity financing prior to December 31, 2022 that yields aggregate gross proceeds of at least $20.0 million or if a liquidity or dissolution event of the Company does not occur, each SAFE will automatically convert into the Company's Series C convertible preferred stock at the original issuance price of such Series C convertible preferred stock.

The SAFEs were not mandatorily redeemable, nor did they require the Company to repurchase a fixed number of shares. The Company determined that the SAFEs contained a liquidity event provision that embodies an obligation indexed to the fair value of the Company's preferred shares and could require the Company to settle the SAFE obligation by transferring assets or cash. For this reason, the Company recorded the SAFEs as a liability under ASC 480 and re-measured the fair value at the end of each reporting period, with changes in fair value reported in earnings. As of December 31, 2022, the fair value of the SAFEs was determined to be $0.98, the price at which they will convert into shares of Series C convertible preferred stock.

As the Company did not have an equity financing, liquidity or dissolution event prior to December 31, 2022, the SAFEs were converted into Series C convertible preferred stock during the three-month period ended June 30, 2023 at their fair value price of $0.98 each, resulting in the issuance by the Company of a total of 15,063,817 shares of Series C convertible preferred stock.

The following table sets forth a summary of the activities of the SAFEs which represents a recurring measurement that is classified within Level 3 of the fair value hierarchy wherein fair value is estimated using significant unobservable inputs (in thousands):

	Amount
Balance as of December 31, 2022	$ 13,435
Change in fair value	—
Conversion of SAFEs into Series C convertible preferred stock	(13,435)
Balance as of September 30, 2023	$ —

Non-Recurring Fair Value Measurements

The Company issued warrants to purchase shares of its common stock in 2014, 2015, 2018, and 2019, pursuant to its convertible preferred stock issuances (See Note 10 of Notes to unaudited condensed consolidated financial statements) and its license agreement with Vivarta Therapeutics LLC (See Note 8 of Notes to unaudited condensed consolidated financial statements). All warrants were determined to be equity-classified and recorded as part of additional paid in capital at fair value using the Black-Scholes option pricing model. The warrants are not subsequently remeasured.

Preferred Stock Warrants

Prior to 2020, the Company had issued to its preferred stockholders a total of 7,096,828 warrants to purchase shares of common stock. Of these warrants, 3,043,184 were granted in connection with Series A and Series B convertible preferred stock ("Series A" and "Series B") issuances and 4,053,644 were granted in conjunction with the issuance of the Company's Series C convertible preferred stock ("Series C") (See Note 10 of Notes to unaudited condensed consolidated financial statements). In November 2021, the Company issued an additional 122,045 warrants to purchase shares of common stock. No additional warrants to purchase shares of common stock have been issued since 2021. The Company had determined the fair value of these warrants using the following inputs: fair value of common stock at the time of issuance, exercise price, the contractual period, risk free rate, volatility, and dividend yield. These warrants to purchase a total of 7,218,873 shares of the Company's common stock remained outstanding as of September 30, 2023 and December 31, 2022 and none have been exercised as of September 30, 2023.

Vivarta Therapeutics LLC Warrants

In March 2018, the Company had issued warrants to purchase 75,000 shares of common stock to Vivarta Therapeutics LLC ("Vivarta"). The Company determined the fair value of the warrants using the fair value of the common stock at the time of issuance, the exercise price, contractual period, volatility, and dividend yield. These warrants to purchase 75,000 shares of common stock were wholly exercised by Vivarta during the year ended December 31, 2022 at a price of $0.12 per share.

Note 4. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following (in thousands):

	As of September 30, 2023	As of December 31, 2022
Prepaid research and development	$ 1,996	$ 2,544
Other	151	170
Total prepaid and other current assets	$ 2,147	$ 2,714

Note 5. Property and Equipment, net

Property and equipment, net consisted of the following (in thousands):

	As of September 30, 2023	As of December 31, 2022
Property and equipment:		
Furniture and equipment	$ 53	$ 53
Total property and equipment	53	53
Less: accumulated depreciation	(50)	(48)
Property and equipment, net	$ 3	$ 5

Depreciation expense was $2,000 and $3,000 for the nine months ended September 30, 2023 and 2022, respectively.

Note 6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	As of September 30, 2023	As of December 31, 2022
Accrued compensation and benefits	$ 736	$ 904
Clinical and development costs	1,125	657
Deferred financing costs	—	—
Other	249	192
Total accrued expenses and other current liabilities	$ 2,110	$ 1,753

Note 7. Licensing Arrangement with Taiho

On November 12, 2020, the Company entered into the License Agreement with Taiho pursuant to which the Company is collaborating with Taiho regarding the development and potential commercialization of the Company's product candidate, LTI-01. Under the License Agreement, the Company granted Taiho an exclusive, royalty-bearing license to develop, seek regulatory approval for, and commercialize LTI-01 in Japan. The Company is obligated to conduct all development activities for LTI-01 through regulatory approval in the United States or other markets worldwide, except Japan. The Company retained the right to commercialize LTI-01 in all markets worldwide except Japan. Under the terms of the License Agreement, the Company, in part through its participation in a joint development committee with Taiho, may participate in overseeing the development and commercialization of LTI-01 in Japan.

In consideration for the exclusive, royalty-bearing license and other rights contained in the License Agreement, Taiho agreed to make a non-refundable, non-creditable payment to the Company of $5.0 million. This up-front payment, deemed a partial reimbursement of past and future development costs for LTI-01, was received by the Company in February 2021. The License Agreement also provides that the Company is eligible to receive an additional milestone payment of $10.0 million.

In addition, the Company is eligible to receive royalties on net sales of LTI-01 in Japan. Royalties are payable during the period commencing on the first commercial sale of LTI-01 in Japan and ending upon the later of: (a) ten years from the date of first commercial sale of LTI-01 in Japan; and (b) expiration of the last-to-expire valid claim of the Company's patents covering the manufacture, use or sale or exploitation of LTI-01 in Japan.

The Company evaluated the License Agreement under ASC 606 and determined that there is one combined performance obligation that consists of the license and data transfer, the research and development services in which the Company is required to use commercially reasonable efforts to further the development of LTI-01, including execution of the necessary clinical trials, and supply of all clinical products during the term of the License Agreement. These deliverables are non-contingent in nature.

The Company's assessment of the transaction price included an analysis of amounts it expected to receive, which at contract inception consisted of the non-refundable, upfront payment of $5.0 million that was received by the Company in 2021. The Company considered this non-refundable fee of $5.0 million to be the initial transaction price.

The Company determined that the combined performance obligation is satisfied over time. The Company concluded that it will utilize a cost-based input method to measure its progress toward completion of its performance obligation and to calculate the corresponding amount of revenue to recognize each period. The Company believes this is the best measure of progress because other measures do not reflect how the Company transfers its performance obligation to Taiho. In applying the cost-based input method of revenue recognition, the Company uses actual clinical study enrollment figures as well as actual costs incurred relative to budgeted costs expected to be incurred for the combined performance obligation. These costs consist primarily of third-party contract costs relative to the level of patient enrollment in the studies. Revenue will be recognized based on the level of costs incurred relative to the total budgeted costs for the performance obligations. A cost-based input method of revenue recognition requires management to make estimates of costs to complete the Company's performance obligation. In making such estimates, significant judgment is required to evaluate assumptions related to cost estimates. The cumulative effect of revisions to estimated costs to complete the Company's performance obligation will be recorded in the period in which changes are identified and amounts can be reasonably estimated. A significant change in these assumptions and estimates could have a material impact on the timing and amount of revenue recognized in future periods.

The Company also determined that the milestone payment of $10.0 million under the License Agreement is variable consideration under Topic 606 is added to the transaction price when it is probable that a significant revenue reversal will not occur. Based on the nature of milestones, such as the regulatory approvals which are generally not within the Company's control, the Company will not consider achievement of this milestone to be probable until the uncertainty associated with such milestone has been resolved. When it is probable that a significant reversal of revenue will not occur, the milestone payment will be added to the transaction price for which the Company recognizes revenue. As of September 30, 2023 and December 31, 2022, no milestones had been achieved under the License Agreement.

The Company will recognize royalty revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied). As of September 30, 2023 and December 31, 2022, no royalty revenue has been recognized.

For the nine months ended September 30, 2023 and 2022, the Company recognized revenue totaling $153,000 and $766,000, respectively, from the License Agreement with Taiho. As of September 30, 2023 and December 31, 2022, the Company recorded current deferred revenue of $0 and $0.35 million, and noncurrent deferred revenue of $2.71 million and $2.52 million, respectively, on its condensed consolidated balance sheets.

Note 8. License Agreements

Agreements with the Board of Regents of the University of Texas System ("UT System")

In June 2013, May 2014 and May 2015, the Company entered into three license agreements with affiliates of the Board of Regents of the University of Texas (collectively, the "UT Agreements"). These three affiliated entities (collectively, the "UT entities") are as follows: University of Texas Health Science Center at Tyler ("UTHSCT"), University of Texas Horizon Fund ("UT Horizon Fund") and University of Texas at Austin ("UT Austin"). The UT Agreements were accounted for as asset acquisitions and do not meet the definition of a business under ASU 2017-01, *Business Combinations—Clarifying the definition of a business* ("ASC 805").

Pursuant to the UT Agreements, the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the UT intellectual property, which includes future rights to royalties on licensed products. The UT Agreements also provide for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms within the UT Agreements. The UT Agreements can be terminated at-will by the Company with 90 days' notice, or by the UT entities in the event of a material breach of terms. Under the UT Agreements, the Company is responsible for the following payments, which are made to the indicated parties:

- *License Fees* – The Company is required to make annual payments of $10,000 for license fees under the license agreement with UT Austin until the agreement is terminated.
- *Sublicensing fees* – The Company will pay a percentage of non-royalty sublicensing consideration for the UT Agreements, with varying rates that will depend on when the sublicensing agreement is executed.
- *Assignment fee* – The Company will pay the greater of 10% of the consideration received or $100,000, if any of the UT Agreements are assigned to a third party.
- *Royalties* – The Company will pay tiered royalties that are in the low-to-mid single-digit percentages, based on net sales of all products licensed under the UT Agreements.
- *Milestones* – The Company will make milestone payments to UT Austin of up to $395,000 if specified regulatory and clinical development milestone events occur. All license fee and milestone payments are recorded as general and administrative expenses in the consolidated statements of operations and comprehensive loss.

The Company's expense associated with annual license fees and milestone payments under the UT Agreements was $0 for each of the nine-month periods ended September 30, 2023 and 2022, respectively. All license fee and milestone payments are generally incurred during the Company's fourth quarter ending December 31 of each year and are recorded as general and administrative expenses in the consolidated statements of operations and comprehensive loss.

Agreement with Medical University of South Carolina ("MUSC")

In March 2016, the Company entered into a license agreement with MUSC (the "MUSC Agreement"), pursuant to which the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The MUSC Agreement was accounted for as an asset acquisition and does not meet the definition of a business under ASC 805.

The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the MUSC intellectual property, which includes future rights to royalties on licensed products. The MUSC Agreement also provided for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms in the MUSC Agreement. The MUSC Agreement can be terminated at-will by the Company with 90 days' notice, or by MUSC only in the event of a material breach of terms. Under the MUSC Agreement, the Company is responsible for the following payments:

- *License Fee* – The Company was obligated to and paid a one-time, nonrefundable license fee of $10,000 at the execution of the MUSC Agreement.
- *Sublicensing fees* – The Company will pay sublicensing fees, which vary from 15-30% of total consideration based on the Company's progression through each phase of development.
- *Transaction fee* – The Company will pay the lesser of $2.5 million or 1% of total consideration in the event of a liquidation.
- *Royalties* – The Company will pay a running royalty rate in the low single digits on all net sales and is also required to pay annual minimum royalties of $10,000 on the third, fourth, and fifth anniversaries of the execution date of the MUSC Agreement and $25,000 on the sixth anniversary of the execution date of the MUSC Agreement and all years thereafter.
- *Milestones* – The Company will make milestone payments to MUSC of up to $300,000 if specified regulatory and clinical development milestone events occur.

The Company's expense associated with minimum royalty and milestone payments under the MUSC Agreement was $25,000 for each of the nine-month periods ended September 30, 2023 and 2022, respectively. All minimum royalty and milestone payments under the MUSC Agreement are recorded as general and administrative expenses in the condensed consolidated statements of operations and comprehensive loss.

Agreement with Vivarta Therapeutics LLC ("Vivarta")

In March 2018, the Company entered into a license agreement with Vivarta (the "Vivarta Agreement"), pursuant to which the Company acquired licenses and underlying technology rights to certain intellectual property within defined fields to develop its product candidates. The Vivarta Agreement was accounted for as an asset acquisition and does not meet the definition of a business under ASC 805.

The Company received an exclusive, royalty-bearing license to certain patent rights and know-how, as well as a non-exclusive license to the Vivarta intellectual property, which includes future rights to royalties on licensed products. The Vivarta Agreement also provided for sublicensing rights, whereby the Company may grant sublicenses to third parties to use the licensed technology, subject to certain terms in the Vivarta Agreement. The Vivarta Agreement can be terminated at-will by the Company with 90 days' notice, or by Vivarta only in the event of a material breach of terms. Under the Vivarta Agreement, the Company is responsible for the following payments:

- *License Fee* – The Company was obligated to and paid one-time, nonrefundable license fees of $10,000 due upon the execution of the Vivarta Agreement and $40,000 due upon receipt by the Company of a positive freedom to operate analysis.
- *Sublicensing fees* – The Company will pay sublicensing fees, which vary from 5-40% of total consideration based on the Company's progression through each phase of development.
- *Royalties* – The Company will pay a running royalty rate in the low single digits on all net sales.
- *Milestones* – The Company will make milestone payments to Vivarta of up to $6.83 million if specified research, regulatory and clinical development milestone events occur. Milestone payments in the amount of $0 and $50,000 were made to Vivarta during the nine months ended September 30, 2023 and 2022, respectively, following the attainment of a research and development milestone.

Pursuant to the Vivarta Agreement, the Company issued warrants to Vivarta to purchase 75,000 shares of common stock at an exercise price of $0.12 per share in 2018 (See Note 3 of Notes to unaudited condensed consolidated financial statements). These warrants were wholly exercised by Vivarta during the three months ended December 31, 2022.

The Company's expense associated with license fees and milestones under the Vivarta Agreement amounted to $0 and $50,000 in each of the nine-month periods ended September 30, 2023 and 2022, respectively. The expense incurred in 2022 was associated with the milestone payment mentioned above. Any license fee and milestone payments are recorded as general and administrative expenses in the condensed consolidated statements of operations and comprehensive loss.

Note 9. Commitments and Contingencies

Lease Agreements

On August 16, 2021, the Company entered into an operating lease agreement to rent approximately 6,455 square feet of office space for its corporate headquarters in Austin, Texas, beginning on October 1, 2021. The lease agreement is for a 30-month term that ends on March 31, 2024 and includes a rent escalation clause and a rent holiday. In addition to the base rent, the Company is also responsible for its share of operating expenses, electricity and real estate taxes, in accordance with the terms of the lease agreement.

Amounts reported in the condensed consolidated balance sheets as of September 30, 2023 and December 31, 2022 for the Company's operating lease were as follows, in thousands:

	As of September 30, 2023	As of December 31, 2022
Assets		
Operating lease right-of-use assets	$ 91	$ 221
Total operating lease right-of-use assets	$ 91	$ 221
Liabilities		
Current		
Operating lease liabilities	$ 96	$ 184
Noncurrent		
Operating lease liabilities, net of current	—	48
Total operating lease liabilities	$ 96	$ 232

Operating lease costs for each of the nine-month periods ended September 30, 2023 and 2022 amounted to $138,000, respectively.

The maturities of the operating lease liabilities and minimum lease payments as of September 30, 2023 were as follows, in thousands:

For the Periods Ending December 31,	Operating Lease
2023	$ 49
2024	48
Total undiscounted lease payments	97
Less: Imputed interest	(1)
Present value of operating lease liabilities	$ 96

The following table summarizes the lease term and discount rate as of September 30, 2023:

	As of December 31, 2022
Remaining lease term (years)	
Operating lease	0.5
Discount rate	
Operating lease	6.6%

Operating cash flows used for the operating lease during the nine months ended September 30, 2023 and 2022 amounted to $144,000 and $125,000, respectively.

License Agreements

The Company is required to make certain payments under its license agreements, related to patent expenses, license fees, and assignment fees, as well as milestone and royalty payments upon the achievement of certain development and sales-based events (See Note 8 of Notes to unaudited condensed consolidated financial statements).

Legal Proceedings

The Company may from time to time be party to litigation arising in the ordinary course of business. As of September 30, 2023 and December 31, 2022, the Company was not party to any legal proceedings and no material legal proceedings are currently pending or, to the best of the Company's knowledge, threatened.

Note 10. Convertible Preferred Stock

The Company has issued Series A, Series B and Series C preferred stock (collectively, the "Preferred Stock").

As of September 30, 2023 and December 31, 2022, the authorized shares of Preferred Stock consisted of the following:

	As of September 30, 2023	As of December 31, 2022
Series A	10,888,283	10,888,283
Series B	23,152,737	23,152,737
Series C	56,176,061	41,076,061
	90,217,081	75,117,081

As of September 30, 2023, the issued and outstanding shares of Preferred Stock consisted of the following (in thousands, except amounts):

	Preferred stock issued and outstanding	Carrying value	Liquidation value	Common stock issuable upon conversion
Series A	10,888,283	$ 2,874	$ 2,931	10,888,283
Series B	23,152,737	14,293	14,307	23,152,737
Series C	56,139,878	53,293	54,711	56,139,878
	90,180,898	$70,460	$ 70,584	90,180,898

As of December 31, 2022, the issued and outstanding shares of Preferred Stock consisted of the following (in thousands, except amounts):

	Preferred stock issued and outstanding	Carrying value	Liquidation value	Common stock issuable upon conversion
Series A	10,888,283	$ 2,874	$ 2,931	10,888,283
Series B	23,152,737	14,293	14,307	23,152,737
Series C	41,076,061	39,858	39,911	41,076,061
	75,117,081	$57,025	$ 57,149	75,117,081

The Company recorded all issued shares of Preferred Stock at fair value on the date of issuance, net of issuance costs. All Preferred Stock has a par value of $0.0001 per share. The rights, privileges, and preferences of the Preferred Stock are discussed below.

Voting

On any matter presented to the stockholders of the Company for their action or consideration at any meeting of stockholders of the Company (or by written consent of stockholders in lieu of meeting), each holder of outstanding shares of Preferred Stock shall be entitled to cast the number of votes equal to the number of whole shares of common stock into which the shares of Preferred Stock held by such holder are convertible as of the record date for determining stockholders entitled to vote on such matter. Except as provided by law or by the other provisions of the Company's articles of incorporation, holders of Preferred Stock shall vote together with the holders of common stock as a single class.

The holders of outstanding shares of Preferred Stock shall be entitled to elect one member of the Board of Directors (the "Board").

Dividends

The holders of Preferred Stock are entitled to an 8% non-cumulative dividend. Dividends are payable only when and if declared by the Board. No dividends are payable to the common stockholders unless a dividend is also paid to preferred stockholders equal to at least the amount that would be received if the shares of Preferred Stock were converted into common stock. To date, the Company has not declared or paid any dividends.

Liquidation Preference

In the event of any voluntary or involuntary liquidation, dissolution, or winding up of the Company, holders of shares of Preferred Stock then outstanding shall be entitled to receive an amount per share equal to the Preferred Stock original issue price, plus any dividends declared but unpaid thereon, prior to any distribution to the common stockholders.

Note that in relation to the above, no series of the Preferred Stock has a higher liquidation preference than another, but the Preferred Stock as a whole has a higher liquidation preference than the common stock.

Redemption

The Company's certificate of incorporation, as amended and restated, does not provide redemption rights to the holders of Preferred Stock.

Conversion

Each share of Preferred Stock shall be convertible into shares of common stock on a one-for-one basis at the option of the stockholder, at any time, and without the payment of additional consideration by dividing the Preferred Stock original issue price by the conversion price. The conversion price may be adjusted for issuance of additional shares of common stock, for stock splits, for stock combinations, for certain dividends and distributions, and for mergers and reorganizations.

Note 11. Stockholders' Deficit

Common Stock

As of September 30, 2023, the Company had 121,000,000 shares of common stock authorized, of which 9,245,103 were issued and outstanding.

The holders of the Company's common stock are entitled to one vote for each share of common stock held at all meetings of stockholders and written action in lieu of meetings; there is no cumulative voting. The holders of outstanding shares of common stock shall be entitled to elect one member of the Board.

After payment to the holders of shares of Preferred Stock of their liquidation preferences, the remaining assets of the Company are distributed to the holders of the Company's common stock.

Shares of common stock reserved for future issuance were as follows:

	As of September 30, 2023	As of December 31, 2022
Preferred Stock issued and outstanding	90,180,898	75,117,081
Warrants to issue shares of common stock	7,218,873	7,218,873
Stock options outstanding	11,780,824	11,611,674
Shares available for future grants under the Plan	2,237,995	2,407,145
	111,418,590	96,354,773

Warrants

As of September 30, 2023, a total of 7,218,873 warrants to purchase shares of the Company's common stock were outstanding. All of the Company's outstanding warrants are non-tradeable and equity-classified because they meet the derivative scope exception under ASC Topic 815-40, *Derivatives and Hedging—Contracts in Entity's Own Equity* ("ASC 815-40").

Note 12. Stock-Based Compensation

In October 2013, the Board approved the 2013 Long-Term Incentive Plan (the "Plan") to provide long-term incentives for its employees, non-employee directors and certain consultants. As of September 30, 2023, the Company was authorized to issue a total of 14,188,922 shares of common stock under the Plan and as of that date, a total of 2,237,995 shares remained available for future issuance.

The Plan is administered by the Board or, at the discretion of the Board, by a committee of the Board. The exercise prices, vesting and other restrictions are determined at the discretion of the Board, or its committee if so delegated, except that the exercise price per share of stock options may not be less than 100% of the fair market value of the share of common stock on the date of grant and the term of stock option may not be greater than ten years. The vesting periods for equity awards are determined by the Board, but generally are four years. The contractual term for stock option awards is ten years.

A summary of the stock option activity for the nine months ended September 30, 2023 is as follows:

	Nine Months Ended September 30, 2023	
	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	11,611,674	$ 0.21
Granted	574,000	0.40
Cancelled or forfeited	(279,538)	0.63
Expired	(125,312)	0.20
Outstanding, end of period	11,780,824	$ 0.21
Vested and expected to vest, end of period	11,780,824	$ 0.21
Exercisable, end of period	8,915,290	
Weighted-average fair value of options granted during the period	$ 0.35	

Stock-based compensation expense amounted to $233,000 and $304,000 for the nine months ended September 30, 2023 and 2022, respectively. The table below shows the allocation of this stock-based compensation expense (in thousands):

	Nine Months Ended September 30	
	2023	2022
General and administrative	$ 169	$ 239
Research and development	64	65
Total	$ 233	$ 304

Stock-based compensation expense recognized in the condensed consolidated statement of operations and comprehensive loss for the nine months ended September 30, 2023 and 2022 does not reflect tax related effects on stock-based compensation given the Company's historical and anticipated operating losses.

The fair value of each option granted by the Company is estimated on the grant date using the Black-Scholes stock option pricing model. For the options granted during the nine months ended September 30, 2023 and 2022, the following assumptions were made in estimating fair value:

	Nine Months Ended September 30	
	2023	2022
Dividend yield	—%	—%
Expected term (in years)	6.03 - 6.08	5.00 - 6.08
Risk-free interest rate	3.9% to 3.9%	1.6% to 3.0%
Expected volatility	120.6% - 120.8%	96.1% - 99.0%

Note 13. Related Party Transactions

Loan from Related Party

On September 14, 2023, the Company entered into a short-term unsecured loan arrangement (Convertible Promissory Note) with Bios Clinical Opportunities Fund, LP ("Bios Clinical"), an entity controlled by the Company's majority shareholder, pursuant to which the Company would receive an advance of up to $720,000 from Bios Clinical. Interest on the Convertible Promissory Note is based on a rate of 10% per annum and the note was due and payable on October 20, 2023, its maturity date. If the Company does not execute a financing transaction by the note's maturity date, the principal amount of $720,000 and any accrued interest thereon, are convertible into shares of Preferred Stock based on the current price of shares of Series C of $0.98. However, if the Company executes a financing transaction prior to the maturity date, at the date of such closing the principal amount and any accrued interest would automatically convert into a number of shares equal to 90% of the per share price of such financing event, including an equivalent number of warrants to purchase capital stock of the Company or any successor entity that would be issuable to investors that participate in the financing event. As of September 30, 2023, accrued interest on the note amounted to $3,000 and is included in Accrued expenses and other current liabilities on the accompanying condensed consolidated balance sheet.

On October 31, 2023, Aileron acquired the Company pursuant to the Merger Agreement by and among First Merger Sub, Second Merger Sub and the Company. Pursuant to the Merger Agreement, among other matters, First Merger Sub merged with and into the Company, with the Company surviving as a wholly owned subsidiary of Aileron, and, immediately following the First Merger, the Company merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity. Following the completion of the Merger, the business conducted by the Company became primarily the business conducted by Aileron, which is developing novel therapies for the treatment of orphan pulmonary and fibrosis indications that have no approved or limited effective treatments. The Merger was intended to qualify for U.S. federal income tax purposes as a tax-free reorganization under the provision of Sections 368(a) of the Code (See Note 14 of Notes to unaudited condensed consolidated financial statements).

Sale of TFF common stock

In April 2022, the Company sold 500,000 shares of common stock of TFF to Bios Special Opportunity Fund, LP, an entity controlled by the Company's majority shareholder, at a price of $6.43 per share, generating net proceeds of $3.2 million. The Company recorded a gain from the sale of these shares of $3.2 million that are reflected within Gain from sale of equity securities in TFF on its condensed consolidated statements of operations and comprehensive loss for the nine months ended September 30, 2022.

The Company did not have any other material related party transactions during the nine months ended September 30, 2023 and 2022 other than the Convertible Promissory Note from Bios Clinical and the sale of TFF common stock to Bios Special Opportunity Fund, LP as noted above.

Note 14. Subsequent Events

For its condensed consolidated financial statements as of September 30, 2023 and for the nine months then ended, the Company evaluated subsequent events through December 31, 2023, the date on which these condensed consolidated financial statements were issued, to ensure that the condensed consolidated financial statements include appropriate disclosure of events both recognized in the condensed consolidated financial statements as of September 30, 2023 and events which occurred subsequently but were not recognized in the condensed consolidated financial statements.

Bios Convertible Promissory Note

On October 12, 2023, the Company executed another Convertible Promissory Note with Bios Clinical, an entity controlled by the Company's majority shareholder, pursuant to which the Company would receive an additional advance of up to $833,000. Similar to the initial arrangement (See Note 13 of the Notes to unaudited condensed consolidated financial statements), interest on the Convertible Promissory Note is based on a rate of 10% per annum and the note was due and payable on November 10, 2023, its maturity date. The maturity date of the initial $720,000 loan was amended to November 10, 2023. If the Company does not execute a financing transaction by the notes' maturity date, the principal amount of $720,000 and $833,000 and any accrued interest thereon, are convertible into shares of Preferred Stock based on the current price of a share of Series C of $0.98. However, if the Company executes a financing transaction prior to the maturity date, at the date of such closing the principal amount and any accrued interest would automatically convert into a number of shares equal to 90% of the per share price of such financing event, including an equivalent number of warrants to purchase capital stock of the Company or any successor entity that would be issuable to investors that participate in the financing event.

Bios Warrant Exercises

In October 2023, Bios Partners, the Company's majority shareholder, and related affiliates exercised warrants to convert warrants into 923,167 shares of common stock of the Company. No proceeds were received by the Company as net settlement was utilized to exercise the warrants.

Acquisition and Financing

On October 31, 2023, the Company entered into the Merger Agreement with Aileron, First Merger Sub and Second Merger Sub. On that same day, the Company was acquired by Aileron in accordance with the terms of the Merger Agreement, pursuant to which, among other matters, First Merger Sub merged with and into the Company, with the Company surviving as a wholly owned subsidiary of Aileron, and, immediately following the First Merger, the Company merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity. Following the completion of the Merger, the business conducted by the Company became primarily the business conducted by Aileron, which is developing novel therapies for the treatment of orphan pulmonary and fibrosis indications that have no approved or limited effective treatments. The Merger was intended to qualify for U.S. federal income tax purposes as a tax-free reorganization under the provision of Sections 368(a) of the Code.

Under the terms of the Merger Agreement, at the closing of the Merger, Aileron issued to the stockholders of the Company 344,345 shares of common stock, $0.001 par value per share, of Aileron (the "Aileron Common Stock") and 19,903 shares of Series X non-voting convertible preferred stock, $0.001 par value per share, of Aileron (the "Aileron Series X Preferred Stock"). In addition, Aileron assumed (i) all Company stock options immediately outstanding prior to the First Merger, each becoming an option for Aileron Common Stock subject to adjustment pursuant to the terms of the Merger Agreement, and (ii) all warrants exercisable for the Company's common stock, subject to adjustment pursuant to the terms of the Merger Agreement.

Immediately following the closing of the Merger, Aileron entered into a Stock and Warrant Purchase Agreement with a group of accredited investors led by Bios Partners, the majority stockholder of the Company prior to the closing of the Merger, and including Nantahala Capital, as well as additional undisclosed investors, pursuant to which Aileron issued and sold (i) an aggregate of 4,707 shares of Aileron Series X Preferred Stock, and (ii) warrants to purchase up to an aggregate of 2,353,500 shares of Aileron Common Stock for an aggregate purchase price of approximately $18.4 million, which included the conversion of convertible promissory notes in the aggregate principal amount of $1.6 million issued by the Company to Bios Partners prior to the closing of the Merger at a 10% discount to the per share price of Aileron Series X Preferred Stock (the "Financing"). The Financing closed on November 2, 2023.

SELECTED HISTORICAL FINANCIAL DATA AND UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

Selected Historical Condensed Financial Data of Aileron

The following tables summarize financial data of Aileron Therapeutics, Inc., a Delaware corporation ("Aileron" or the "Company"). The statement of operations data for the nine months ended September 30, 2023, and 2022 and the balance sheet data as of September 30, 2023, have been derived from the unaudited condensed financial statements included in Aileron's Quarterly Report on Form 10-Q as of and for the fiscal quarter ended September 30, 2023, filed with the Securities and Exchange Commission (the "SEC") on October 13, 2023. The statement of operations data for the years ended December 31, 2022, and 2021 and the balance sheet data as of December 31, 2022, and 2021 have been derived from the audited financial statements included in Aileron's Annual Report on Form 10-K for the fiscal year ended December 31, 2022, filed with the SEC on March 20, 2023. You should read the following selected condensed financial data together with "*Aileron's Management's Discussion and Analysis of Financial Condition and Results of Operations*" and Aileron's financial statements and the related notes included in Aileron's Quarterly Report on Form 10-Q as of and for the fiscal quarter ended September 30, 2023, filed with the SEC on October 13, 2023 and included in Aileron's Annual Report on Form 10-K for the fiscal year ended December 31, 2022, filed with the SEC on March 20, 2023. Aileron's historical results are not necessarily indicative of results that should be expected in any future period and Aileron's results for the interim period are not necessarily indicative of the results that should be expected for the full year ended December 31, 2023.

Selected Condensed Statement of Operations Data:

	Nine Months Ended September 30,		Year Ended December 31,	
	2023	2022	2022	2021
	(in thousands, except share and per share data)			
Operating expenses				
Research and development	$ 2,019	$ 15,565	$ 17,967	$ 17,008
General and administrative	6,027	7,379	9,680	9,597
Restructuring and other charges	940	—	—	—
Total operating expenses	8,986	22,944	27,647	26,605
Loss from operations	(8,986)	(22,944)	(27,647)	(26,605)
Interest income	322	180	—	—
Other income (expense), net	271	(18)	318	441
Net Loss	(8,393)	(22,782)	(27,329)	(26,164)
Net loss per share, basic and diluted	$ (1.85)	$ (5.02)	$ (6.02)	$ (5.89)
Weighted average common shares outstanding, basic and diluted	4,541,167	4,538,707	4,539,318	4,440,338
Comprehensive loss:				
Net loss	$ (8,393)	$ (22,782)	$ (27,329)	$ (26,164)
Other comprehensive loss:				
Unrealized gain (loss) on investments, net of tax of $0	48	(85)	(35)	(11)
Total other comprehensive gain (loss)	48	(85)	(35)	(11)
Total comprehensive loss	$ (8,345)	$ (22,867)	$ (27,364)	$ (26,175)

Selected Condensed Balance Sheet Data:

	As of September 30, 2023	As of December 31, 2022	As of December 31, 2021
		(in thousands)	
Cash and cash equivalents	$ 12,069	$ 5,194	$ 3,600
Investments	—	16,048	42,333
Working capital (1)	11,169	18,489	43,669
Total assets	12,822	22,007	48,481
Total liabilities	1,624	3,384	4,577
Accumulated deficit	(281,178)	(272,785)	(245,456)
Total stockholders' equity	11,198	18,623	43,904

(1) Working capital is defined as current assets less current liabilities.

Selected Historical Consolidated Financial Data of Lung

The following tables summarize consolidated financial data of Lung Therapeutics, Inc., a Texas corporation ("Lung"). The consolidated statement of operations data for the nine months ended September 30, 2023, and 2022, and the consolidated balance sheet data as of September 30, 2023, have been derived from Lung unaudited condensed consolidated financial statements included as Exhibit 99. 2 to Aileron's Current Report on Form 8-K/A of which this Exhibit 99.3 is a part. The unaudited condensed consolidated financial statements have not been audited or reviewed by an independent accountant. The consolidated statement of operations data for the years ended December 31, 2022, and 2021, and the consolidated balance sheet data as of December 31, 2022, and 2021, have been derived from Lung audited consolidated financial statements included as Exhibit 99.1 to Aileron's Current Report on Form 8-K/A of which this Exhibit 99.3 is a part. You should read the following selected financial data together with Lung consolidated financial statements and related notes included as Exhibits 99.1 and 99.2 to Aileron's Current Report on Form 8-K/A of which this Exhibit 99.3 is a part. Lung historical results are not necessarily indicative of results that should be expected in any future period and Lung results for the interim period are not necessarily indicative of the results that should be expected for the full year ended December 31, 2023.

Selected Consolidated Condensed Statement of Operations Data:

	Nine Months Ended September 30,		Year Ended December 31,	
	2023	2022	2022	2021
		(in thousands)		
Revenues:				
Licensing revenue	$ 153	$ 766	$ 688	$ 556
Operating expenses:				
Research and development	(10,861)	(16,105)	(22,465)	(15,397)
General and administrative	(4,525)	(5,287)	(6,763)	(4,720)
Total operating expenses	(15,386)	(21,392)	(29,228)	(20,117)
Loss from operations before gains from affiliate	(15,233)	(20,626)	(28,540)	(19,561)
Gain from sale of equity securities in TFF	—	9,400	9,400	9,373
Loss from operations	(15,233)	(11,226)	(19,140)	(10,188)
Other income				
Interest income	76	42	99	30
Gain on extinguishment of PPP loan	—	—	—	253
Other income, net	—	—	—	2
Total other income, net	76	42	99	285
Net loss	$(15,157)	$(11,184)	$(19,041)	$ (9,903)

Selected Consolidated Condensed Balance Sheet Data:

	As of September 30, 2023	As of December 31, 2022	As of December 31, 2021
		(in thousands)	
Cash and cash equivalents	$ 20	$ 11,881	$ 11,483
Working capital (1)	(3,541)	(1,989)	15,231
Total assets	2,288	14,848	20,625
Total liabilities	8,076	19,147	6,289
Convertible preferred stock	70,460	57,025	57,025
Accumulated deficit	(78,601)	(63,444)	(44,403)
Total stockholders' deficit	(76,248)	(61,324)	(42,689)

(1) Working capital is defined as current assets less current liabilities.

Selected Unaudited Pro Forma Condensed Combined Financial Data of Aileron and Lung

The following unaudited pro forma condensed combined financial information was prepared in accordance with Article 11 of Regulation S-X under the Securities Act of 1933, as amended (the "Securities Act") and is based on the expectation that the Merger (as defined below) will be treated as a business acquisition using the acquisition method of accounting in accordance with U.S. Generally Accepted Accounting Principles ("US GAAP"). For accounting purposes, Aileron is considered to be the acquirer in the Merger. This determination is primarily based on the expectation that, immediately following the Merger: (i) Aileron's equity holders will own a substantial majority of the voting rights in the combined company; (ii) Aileron's largest stockholder will retain the largest interest in the combined company; (iii) Aileron will designate a majority (4 out of 6) of the initial members of the board of directors of the combined company; and (iv) Aileron's executive management team will become the management of the combined company.

Aileron will finalize the acquisition accounting (including the necessary valuation and other studies) as soon as practicable within the required measurement period, but in no event later than one year following completion of the Merger.

Accordingly, for accounting purposes: (i) the Merger will be treated as the equivalent of Aileron issuing stock to acquire the net assets of Lung, (ii) the net assets of Lung will be recorded based on their fair value in the combined financial statements at the time of closing and (iii) the reported historical operating results of the combined company prior to the Merger will be those of Aileron.

The unaudited pro forma condensed combined balance sheet assumes that the Merger and the Financing (as defined below) were consummated as of September 30, 2023, and combines the historical balance sheets of Aileron and Lung as of such date. The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2023, and for the year ended December 31, 2022, assumes that the Merger and the Financing were consummated as of January 1, 2022, and combines the historical results of Aileron and Lung for the respective periods presented.

The selected unaudited pro forma condensed combined financial data are presented for illustrative purposes only and are not necessarily indicative of the combined financial position or results of operations of future periods or the results that actually would have been realized had the entities been a single entity during these periods. The selected unaudited pro forma condensed combined financial data as of and for the nine months ended September 30, 2023, and as of December 31, 2022, are derived from the unaudited pro forma condensed combined financial information and should be read in conjunction with that information. For more information, please see the section titled "*Unaudited Pro Forma Condensed Combined Financial Information*" below.

Selected Unaudited Pro Forma Condensed Combined Statement of Operations:

	Nine Months Ended September 30, 2023	Year Ended December 31, 2022
	(in thousands, except share and per share data)	
Revenues		
Licensing revenue	$ 153	$ 688
Operating expenses		
Research and development	12,880	40,432
General and administrative	10,552	21,194
Restructuring and other costs	940	—
Total operating expenses	24,372	61,626
Loss from operations before gains from affiliate	(24,219)	(60,938)
Gain from sale of equity securities in TFF	—	9,400
Loss from operations	(24,219)	(51,538)
Other income		
Interest and other income, net	398	417
Other income	271	—
Total other income, net	669	417
Net loss	$ (23,550)	$ (51,121)
Net loss per share, basic and diluted	$ (0.80)	$ (1.73)
Weighted average common shares outstanding, basic and diluted	29,495,512	29,493,663

Selected Unaudited Pro Forma Condensed Combined Balance Sheet Data:

	September 30, 2023
	(in thousands)
Cash and cash equivalents	$ 28,877
Working capital(1)	20,295
Total assets	153,487
Total liabilities	37,503
Accumulated deficit	(285,929)
Total stockholders' equity	$ 115,984

(1) Working capital is defined as current assets less current liabilities.

Unaudited Pro Forma Condensed Combined Financial Information

The following unaudited pro forma condensed combined financial information are based on Aileron historical financial statements and Lung historical consolidated financial statements as adjusted to give effect to the Merger, accounted for as a business acquisition, and to the issuance of shares of Series X Preferred Stock (as defined below) and Warrants (as defined below) in the Financing.

The Merger

On October 31, 2023, Aileron acquired Lung, pursuant to that certain Agreement and Plan of Merger, dated October 31, 2023 (the "Merger Agreement"), by and among Aileron, AT Merger Sub I, Inc., a Delaware corporation, and a wholly owned subsidiary of Aileron ("First Merger Sub"), AT Merger Sub II, LLC, a Delaware limited liability company and wholly owned subsidiary of Aileron ("Second Merger Sub"), and Lung. Pursuant to the Merger Agreement, First Merger Sub merged with and into Lung, pursuant to which Lung was the surviving entity and became a wholly owned subsidiary of Aileron (the "First Merger"). Immediately following the First Merger, Lung merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity (the "Second Merger," together with the First Merger, the "Merger"). The Merger is intended to qualify for federal income tax purposes as a tax-free reorganization under the provisions of Section 368(a) of the Internal Revenue Code of 1986, as amended (the "Code"). The business of Lung will continue as the business of the combined company.

Subject to the terms and conditions of the Merger Agreement, at the effective time of the Merger, each share of Lung common stock outstanding immediately prior to the effective time, including those shares of Lung common stock issued upon conversion of Lung preferred stock, which conversion occurred immediately prior to the effective time of the Merger, were converted into the right to receive a number of shares of common stock, par value $0.001 per share, of Aileron and shares of Series X Non-Voting Convertible Preferred Stock, par value $0.001 per share, of Aileron (the "Series X Preferred Stock") based on the exchange ratio calculated in accordance with the Merger Agreement ("Exchange Ratio"). Accordingly, the Merger is expected to be treated as a business acquisition accounted in accordance with US GAAP.

The Financing

Immediately following the closing of the Merger, on October 31, 2023, Aileron entered into a Stock and Warrant Purchase Agreement (the "Purchase Agreement") with a group of accredited investors, pursuant to which Aileron issued and sold (i) an aggregate of 4,707 shares of Series X Preferred Stock, and (ii) warrants (the "Warrants") to purchase up to an aggregate of 2,353,500 shares of Aileron common stock (the "Warrant Shares"), for an aggregate purchase price of approximately $18.4 million, which included the conversion of certain convertible promissory notes in the aggregate principal amount of $1.6 million issued by Lung to Bios Partners, the majority stockholder of Lung prior to the closing of the Merger, prior to the closing of the Merger at a 10% discount to the per share price of the Series X Preferred Stock (the "Financing"). The Financing closed on November 2, 2023. Subject to stockholder approval for the conversion rights of the Series X Preferred Stock, each share of Series X Preferred Stock is convertible into 1,000 shares of common stock.

The unaudited pro forma condensed combined balance sheet assumes that the Merger and the Financing were consummated as of September 30, 2023, and combines the historical balance sheets of Aileron and Lung as of such date. The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2023, and year ended December 31, 2022, assumes that the Merger and the Financing were consummated as of January 1, 2022, and combines the historical results of Aileron and Lung for the periods presented.

The unaudited pro forma condensed combined financial information is presented for illustrative purposes only and is not necessarily indicative of the combined financial position or results of operations of future periods or the results that actually would have been realized had the entities been a single entity during these periods.

The unaudited pro forma condensed combined financial information is based on the assumptions and adjustments that are described in the accompanying notes. Accordingly, the pro forma adjustments are preliminary, subject to further revision as additional information becomes available and additional analyses are performed and have been made solely for the purpose of providing unaudited pro forma condensed combined financial information. Differences between these preliminary estimates and the final accounting, expected to be completed after the closing of the Merger, will occur and these differences could have a material impact on the accompanying unaudited pro forma condensed combined financial information and the combined organization's future results of operations and financial position.

The unaudited pro forma condensed combined financial information does not give effect to the potential impact of current financial conditions, regulatory matters, operating efficiencies or other savings or expenses that may be associated with the integration of the two companies. The unaudited pro forma condensed combined financial information is not necessarily indicative of the financial position or results of operations in future periods or the results that actually would have been realized had Aileron and Lung been a combined organization during the specified periods. The actual results reported in periods following the Merger may differ significantly from those reflected in the unaudited pro forma condensed combined financial information presented herein for a number of reasons, including, but not limited to, differences in the assumptions used to prepare this unaudited pro forma condensed combined financial information.

The unaudited pro forma condensed combined financial information, including the notes thereto, should be read in conjunction with the separate historical financial statements of Aileron and Lung, and "*Aileron's Management's Discussion and Analysis of Financial Condition and Results of Operations*" included in its Quarterly Report on Form 10-Q as of and for the fiscal quarter ended September 30, 2023, filed with the SEC on October 13, 2023.

Accounting rules require evaluation of certain assumptions, estimates, or determination of financial statement classifications. The accounting policies of Aileron may materially vary from those of Lung. During preparation of the unaudited pro forma condensed combined financial information, management has performed a preliminary analysis and is not aware of any material differences, and accordingly, this unaudited pro forma condensed combined financial information assumes no material differences in accounting policies. Following the Merger, management will conduct a final review of Lung accounting policies in order to determine if differences in accounting policies require adjustment or reclassification of Lung results of operations or reclassification of assets or liabilities to conform to Aileron's accounting policies and classifications. As a result of this review, management may identify differences that, when conformed, could have a material impact on this unaudited pro forma condensed combined financial information.

UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET
AS OF SEPTEMBER 30, 2023
(in thousands)

	Historical				
	Aileron	Lung	Transaction Accounting Adjustments		Pro Forma Combined Total
Assets					
Current assets:					
Cash and cash equivalents	$ 12,069	$ 20	$ 16,788	(a)(b)(d)	$ 28,877
Prepaid expense and other current assets	699	2,147	—		2,846
Restricted cash	25	—	—		25
Total current assets	12,793	2,167	16,788		31,748
Property and equipment, net	29	3	—		32
Right-of-use lease assets	—	91	(15)	(f)	76
Intangible assets	—	—	104,200	(f)	104,200
Goodwill	—	—	17,404	(f)	17,404
Other assets and restricted cash	—	27	—		27
Total assets	$ 12,822	$ 2,288	$ 138,377		$ 153,487
Liabilities, convertible preferred stock and stockholders' equity (deficit)					
Current liabilities:					
Convertible promissory notes	$ —	$ 720	$ (720)	(a)	$ —
Accounts payable	484	2,436	893	(a)	3,813
Accrued expense and other current liabilities	1,140	2,110	4,310	(d)(g)	7,560
Deferred revenue	—	346	(346)	(f)	—
Operating lease liabilities, current	—	96	(16)	(f)	80
Total current liabilities	1,624	5,708	4,121		11,453
Deferred revenue	—	2,368	(2,368)	(f)	—
Deferred tax liability	—	—	26,050	(f)	26,050
Total liabilities	1,624	8,076	27,803		37,503
Convertible preferred stock	—	70,460	(70,460)	(a)(c)	—
Stockholders' equity (deficit):					
Common stock	91	1	(1)	(c)(e)	91
Series X convertible preferred stock	—	—	—		—
Additional paid-in capital	292,285	2,352	107,185	(a)(b)(c)(e)(f)	401,822
Accumulated deficit	(281,178)	(78,601)	73,850	(d)(e)(g)	(285,929)
Total stockholders' equity (deficit)	11,198	(76,248)	181,034		115,984
Total liabilities, convertible preferred stock and stockholders' equity	$ 12,822	$ 2,288	$ 138,377		$ 153,487

UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2023
(in thousands, except share and per share data)

	Historical		Transaction Accounting Adjustments		Pro Forma Combined Total
	Aileron	Lung			
Revenues					
Licensing revenue	$ —	$ 153	$ —		$ 153
Operating expenses					
Research and development	2,019	10,861	—		12,880
General and administrative	6,027	4,525	—		10,552
Restructuring and other costs	940	—			940
Total operating expenses	8,986	15,386	—		24,372
Loss from operations	(8,986)	(15,233)	—		(24,219)
Interest income	322	76	—		398
Other income	271	—	—		271
Total other income, net	593	76	—		669
Net loss	(8,393)	(15,157)	—		(23,550)
Net loss per share, basic and diluted	(1.85)				$ (0.80)
Weighted average common shares outstanding, basic and diluted	4,541,167	—		(h)	29,495,512

UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2022
(in thousands, except share and per share data)

	Historical		Transaction Accounting Adjustments		Pro Forma Combined Total
	Aileron	Lung			
Revenues					
Licensing revenue	$ —	$ 688	$ —		$ 688
Operating expenses					
Research and development	17,967	22,465	—		40,432
General and administrative	9,680	6,763	4,751	(d)(g)	21,194
Total operating expenses	27,647	29,228	4,751		61,626
Loss from operations before gains from affiliate	(27,647)	(28,540)	(4,751)		(60,938)
Gain from sale of equity securities in TFF	—	9,400	—		9,400
Loss from operations	(27,647)	(19,140)	(4,751)		(51,538)
Interest and other income, net	318	99	—		417
Total other income, net	318	99	—		417
Net loss	(27,329)	(19,041)	(4,751)		(51,121)
Net loss per share, basic and diluted	$ (6.02)	—			$ (1.73)
Weighted average common shares outstanding, basic and diluted	4,539,318	—		(h)	29,493,663

NOTES TO THE UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

1. Description of the Transaction

Description of the Merger

On October 31, 2023, Aileron acquired Lung, pursuant to the Merger Agreement, by and among Aileron, First Merger Sub, Second Merger Sub and Lung. Pursuant to the Merger Agreement, First Merger Sub merged with and into Lung, pursuant to which Lung was the surviving entity and became a wholly owned subsidiary of Aileron. Immediately following the First Merger, Lung merged with and into Second Merger Sub, pursuant to which Second Merger Sub was the surviving entity. The Merger is intended to qualify as a tax-free reorganization under the provisions of Section 368(a) of the Code.

Under the terms of the Merger Agreement, at the closing of the Merger, Aileron issued to the stockholders of Lung 344,345 shares of Aileron's common stock, and 19,903 shares of Series X Preferred Stock. In addition, Aileron assumed (i) all Lung stock options immediately outstanding prior to the First Merger, each becoming an option for Aileron's common stock subject to adjustment pursuant to the terms of the Merger Agreement, and (ii) all warrants exercisable for Lung common stock immediately outstanding prior to the First Merger, each becoming a warrant to purchase Aileron's common stock, subject to adjustment pursuant to the terms of the Merger Agreement. Immediately following the closing of the Merger, Aileron had 4,885,512 shares of common stock issued and outstanding. The Exchange Ratio is estimated to be approximately 0.1706 shares of Aileron's common stock for each share of Lung common stock.

Subject to stockholder approval for the conversion rights of the Series X Preferred Stock, each share of Series X Preferred Stock will convert into 1,000 shares of Aileron's common stock, subject to certain beneficial ownership limitations.

Pursuant to the Merger Agreement, Aileron has agreed to hold a stockholders' meeting no later than 120 days after the date on which the closing of the Merger occurs to submit certain matters to its stockholders for their consideration, including: (i) the approval of the conversion of the Series X Preferred Stock issued pursuant to the Merger Agreement and the Purchase Agreement into shares of Aileron's common stock in accordance with Nasdaq Listing Rule 5635(a) and (ii) if deemed necessary or appropriate by Aileron or as otherwise required by law or contract, the approval of an amendment to the certificate of incorporation of Aileron to authorize sufficient shares of Aileron common stock for the conversion of the Series X Preferred Stock issued pursuant to the Merger Agreement and the Purchase Agreement and/or to effectuate a reverse stock split.

The Board of Directors of Aileron (the "Board") approved the Merger Agreement and the related transactions, and the consummation of the Merger was not subject to approval of the Aileron stockholders.

Each stock option granted under Lung's 2013 Long-Term Incentive Plan (the "Plan") that was outstanding immediately prior to the First Merger was assumed by Aileron and became an option to acquire, on the same terms and conditions as were applicable to such Lung stock option immediately prior to the First Merger, a number of shares of Aileron's common stock equal to the number of shares of Lung common stock subject to the unexercised portion of the Lung stock option immediately prior to the First Merger, multiplied by the Exchange Ratio (rounded down to the nearest whole share number) with an exercise price per share for the options equal to the exercise price per share of such Lung stock option immediately prior to the First Merger divided by the Exchange Ratio (rounded up to the nearest whole cent). Such assumed options will continue to be governed by the terms and conditions of the Plan.

Each warrant granted by Lung that was outstanding immediately prior to the First Merger was converted into a warrant to purchase shares of Aileron common stock on the same terms and conditions as were applicable to such Lung warrant immediately prior to the First Merger, a number of shares of Aileron's common stock equal to the number of shares of Lung common stock subject to the warrant immediately prior to the First Merger, multiplied by the Exchange Ratio (rounded down to the nearest whole share number) with an exercise price per share for the warrant equal to the exercise price per share of such Lung warrant immediately prior to the First Merger divided by the Exchange Ratio (rounded up to the nearest whole cent).

Description of the Financing

Immediately following closing of the Merger, Aileron entered into the Purchase Agreement with a group of accredited investors, pursuant to which Aileron issued and sold (i) an aggregate of 4,707 shares of Series X Preferred Stock, and (ii) warrants to purchase up to an aggregate of 2,353,500 shares of Aileron's common stock, for an aggregate purchase price of approximately $18.4 million, which included the conversion of certain convertible promissory notes in the aggregate principal amount of approximately $1.6 million issued by Lung to Bios Partners, the majority stockholder of Lung prior to the closing of the Merger, prior to the closing of the Merger at a 10% discount to the per share price of the Series X Preferred Stock (see Note 5). The Financing closed on November 2, 2023.

2. Basis of Pro Forma Presentation

The unaudited pro forma condensed combined financial information was prepared in accordance with Article 11 of Regulation S-X under the Securities Act and in accordance with U.S. GAAP. The unaudited pro forma condensed combined balance sheet as of September 30, 2023, was prepared using the historical balance sheets of Aileron and Lung as of September 30, 2023. The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2023, and for the year ended December 31, 2022, were prepared using the historical statements of operations and comprehensive loss of Aileron and Lung for the nine months ended September 30, 2023, and for the year ended December 31, 2022, respectively, and gives effect to the Merger and the Financing as if they occurred on January 1, 2022.

For legal and accounting purposes, Aileron is considered to be the acquirer, and the Merger is expected to be accounted for as a business acquisition using the acquisition method of accounting. The acquisition method of accounting is based on Accounting Standards Codification ("ASC") 805 "Business Combinations" ("ASC 805"), with Aileron as the accounting acquirer, and uses the fair value concepts defined in ASC 820 "Fair Value Measurement" ("ASC 820").

ASC 805 requires, among other things, that most assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date. In addition, ASC 805 requires that the consideration transferred be measured at the date the acquisition is completed at the then-current market price.

ASC 820 defines the term "fair value," sets forth the valuation requirements for any asset or liability measured at fair value, expands related disclosure requirements and specifies a hierarchy of valuation techniques based on the nature of the inputs used to develop the fair value measures. Fair value is defined in ASC 820 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date." This is an exit price concept for the valuation of the asset or liability. In addition, market participants are assumed to be buyers and sellers in the principal (or the most advantageous) market for the asset or liability. Fair value measurements for an asset assume the highest and best use by these market participants. As a result of these standards, Aileron may be required to record the fair value of assets which are not intended to be used or sold and/or to value assets at fair value measures that do not reflect Aileron's intended use of those assets. Many of these fair value measurements can be highly subjective, and it is possible that other professionals, applying reasonable judgment to the same facts and circumstances, could develop and support a range of alternative estimated amounts.

Under the acquisition method of accounting, the assets acquired and liabilities assumed are recorded, as of the completion of the Merger, primarily at their respective fair values, with the excess of the purchase consideration over the fair value of Lung net assets, allocated to goodwill, if any, and added to those of Aileron. Financial statements and reported results of operations of Aileron issued after completion of the Merger will reflect these values but will not be retroactively restated to reflect the historical financial position or results of operations of Lung. The pro forma allocation of the purchase price reflected in the unaudited pro forma condensed combined financial information is preliminary and thus subject to adjustment and may vary materially from the final purchase price allocation that will be completed within the measurement period, but in no event later than one year following the closing date since, among other reasons, prior to the closing of the Merger, both companies were limited in their ability to share information.

Under ASC 805, acquisition-related transaction costs (e.g., advisory, legal, and other professional fees) are not included as a component of consideration transferred but are accounted for as expenses in the periods in which such costs are incurred. Total acquisition-related transaction costs incurred by Aileron and Lung are estimated to be $4.1 million, out of which $0.9 million were recorded in the historical financial statements for the nine months ended September 30, 2023. The remaining acquisition related transaction costs in the amount of $3.2 million are reflected as a pro forma adjustment to the unaudited pro forma combined statements of operations for those same periods as a reduction in acquisition-related costs because those net costs are not expected to have a continuing impact on the combined company's results. In addition, Aileron incurred $1.5 million in severance related costs in connection with the acquisition and have been reflected as a pro forma adjustment. See Note 5 below.

Lung and Aileron may incur significant costs associated with integrating their operations following closing of the Merger. The unaudited pro forma condensed combined financial information does not reflect the costs of any integration activities or benefits that may result from realization of future cost savings from operating efficiencies which may result from the Merger.

To the extent that there are significant changes to the business following closing of the Merger, the assumptions and estimates set forth in the unaudited pro forma condensed financial information could change significantly. Accordingly, the pro forma adjustments are subject to further adjustments as additional information becomes available and as additional analyses are conducted following the closing of the Merger. There can be no assurances that these additional analyses will not result in material changes to the estimates of fair value.

3. Purchase Price

For purposes of this unaudited pro forma condensed combined financial information, the total estimated purchase price is summarized as follows (in thousands, except share and per share amounts):

Estimated number of common shares of the combined company issued to Lung stockholders (1)	344,345
Multiplied by the fair value per share of Aileron common stock (2)	$ 1.17
Estimated fair value of Aileron common stock issued to Lung stockholders	$ 403
Fair value of Aileron Series X Preferred Stock issued to Lung stockholders	$ 16,795
Estimated fair value of stock options attributable to pre-combination services (3)	$ 1,050
Estimated purchase price	$ 18,248

(1) The number of shares is based on the Merger Agreement.
(2) The estimated purchase price was based on the closing price of Aileron's common stock as reported on the Nasdaq Capital Market on October 31, 2023.
(3) The acquisition date fair value of these stock options attributable to the pre-combination services is included in the estimated purchase price. The acquisition date fair value of these stock options is calculated based on the number of such stock options expected to vest assuming that the Merger closed on October 31, 2023. The following table presents the assumptions used in the Black-Scholes option-pricing model to determine the estimated acquisition-date fair value of the assumed Lung stock options:

Risk-free interest rate	4.82-5.58%
Expected term (in years)	0.42-6.28
Expected volatility	75-91%
Expected dividend yield	0%

4. Preliminary Allocation of the Purchase Price

The following summarizes a preliminary estimate of the assets acquired and the liabilities assumed by Aileron as of the Merger date, and includes a reconciliation to the total consideration transferred:

Assets acquired:	
Cash, cash equivalents and restricted cash	$ 194
Property and equipment, net	3
Right of use asset	76
Prepaid expenses and other assets	2,131
Intangible assets	104,200
Other assets	27
Goodwill	17,404
	124,035
Liabilities assumed:	
Accounts payable	4,453
Accrued expenses and other current liabilities	1,899
Operating lease liabilities	80
Deferred tax liability	26,050
	32,482
Net assets acquired	$ 91,553

As of the completion of the acquisition, identifiable intangible assets are required to be measured at fair value, and these acquired assets could include assets that are not intended to be used or sold or that are intended to be used in a manner other than their highest and best use. For purposes of these unaudited pro forma combined financial statements and consistent with the ASC 820 requirements for fair value measurements, it is assumed that all acquired assets will be used, and that all acquired assets will be used in a manner that represents the highest and best use of those acquired assets.

The fair value of IPR&D was capitalized as of the Merger date and accounted for as indefinite-lived intangible assets until completion or disposition of the assets or abandonment of the associated research and development efforts. Upon successful completion of the development efforts, the useful lives of the IPR&D assets will be determined based on the anticipated period of regulatory exclusivity and will be amortized within operating expenses. Until that time, the IPR&D assets will be subject to impairment testing and will not be amortized. The goodwill recorded related to the acquisition is the excess of the fair value of the consideration transferred by the acquirer over the fair value of the net identifiable assets acquired and liabilities assumed at the date of acquisition. The goodwill recorded is not deductible for tax purposes. Goodwill is not amortized.

5. Transaction Accounting Adjustments

Adjustments included in the column under the heading “Transaction Accounting Adjustments” are primarily based on information contained within the Merger Agreement and the Purchase Agreement.

Based on Aileron’s management’s review of Lung summary of significant accounting policies, the nature and amount of any adjustments to the historical consolidated financial statements of Lung to conform to the accounting policies of Aileron are not expected to be significant.

Both Aileron and Lung have a history of generating net operating losses and maintain a full valuation allowance against their net deferred tax assets. As a result, both entities have not previously reflected an income tax benefit or expense within the financial statement period presented. Management has not identified any changes to the income tax positions due to the Merger that would result in an incremental tax expense or benefit. Accordingly, no tax-related adjustments have been reflected for the pro forma adjustments.

The pro forma adjustments, based on preliminary estimates that may change significantly as additional information is obtained, are as follows:

(a) To reflect $18.4 million in proceeds, less issuance costs of $0.9 million, in connection with the Financing, in which Aileron issued and sold 4,707 shares of its Series X Preferred Stock and warrants to purchase an aggregate of 2,353,500 shares of its common stock. Bios Partners, the majority stockholder of Lung prior to the closing of the Merger, received certain of its shares of Series X Preferred Stock and Warrants by exchanging its convertible promissory notes issued by Lung on September 14, 2023 and October 12, 2023, in aggregate amount of $1.6 million. Based on an assessment of the Warrants' specific terms in the Purchase Agreement and applicable authoritative guidance in ASC 480 and ASC 815, the combined company will account for the Warrants as equity-classified instruments. The Series X Preferred Stock was also classified as an equity instrument.

(b) To reflect the payment in the amount of $0.3 million in lieu of fractional shares upon conversion of Lung common and preferred stock into shares of Aileron common stock and Series X Preferred Stock.

(c) To reflect the conversion of Lung convertible preferred stock into shares of Aileron's common stock at the closing of the Merger.

(d) To reflect transaction costs of $3.2 million in connection with the Merger, such as advisor fees, legal fees, printer fees, and accounting expenses that were incurred by Lung and Aileron. As $0.4 million of transaction costs had been already paid by the date of this Current Report on Form 8-K/A to which this Exhibit 99. 3 is a part, the adjustment was recorded as a decrease in cash of $0.4 million, an increase in accrued liabilities of $2.8 million, an increase in general and administrative expenses of $3.2 million and an increase in accumulated deficit of $3.2 million.

(e) To reflect the elimination of Lung historical equity.

(f) To reflect application of purchase accounting under the acquisition method.

(g) To reflect Aileron compensation expense of $1.5 million related to severance payments resulting from pre-existing employment agreements that were payable in cash in connection with the Merger. The adjustment was recorded as an increase in accrued liabilities of $1.5 million, an increase in general and administrative expenses of $1.5 million and an increase in accumulated deficit of $1.5 million.

(h) The pro forma combined basic and diluted earnings per share have been adjusted to reflect the pro forma net loss for the nine months ended September 30, 2023, and the year ended December 31, 2022. In addition, the number of shares used in calculating the pro forma combined basic and diluted net loss per share has been adjusted to reflect the estimated total number of shares of common stock of the combined company that would be outstanding as of the Merger closing date, including the shares issued in the Financing. For the nine months ended September 30, 2023, and the year ended December 31, 2022, the pro forma weighted average shares outstanding has been calculated as follows, after the Exchange Ratio has been applied:

	September 30, 2023	December 31, 2022
Weighted-average Aileron common shares outstanding—basic and diluted	4,541,167	4,539,318
Impact of the Financing assuming consummation and conversion as of January 1, 2022	4,707,000	4,707,000
Impact of Aileron Series X Preferred Stock issued at Merger assuming conversion as of January 1, 2022	19,903,000	19,903,000
Adjusted weighted-average Aileron common shares outstanding—basic and diluted	29,151,167	29,149,318
Impact of Aileron common stock issued to Lung shareholders	344,345	344,345
Pro forma combined weighted average number of shares of common stock—basic and diluted	29,495,512	29,493,663

(i) The total impact to equity for the above adjustments as reflected in the table below:

(in thousands, except share data)		Series X preferred stock		Common Stock				Additional Paid-in-Capital	Accumulated Deficit	Stockholders' equity
				Aileron		Lung				
		Shares	Amount	Shares	Amount	Shares	Amount			
Conversion of outstanding Lung convertible preferred stock into common stock	(c)	—	$ —	344,345	$ —	90,217,081	$ 9	$ 70,451	$ —	$ 70,460
The Financing	(a)	4,707	—	—	—	—	—	17,347	—	17,347
Elimination of Lung historical equity carrying value	(e)	—	—	—	—	(99,462,184)	(10)	(78,591)	78,601	—
Purchase price allocation	(f)	19,903	—	—	—	—	—	98,269	—	98,269
Payment for partial shares in the exchange	(b)	—	—	—	—	—	—	(291)	—	(291)
Retention and severance payments to Aileron employees	(g)	—	—	—	—	—	—	—	(1,526)	(1,526)
Transaction costs associated with the Merger	(d)	—	—	—	—	—	—	—	(3,225)	(3,225)
Total adjustment		24,610	$ —	344,345	$ —	(9,245,103)	$ (1)	$ 107,185	$ 73,850	$ 181,034