

Member FINRA/SIPC

 Toll Free: 561-391-5555 ♦ www.DawsonJames.com ♦ 1 N. Federal Highway, 5th Floor ♦ Boca Raton, FL 33432

April 14, 2016

Capnia (Nasdaq/CAPN)
Robert M. Wasserman

Director of Research

561-208-2905

rwasserman@dawsonjames.com

BUY
2016 off to a fast start
Capnia makes and markets medical devices
Investment Highlights

1) **Capnia made significant progress in 2015 in a number of areas, including product marketing, R&D pipeline, and corporate/balance sheet.** First, Capnia's lead product at present is CoSense, and in 2015 (or soon afterward), the Company signed an exclusive distribution with Bemes for sales of CoSense in the US – sales which will be helped along by recent initiatives such as showcasing the product (by technology partner Harman International) at the February 2016 Mobile World Congress in Barcelona. Internationally, Capnia recently signed an exclusive agreement with Shanghai CiiC for the sale of CoSense in China; sales are expected to begin in that country by the end of this year pending regulatory clearances. Next, Capnia was able to receive re-certification for its Serenz allergy treatment device with a CE Mark for the European Union, and the Company plans to begin pilot sales to pharmacies in the European Union during Q2/2016 with a goal of full-scale launch relatively soon thereafter. In addition, Capnia now has six months of operations under its belt after the September 2015 acquisition of NeoForce Group, which currently markets several products in the neonatal pulmonary resuscitation market and is working on several new products as well.

2) **Beyond existing products and the new NeoForce Group line, Capnia made further progress on its product pipeline portfolio over the past twelve months.** Heading up this list is the Company's Trigeminal Neuralgia treatment program, in which Capnia was able to obtain Orphan Drug Designation for its Nasal CO₂ Serenz device and enroll its first patient in a 50-patient US multi-center Phase 2 clinical trial, with top-line data from this study expected by the end of 2016. In addition, Capnia is also looking forward to releasing data sometime this year from its 50-patient investigator-sponsored clinical trial with Serenz in for the treatment of episodic cluster headaches, with partner Clinvest. And finally, the Company continues to hold technology with potential applications for the treatment and/or diagnosis of a number of

Current Price \$1.22
Price Target \$2.00

Estimates	F2014A	F2015A	F2016E
Revenues(\$000s)	\$0	\$607	\$1,900
1Q March			
2Q June			
3Q September			
4Q December			

EPS (diluted)	(\$10.92)	(\$1.69)	(\$0.80)
1Q March			
2Q June			
3Q September			
4Q December			

P/E (x)	N/A	N/A	N/A
EBITDA/Share	(\$7.39)	(\$1.18)	(\$0.72)
EV/EBITDA (x)	N/A	N/A	N/A

Stock Data	
52-Week Range	\$0.84-\$8.00
Shares Outstanding (mil.)	15.5
Market Capitalization (mil.)	\$18.9
Enterprise Value (mil.)	\$16.1
Debt to Capital (12/15)	0.0%
Book Value/Share (12/15)	\$0.21
Price/Book	5.9 X
Average Trading Volume (3-month)	122,000
Insider Ownership	73.9%
Institutional Ownership	7.3%
Short interest	462,000
Dividend / Yield	\$0.00/0.0%



Price target and ratings changes over the past 3 yrs:
 Initiated - May 5, 2015 - Buy - Price Target \$12.70
 Updated - April 16, 2016 - Buy - Price Target adjusted to \$2.00

Please find Important Disclosures beginning on Page 5.

other conditions, such as diabetes management, alkanes (transplant rejection), oncology, heart failure and multiple sclerosis.

3) On the corporate front, Capnia was able recently to maintain compliance with Nasdaq listing requirements, announce the expiration of all remaining Series B warrants issued as part of the Company's IPO, and close the second tranche of its convertible preferred stock private placement, with a total of \$10 million gained in both tranches together. Combined with the approximately \$5.5 million in cash on hand at the start of 2016 and the recently received (January 2016) \$5.4 million proceeds from the Convertible Preferred private placement, Capnia now has nearly \$11 million in resources available (with no long-term debt) to fund its operations going forward. In March, the Company announced financial results for calendar and fiscal year 2015, including revenues of \$600,000, a net loss of \$15.9 million or (\$1.69) per share, which included approximately \$3.6 million in non-cash, one-time charges for warrant liability inducements and adjustments. Taking into consideration recent financial results, including those for Q4/2015, the first quarterly result including the NeoForce acquisition, we are estimating that Capnia will post revenues of \$1.9 million in 2016, with a net loss of \$12.5 million or (\$0.80) per share. Taking out non-cash items such as depreciation, amortization and stock compensation, operating cash burn for this year for Capnia is anticipated to be \$10-\$11 million, within range of cash on hand at the start of the year plus proceeds from recent private placements.

Conclusion/Stock Valuation

Capnia shares have held steady this year, perhaps not yet responding to recent positive news on the product, R&D, and corporate front. Still, with a solid balance sheet, initial product sales from its first product, a successful first acquisition under its belt, and a deep product pipeline, value-oriented as well as growth investors still have something to look forward to with CAPN shares, and thus we are maintaining our Buy rating on CAPN shares, while adjusting our 12-18 month price target to \$2 per share due to recent share dilution from warrant exercises and private placements, based on a medical device comparable company valuation analysis and cash on hand. (For full stock valuation analysis, please see our Initiation Report dated May 5, 2015.)

Risk Factors

In addition to normal economic and market risk factors that impact most equities and the common risks shared by Capnia with other companies in the industry, we believe an investment in CAPN involves the following risks:

- **FDA and regulatory risks** – Capnia is subject to regulatory review for its ongoing research and development activities, as well as manufacturing facilities, principally with the US Food and Drug Administration but also potentially with other international regulatory agencies as well.
- **Reliance on co-development/marketing partners** — At present, Capnia does not have a marketing or development partner for all of its currently approved or product development programs, although the Company has had such partnership programs in the past. Co-development and marketing partnerships, if signed, would bring certain risks that are not present in internal operations, such as potential delays, company disagreements, or unforeseen financial difficulties at the external entity, and there can be no assurance that these partnerships will prove to be ultimately successful.
- **Need to defend patents, trade secrets and other intellectual property** – At present, CAPN holds certain intellectual property related to both its Sensalyze technology platform and Serenz products. The Company may need to defend its intellectual property in the US and overseas in the future, particularly if its CoSense

medical device is commercially successful and/or if the Company is able to obtain marketing approval for one or more of its R&D pipeline programs.

- **Need to raise additional capital** - Currently, CAPN has enough cash on hand to fund ongoing research and development programs and product commercialization activities through calendar 2016, approximately. However, the Company does not have a history of profitable operations and unforeseen events including potential delays in product sales, clinical programs and regulatory approvals could require CAPN to raise additional capital through the sale of equity within a shorter time-frame, therefore potentially diluting current shareholders.
- **Limited stock liquidity** – Trading volume in CAPN has been comparatively light compared to other stocks in its industry, and as such, news regarding CAPN, its target market, partners and/or competitors could lead to significant volatility in the stock price.
- **Competitive Markets** – The Company will potentially compete in its target medical device markets with a number of other manufacturers, some of which represent much larger companies. There can be no assurance that the Company will be able to successfully launch new products into these competitive markets in the future.

Capnia, Inc.
Consolidated Statements of Income

Robert M. Wasserman

FYE December	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>2016E</u>	<u>2017E</u>
Revenues						
Devices				\$150,000	\$500,000	\$2,500,000
Disposables				237,555	1,000,000	5,000,000
License fees and grants		\$3,000,000	0	219,917	400,000	500,000
Total revenue	\$0	\$3,000,000	\$0	\$607,472	\$1,900,000	\$8,000,000
Cost of revenues				352,683	1,000,000	3,000,000
Gross Profit (loss)				254,789	900,000	5,000,000
Operating Expenses:						
Research and development	2,470,000	2,379,832	2,242,216	4,536,244	4,800,000	5,200,000
Sales and marketing	0	0	252,359	1,737,470	1,900,000	2,100,000
General and administrative	1,127,000	1,466,951	2,665,154	6,140,821	6,500,000	6,750,000
Impairment and other one-time	0	0	0	0	0	0
Operating income (loss)	(3,597,000)	(846,783)	(5,159,729)	(12,159,746)	(12,300,000)	(9,050,000)
Other income (expense), net						
Interest income	3,000	1,772	1,085	0	100,000	100,000
Interest expense	(2,866,000)	(2,860,267)	(4,130,394)	(183,565)	(200,000)	(50,000)
Other income (expense)	(22,000)	(1,965)	(4,585,475)	(3,565,235)	(50,000)	(50,000)
Income (loss) before tax	(6,482,000)	(3,707,243)	(13,874,513)	(15,908,546)	(12,450,000)	(9,050,000)
Income tax expense (benefit)	0	0	0	0	0	0
Net income (loss)	(6,482,000)	(3,707,243)	(13,874,513)	(15,908,546)	(12,450,000)	(9,050,000)
Basic income per share	(\$12.46)	(\$6.92)	(\$10.92)	(\$1.69)	(\$0.80)	(\$0.55)
Diluted income per share	(\$12.46)	(\$6.92)	(\$10.92)	(\$1.69)	(\$0.80)	(\$0.55)
Basic shares outstanding	520,353	535,648	1,270,033	9,425,880	15,500,000	16,500,000
Diluted shares outstanding	520,353	535,648	1,270,033	9,425,880	15,500,000	16,500,000
Key ratios:						
Revenue growth	N/A	N/A	N/A	N/A	212.8%	321.1%
Gross margins	N/A	N/A	N/A	41.9%	47.4%	62.5%
R&D/revenues	N/A	N/A	N/A	746.7%	252.6%	65.0%
Sales & marketing/revenues	N/A	N/A	N/A	286.0%	100.0%	26.3%
General & admin/revenues	N/A	N/A	N/A	1010.9%	342.1%	84.4%
Depr, amort & stock-based comp.	\$80,000	\$80,000	\$360,000	\$1,050,000	\$1,250,000	\$1,450,000
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cash Flow/share	(\$12.30)	(\$6.77)	(\$10.64)	(\$1.20)	(\$0.72)	(\$0.46)
EBITDA/share	(\$6.80)	(\$1.44)	(\$7.39)	(\$1.18)	(\$0.72)	(\$0.46)

Balance Sheets

Assets:	<u>12/31/14</u>	<u>12/31/15</u>
Cash and equivalents	\$7,956,710	\$5,495,000
Restricted cash	20,000	35,000
Accounts receivable		156,000
Inventory	109,336	551,000
Prepaid expenses & other	252,272	167,000
Total current	8,338,318	6,404,000
Property and equipment, net	57,607	86,000
Intangible assets and other	0	1,711,000
TOTAL ASSETS	\$8,395,925	\$8,201,000
Liabilities:		
Accounts payable	986,799	695,000
Accrued expenses	201,457	1,633,000
Line of credit	101,529	0
Series B warrant liability	0	865,000
Total current	1,289,785	3,193,000
Long-term liabilities	17,438,731	1,784,000
Total liabilities	18,728,516	4,977,000
Convertible Preferred Stock		
Stockholders' equity (deficit)	(10,332,591)	3,224,000
TOTAL LIAB & EQ	\$8,395,925	\$8,201,000

Source: Dawson James Securities, Inc. estimates; Company documents

Important Disclosures:

Price Chart:



Price target and ratings changes over the past 3 years:

Initiated – March 5, 2015 – Price Target \$12.70

Update – April 14, 2016 – Price Target adjusted to \$2.00 – Maintain Buy rating

Dawson James Securities, Inc. (the “Firm”) is a member of the Financial Industry Regulatory Authority (“FINRA”) and the Securities Investor Protection Corporation (“SIPC”).

The Firm does not make a market in the securities of the profiled company. The Firm has received investment banking compensation from this company (CAPN) in the past and may seek compensation for investment banking services in the future. The Firm has not received any other compensation from the profiled company in the last 12 months.

Neither the research analyst(s) whose name appears on this report nor any member of his (their) household is an officer, director or advisory board member of these companies. The Firm and/or its directors and employees may own securities of the company(s) in this report and may increase or decrease holdings in the future. As of March 31, 2016, the Firm as a whole, however, did not beneficially own 1% or more of any class of common equity securities of the subject company.

The Firm, its officers, directors, analysts or employees may effect transactions in and have long or short positions in the securities (or options or warrants related to those securities) of the companies subject to this report. The Firm may effect transactions as principal or agent in those securities.

Analysts receive no direct compensation in connection with the Firm's investment banking business. All Firm employees, including the analyst(s) responsible for preparing this report, may be eligible to receive non-product or service specific monetary bonus compensation that is based upon various factors, including total revenues of the Firm and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.

Although the statements in this report have been obtained from and are based upon recognized statistical services, issuer reports or communications, or other sources that the Firm believes to be reliable, we cannot guarantee their accuracy. All opinions and estimates included in this report constitute the analyst's judgment as of the date of this report and are subject to change without notice.

Information about valuation methods and risks can be found in the “STOCK VALUATION” and “RISK FACTORS” sections of this report.

The securities of the company discussed in this report may be unsuitable for investors depending on their specific investment objectives and financial position. This report is offered for informational purposes only, and does not

constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such would be prohibited. Additional information is available upon request.

Ratings Definitions:

- 1) **Buy:** the analyst believes the price of the stock will appreciate and produce a total return of at least 20% over the next 12-18 months;
- 2) **Neutral:** the analyst believes the price of the stock is fairly valued for the next 12-18 months;
- 3) **Sell:** the analyst believes the price of the stock will decline by at least 20% over the next 12-18 months and should be sold.

The following chart reflects the range of current research report ratings for all companies followed by the analysts of the Firm. The chart also reflects the research report ratings relating to those companies for which the Firm has performed investment banking services.

Ratings Distribution	Company Coverage		Investment Banking	
	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	16	67%	10	63%
Market Perform (Neutral)	8	33%	6	75%
Market Underperform (Sell)	0	0%	0	0%
Total	24	100%	16	67%

Analyst Certification:

The analyst(s) whose name appears on this research report certifies that 1) all of the views expressed in this report accurately reflect his (their) personal views about any and all of the subject securities or issuers discussed; and 2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst in this research report; and 3) all Dawson James employees, including the analyst(s) responsible for preparing this research report, may be eligible to receive non-product or service specific monetary bonus compensation that is based upon various factors, including total revenues of Dawson James and its affiliates as well as a portion of the proceeds from a broad pool of investment vehicles consisting of components of the compensation generated by investment banking activities, including but not limited to shares of stock and/or warrants, which may or may not include the securities referenced in this report.