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COMPANY NOTE

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Capnia, Inc.
(Nasdaq/CAPN/$0.69/Not rated)

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Merger Timeline, 8K and S1 Registration Statement

We recently had the opportunity to sit down with Capnia management and review the "next" steps and timeline involved with the completion of the merger with Essentialis. As a reminder, Essentialis's primary business is the clinical development of a proprietary formulation of diazoxide choline into controlled release tablets (DCCR) for the treatment of Prader-Willi Syndrome, a complex genetically-based metabolic and neurobiological/behavior disorder emanating from a loss of function of a set of genes on chromosome 15. Once the merger is complete, Capnia will be migrating its messaging and corporate presence away from its legacy device products to that of a rare disease therapeutics company. In doing so, management is hopeful that the acquisition of Essentialis's Phase IIb/III-ready "derisked" therapeutic will bring forth enhanced shareholder value.

Merger Timeline:

1) February-Proxy distributed
2) March 6th - Shareholder meeting and vote
3) March 7th or 8th -10K filing
4) Merger closes – as soon as practical; anticipated by early to mid-April

8K filing on February 28th

The above timeline, however, may become disrupted. Capnia filed an 8K on February 28th that updated and refined certain proxy information related the merger in addition to disclosing that a purported shareholder class action lawsuit, captioned *Garfield v. Capnia, Inc., et al.*, Case No. C17-00284, was filed in Superior Court of the State of California, County of Contra Costa, on February 16, 2017, naming Capnia and certain of its officers and directors. The lawsuit generally alleges that Capnia's directors breached their fiduciary duties to Capnia stockholders by seeking to sell control of Capnia through an allegedly defective process, and on unfair terms. The lawsuit also alleges that Capnia failed to disclose all material facts concerning the proposed merger to stockholders. As is usual in such cases, the class action seeks equitable relief that would enjoin the consummation of the proposed merger, compensatory and/or rescissory damages, and attorneys' fees and costs. Although Capnia makes a statement within the 8K denying the allegations and the need for any supplemental disclosures, the 8K did contain a number of supplemental disclosures which addressed Vivo Ventures' Essentialis ownership post bridge loan conversion, Vivo Ventures commitment to purchase approximately 1.4 million shares at $0.96 in the merger financing and on background underlying Capnia's Board recommendation to shareholders to approve the merger. The disclosure of the shareholder lawsuit undoubtedly contributed to Tuesday's share sell-off.

Aspire Capital Fund Registration Statement

In addition to the abovementioned 8K, Capnia recently filed a registration statement covering up to 10 million shares issuable to Aspire Capital Fund under a Stock Purchase Agreement dated January 27, 2017. The Stock Purchase Agreement commits Aspire to purchase an aggregate of $17 million of common stock over the next 30 months in what is essentially an equity line. Capnia had a similar At-the-Market Stock Purchase Agreement with Aspire in 2015. In consideration for entering into the Purchase Agreement, Capnia issued 708,833 common stock shares to Aspire Capital on January 27th as a commitment fee. Capnia agreed to file one or more registration statements in conjunction with this transaction, the first of which was filed on February 1st.

Aspire is also one of the investors who, as a group, have indicated that they will purchase 8,333,333 shares of Capnia common stock at a price of $0.96 per share (the Concurrent Financing) immediately following the merger, subject to the merger being completed on or before April 30, 2017 and to certain other conditions. Aspire will purchase 2,083,333 common shares at $0.96 as part of this Concurrent Financing commitment. Sabby Management LLC, who retains participation rights from a June 2016 private placement, may also purchase up to additional 3,472,222 shares in connection with the Concurrent Financing.

Business View

With regard to the legacy device business, management has indicated the intention is to maintain the business in "steady state" mode while strategic alternatives are reviewed. Management expressed continued difficulty in achieving meaningful sales traction with its neonate product portfolio without obtaining significant additional funding to support a more aggressive sales and marketing plan and to drive clinical progress of therapeutic nasal CO_2 candidates. The uncertain likelihood of securing such financing is, at the end of the day, the primary rationale for the merger transaction, as investor enthusiasm for rare disease therapeutics is currently much higher than investor appetite for early stage niche medical devices. It should be pointed out, however, that management remains committed to the underlying value of the neonate products franchise. As such, management expressed the view that a preferred exit of the business, if possible, would likely incorporate some sort residual interest in the business such as a royalty or residual value stream.

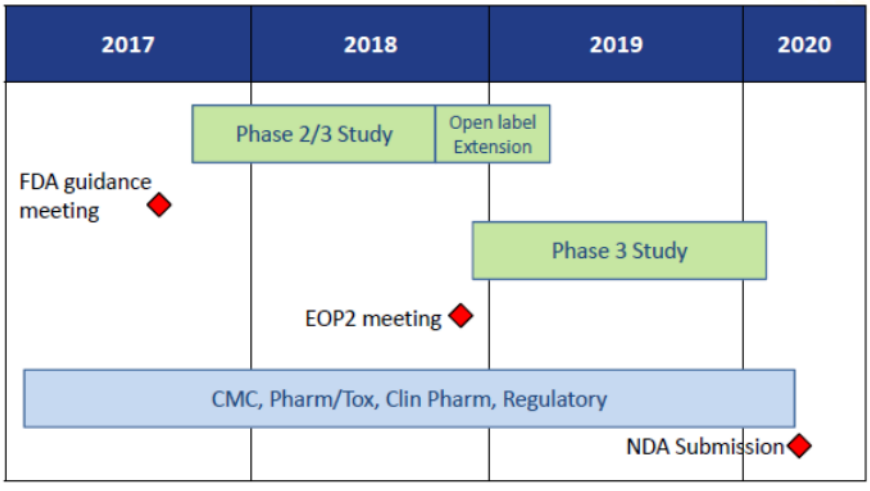
In our opinion, securing a single "business as a whole" exit to the legacy business may prove quite challenging and could take a significant amount of time. The basis of our opinion lies in the fact that, although the commercialized products focus on neonates, the pipeline products attempt to extend core Capnia device technology beyond this market and other pipeline products are directed towards pharmaceutical therapeutic indications, as the chart below depicts. With this "cohesiveness" challenge in mind, we believe that Capnia may find more discussion opportunity in a piece-meal exit, where the pool of assets is broken up to match specific parties' interests. If that were to occur, there may be a possibility that under the right conditions, Capnia could take advantage of a "the parts are worth more than the whole" scenario. This will depend, of course, on management's talent in negotiation. It's our sense that the Company has already begun testing the waters in a variety of options that would include breaking up the legacy products into various segments. The Company has now stated publicly its desire to seek such strategic alternatives as a priority for 2017.

Capnia Legacy Product-Development Snapshot*

Focus on Building a Building a Therapeutics Pipeline

Key to the success of this merger and executing on the promise of an improved shareholder outlook now will rest on the development program for DCCR. As previously mentioned, the Essentialis asset is absent much of the typical "early stage" risk. The active ingredient is already standard of care for the Prader-Willi and other indications and has over 120,000 patient years of treatment history. The Essentialis oral controlled release formulation is well characterized and has shown efficacy in a range of PWS behaviors that is supported by data in 120 patients from five Phase I and three Phase II clinical trials. Management expects that by converting the administration of diazoxide choline from an oral suspension that needs to be given two or more times per day to an oral tablet, convenience and perhaps a better side effect profile, will drive rapid market acceptance if and when DCCR reaches FDA approval. The following is the current development timeline for DCCR.

DCCR Prader-Willi Development Timeline*



Because of the long clinical history of DCCR's active ingredient, the Essentialis team has also been targeting the expansion of DCCR indications into other areas of metabolic/neurologic disorders. Specifically of interest are diseases where there is opportunity to secure Orphan Drug designations and to treat high value rare and ultra-rare disease for which there are few, if any, alternatives.

Future Therapeutic Opportunities for DCCR*

Product	Indication	US Patient Population Estimate	Timing to NDA
DCCR	Prader-Willi Syndrome	12,500 - 21,000	2020
Upside opportunities for DCCR			
DCCR	Hypothalamic Obesity	3,750 – 9,700	2022
DCCR	Smith-Magenis Syndrome	12,500 – 21,000	2022

- Orphan drug designation has been granted for PWS

* Source: Capnia corporate presentation Jan 2017

2017 Milestones Articulated

Concurrently with providing the rationale for the merger, Capnia management has been laying out a set of milestones for the combined business that they intend to accomplish in 2017. We summarize as follows:

1) Close merger and complete the pre-announced $8 million in concurrent financing, thus post-merger, Capnia will have approximately $11 million in cash and no debt
2) Schedule an FDA "guidance" meeting to discuss the clinical path for DCCR
3) Initiate the Prader-Willi Syndrome Phase IIb/III clinical trial in 2H 2017
4) Continue to assess strategic alternatives for the legacy marketed and in-development products
5) Secure orphan drug designation for DCCR in additional indications

Comment

The Essentialis acquisition brings a unique mid-stage, fairly well de-risked asset into Capnia and DCCR doesn't carry the same operational and sales and marketing challenges as Capnia's legacy products. These are positives. However, from an investor viewpoint, there is still a "timeline" risk to assess. Execution against that timeline, and management savvy in terms of leveraging opportunities to perhaps shorten portions of that timeline will be important "valuation" indicators. Looking past the closing of this merger, we expect investors to focus on how quickly management can secure a date for the FDA guidance meeting, which is No.1 on their list of 2017 priorities and milestones. *SG*

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Total	6	100%	5	83%

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