

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

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

For the quarterly period ended **June 30, 2019**

OR

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

For the transition period from _____ to _____

Commission File Number: **001-38529**

Verrica Pharmaceuticals Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
10 North High Street, Suite 200
West Chester, PA
(Address of principal executive offices)

46-3137900
(I.R.S. Employer
Identification No.)

19380
(Zip Code)

Registrant's telephone number, including area code: **(484) 453-3300**

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 | VRCA | The Nasdaq Stock Market LLC |

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-------------------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input type="checkbox"/> |
| Non-accelerated filer | <input checked="" type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |
| Emerging growth company | <input checked="" type="checkbox"/> | | |

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.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of August 5, 2019, the registrant had 25,741,297 shares of common stock, \$0.0001 par value per share, outstanding.

VERRICA PHARMACEUTICALS INC.
QUARTERLY REPORT ON FORM 10-Q
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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Financial Statements

VERRICA PHARMACEUTICALS INC.
CONDENSED BALANCE SHEETS
(in thousands, except share and per share amounts)
(Unaudited)

| | June 30, 2019 | December 31, 2018 |
|---|------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 19,852 | \$ 10,271 |
| Marketable securities | 58,902 | 79,538 |
| Prepaid expenses and other assets | 985 | 1,343 |
| Total current assets | 79,739 | 91,152 |
| Property, plant and equipment, net | 1,252 | 255 |
| Operating lease right-of-use asset | 245 | — |
| Deposits | 14 | 499 |
| Total assets | \$ 81,250 | \$ 91,906 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,467 | \$ 922 |
| Accrued expenses | 2,684 | 1,517 |
| Accounts payable and accrued expenses - related party | 6 | 38 |
| Operating lease liability | 124 | — |
| Total current liabilities | 4,281 | 2,477 |
| Operating lease liability | 124 | — |
| Total liabilities | 4,405 | 2,477 |
| Commitments and Contingencies | | |
| Stockholders' equity: | | |
| Preferred stock, \$0.0001 par value; 10,000,000 shares authorized; no shares issued and outstanding as of June 30, 2019 and December 31, 2018 | — | — |
| Common stock, \$0.0001 par value; 200,000,000 authorized as of June 30, 2019 and December 31, 2018; 25,845,441 shares issued and 25,740,297 shares outstanding as of June 30, 2019 and 25,809,900 shares issued and 25,704,756 shares outstanding as of December 31, 2018 | 3 | 3 |
| Treasury stock, at cost, 105,144 shares as of June 30, 2019 and December 31, 2018 | — | — |
| Additional paid-in capital | 124,269 | 122,526 |
| Accumulated deficit | (47,465) | (33,083) |
| Accumulated other comprehensive gain (loss) | 38 | (17) |
| Total stockholders' equity | 76,845 | 89,429 |
| Total liabilities and stockholders' equity | \$ 81,250 | \$ 91,906 |

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

VERRICA PHARMACEUTICALS INC.
CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(in thousands, except share and per share amounts)
(Unaudited)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|--|-------------------|--|-------------------|
| | 2019 | 2018 | 2019 | 2018 |
| Operating expenses: | | | | |
| Research and development | \$ 3,928 | \$ 3,515 | \$ 8,415 | \$ 4,442 |
| General and administrative | 3,593 | 1,955 | 7,132 | 2,916 |
| Total operating expenses | <u>7,521</u> | <u>5,470</u> | <u>15,547</u> | <u>7,358</u> |
| Loss from operations | <u>(7,521)</u> | <u>(5,470)</u> | <u>(15,547)</u> | <u>(7,358)</u> |
| Other income (expense): | | | | |
| Interest income | 523 | 153 | 1,070 | 194 |
| Other expense | (3) | — | (3) | — |
| Total other income (expense) | <u>520</u> | <u>153</u> | <u>1,067</u> | <u>194</u> |
| Net loss | <u>\$ (7,001)</u> | <u>\$ (5,317)</u> | <u>\$ (14,480)</u> | <u>\$ (7,164)</u> |
| Net loss per share, basic and diluted | <u>\$ (0.28)</u> | <u>\$ (0.92)</u> | <u>\$ (0.58)</u> | <u>\$ (1.66)</u> |
| Weighted average common shares outstanding, basic and diluted | <u>24,875,573</u> | <u>5,751,326</u> | <u>24,866,721</u> | <u>4,308,996</u> |
| Net loss | \$ (7,001) | \$ (5,317) | \$ (14,480) | \$ (7,164) |
| Other comprehensive gain: | | | | |
| Unrealized gain on marketable securities | 27 | — | 55 | — |
| Comprehensive loss | <u>\$ (6,974)</u> | <u>\$ (5,317)</u> | <u>\$ (14,425)</u> | <u>\$ (7,164)</u> |

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

VERRICA PHARMACEUTICALS INC.
CONDENSED STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY
(in thousands, except share amounts)
(Unaudited)

| | Series A Convertible Preferred Stock | | Series B Convertible Preferred Stock | | Series C Convertible Preferred Stock | | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Treasury Stock | | Accumulated Other Comprehensive Gain (Loss) | Total Stockholders' Equity | |
|--|--------------------------------------|--------|--------------------------------------|--------|--------------------------------------|--------|---------------|--------|----------------------------|---------------------|----------------|------|---|----------------------------|-------------|
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares Issued | Amount | | | Shares | Cost | | | Gain (Loss) |
| | | | | | | | | | | | | | | | |
| January 1, 2019 | — | \$ — | — | \$ — | — | \$ — | 25,809,900 | \$ 3 | \$ 122,526 | \$ (33,083) | 105,144 | \$ — | \$ (17) | \$ 89,429 | |
| Stock-based compensation | — | — | — | — | — | — | — | — | 780 | — | — | — | — | 780 | |
| Exercise of stock options | — | — | — | — | — | — | 3,729 | — | 3 | — | — | — | — | 3 | |
| Unrealized gain on marketable securities | — | — | — | — | — | — | — | — | — | — | — | — | 28 | 28 | |
| Net loss | — | — | — | — | — | — | — | — | — | (7,479) | — | — | — | (7,479) | |
| Adoption of ASU 2018-07 (See Note 2) | — | — | — | — | — | — | — | — | (98) | 98 | — | — | — | — | |
| March 31, 2019 | — | — | — | — | — | — | 25,813,629 | 3 | 123,211 | (40,464) | 105,144 | — | 11 | 82,761 | |
| Stock-based compensation | — | — | — | — | — | — | — | — | 846 | — | — | — | — | 846 | |
| Exercise of stock options | — | — | — | — | — | — | 31,812 | — | 212 | — | — | — | — | 212 | |
| Unrealized gain on marketable securities | — | — | — | — | — | — | — | — | — | — | — | — | 27 | 27 | |
| Net loss | — | — | — | — | — | — | — | — | — | (7,001) | — | — | — | (7,001) | |
| June 30, 2019 | — | \$ — | — | \$ — | — | \$ — | 25,845,441 | \$ 3 | \$ 124,269 | \$ (47,465) | 105,144 | \$ — | \$ 38 | \$ 76,845 | |

| | Series A Convertible Preferred Stock | | Series B Convertible Preferred Stock | | Series C Convertible Preferred Stock | | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Treasury Stock | | Accumulated Other Comprehensive Gain (Loss) | Total Stockholders' Equity | |
|--|--------------------------------------|-----------|--------------------------------------|----------|--------------------------------------|----------|---------------|--------|----------------------------|---------------------|----------------|------|---|----------------------------|-------------|
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares Issued | Amount | | | Shares | Cost | | | Gain (Loss) |
| | | | | | | | | | | | | | | | |
| January 1, 2018 | 21,302,972 | \$ 10,508 | 1,937,984 | \$ 5,000 | — | \$ — | 3,804,643 | \$ — | \$ 5,394 | \$ (12,435) | 105,144 | \$ — | \$ — | \$ (7,041) | |
| Stock-based compensation | — | — | — | — | — | — | — | — | 135 | — | — | — | — | 135 | |
| Series C convertible preferred stock | — | — | — | — | 4,606,267 | 21,000 | — | — | — | — | — | — | — | — | |
| Issuance costs for Series C preferred stock | — | — | — | — | — | (7) | — | — | — | — | — | — | — | — | |
| Net loss | — | — | — | — | — | — | — | — | — | (1,847) | — | — | — | (1,847) | |
| March 31, 2018 | 21,302,972 | 10,508 | 1,937,984 | 5,000 | 4,606,267 | 20,993 | 3,804,643 | — | 5,529 | (14,282) | 105,144 | — | — | (8,753) | |
| Stock-based compensation | — | — | — | — | — | — | — | — | 779 | — | — | — | — | 779 | |
| Conversion of preferred stock into common stock | (21,302,972) | (10,508) | (1,937,984) | (5,000) | (4,606,267) | (20,993) | 16,246,872 | 2 | 36,499 | — | — | — | — | 36,501 | |
| Issuance of common stock in connection with IPO, net of offering costs | — | — | — | — | — | — | 5,750,000 | 1 | 78,380 | — | — | — | — | 78,381 | |
| Net loss | — | — | — | — | — | — | — | — | — | (5,317) | — | — | — | (5,317) | |
| June 30, 2018 | — | \$ — | — | \$ — | — | \$ — | 25,801,515 | \$ 3 | \$ 121,187 | \$ (19,599) | 105,144 | \$ — | \$ — | \$ 101,591 | |

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

VERRICA PHARMACEUTICALS INC.
CONDENSED STATEMENTS OF CASH FLOWS
(in thousands)
(Unaudited)

| | For the Six Months Ended June 30, | |
|--|--|--------------------------|
| | 2019 | 2018 |
| Cash flows from operating activities | | |
| Net loss | \$ (14,480) | \$ (7,164) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock-based compensation | 1,626 | 914 |
| Accretion of discounts on marketable securities | (642) | — |
| Depreciation expense | 22 | 5 |
| Amortization on operating lease right-of-use asset | 59 | — |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses and other assets | 358 | (1,035) |
| Accounts payable | 33 | 573 |
| Accrued expenses | 1,147 | 851 |
| Accounts payable and accrued expenses - related party | (32) | 22 |
| Operating lease liability | (58) | — |
| Net cash used in operating activities | <u>(11,967)</u> | <u>(5,834)</u> |
| Cash flows from investing activities | | |
| Sales and maturities of marketable securities | 70,565 | — |
| Purchases of marketable securities | (49,232) | — |
| Purchases of property, plant and equipment | — | (111) |
| Net cash provided by (used in) investing activities | <u>21,333</u> | <u>(111)</u> |
| Cash flows from financing activities | | |
| Proceeds from the issuance of common stock in connection with IPO | — | 86,250 |
| Payment of offering costs in connection with issuance of common stock in connection with IPO | — | (6,812) |
| Proceeds from exercise of stock options | 215 | — |
| Proceeds received from issuance of Series C preferred stock | — | 21,000 |
| Stock issuance costs related to Series C preferred stock | — | (7) |
| Net cash provided by financing activities | <u>215</u> | <u>100,431</u> |
| Net increase in cash and cash equivalents | 9,581 | 94,486 |
| Cash and cash equivalents at the beginning of the period | 10,271 | 8,663 |
| Cash and cash equivalents at the end of the period | <u>\$ 19,852</u> | <u>\$ 103,149</u> |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Fixed asset and construction in process purchases payable or accrued at period end | \$ 534 | \$ 6 |
| Change in unrealized gain on marketable securities | \$ 55 | \$ — |
| Issuance costs included in accounts payable and accrued expenses | \$ — | \$ 1,057 |
| Conversion of preferred stock into common stock | \$ — | \$ 36,501 |

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

VERRICA PHARMACEUTICALS INC.
Notes to Condensed Financial Statements
(Unaudited)

Note 1—Nature of Business

Verrica Pharmaceuticals Inc. (the “Company”) was formed on July 3, 2013 and is incorporated in the State of Delaware. The Company is a medical dermatology company committed to the development and commercialization of novel treatments that provide meaningful benefit for people living with skin diseases.

Liquidity and Capital Resources

The Company has incurred substantial operating losses since inception and expects to continue to incur significant operating losses for the foreseeable future and may never become profitable. As of June 30, 2019, the Company had an accumulated deficit of \$47.5 million.

Since inception, the Company has financed its operations through sales of convertible preferred stock and the sale of common stock in the Company’s initial public offering, with aggregate gross proceeds of \$123.2 million and net proceeds of \$114.9 million. As of June 30, 2019, the Company had cash, cash equivalents and marketable securities of \$78.8 million.

Note 2—Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim condensed financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“GAAP”) as determined by the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the unaudited interim condensed financial statements reflect all adjustments, which include only normal recurring adjustments necessary for the fair statement of the balances and results for the periods presented. They may not include all of the information and footnotes required by GAAP for complete financial statements. Therefore, these financial statements should be read in conjunction with the Company’s audited financial statements and notes thereto for the year ended December 31, 2018 filed with the Securities and Exchange Commission (the “SEC”) on March 7, 2019. The results of operations for any interim periods are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

In the fourth quarter of 2018, the Company changed its policy for recognizing stock-based compensation expense for awards with service conditions only from the graded attribution method to the straight-line attribution method. The following tables present the effect of the change in accounting policy and its impact on the Company’s results of operations as previously reported for the three and six months ended June 30, 2018, as compared to the results of operations after the retrospective application of the change in accounting policy (in thousands, except share and per share amounts):

| | For the Three Months Ended June 30, 2018 | | For the Six Months Ended June 30, 2018 | |
|--|---|---|---|---|
| | As Computed Under Straight-line Attribution Method: | As Previously Reported Under Graded Attribution Method: | As Computed Under Straight-line Attribution Method: | As Previously Reported Under Graded Attribution Method: |
| Operating expenses: | | | | |
| Research and development | \$ 3,515 | \$ 3,609 | \$ 4,442 | \$ 4,538 |
| General and administrative | 1,955 | 2,503 | 2,916 | 3,489 |
| Total operating expenses | 5,470 | 6,112 | 7,358 | 8,027 |
| Loss from operations | (5,470) | (6,112) | (7,358) | (8,027) |
| Total other income | 153 | 153 | 194 | 194 |
| Net loss | \$ (5,317) | \$ (5,959) | \$ (7,164) | \$ (7,833) |
| Net loss per share, basic and diluted | \$ (0.92) | \$ (1.04) | \$ (1.66) | \$ (1.82) |
| Weighted average common shares outstanding, basic and diluted | 5,751,326 | 5,751,326 | 4,308,996 | 4,308,996 |

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. These estimates and assumptions are based on current facts, historical experience and various other factors believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of expenses that are not readily apparent from other sources. Actual results may differ materially and adversely from these estimates. To the extent there are material differences between the estimates and actual results, the Company's future results of operations will be affected.

Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies to those previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018 other than the adoption of the FASB Accounting Standard Update ("ASU") 2016-02, *Leases (Topic 842)*, and ASU 2018-07, *Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*.

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)* in order to increase transparency and comparability among organizations by, among other provisions, recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. For public companies, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. In transition, entities may also elect a package of practical expedients that must be applied in its entirety to all leases commencing before the adoption date, unless the lease is modified, and permits entities to not reassess (a) the existence of a lease, (b) lease classification or (c) determination of initial direct costs, as of the adoption date, which effectively allows entities to carryforward accounting conclusions under previous GAAP. In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, which provides entities an optional transition method to apply the guidance under Topic 842 as of the adoption date, rather than as of the earliest period presented. The Company adopted Topic 842 on January 1, 2019, using the optional transition method to apply the new guidance as of January 1, 2019, rather than as of the earliest period presented, and elected the package of practical expedients described above. Based on the analysis, on January 1, 2019, the Company recorded an operating lease right-of-use asset of \$304,000 and an operating lease liability of \$306,000 and eliminated deferred rent of \$2,000. See Note 8 for additional information.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. The changes take effect for public companies for fiscal years starting after December 15, 2018, including interim periods within that fiscal year. The Company adopted this ASU as of January 1, 2019 and recorded an adjustment to accumulated deficit and additional paid-in capital of \$98,000.

Recently Issued Accounting Pronouncements Not Yet Adopted

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*, which makes a number of changes meant to add, modify or remove certain disclosure requirements associated with the movement amongst or hierarchy associated with Level 1, Level 2 and Level 3 fair value measurements. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted upon issuance of the update. The Company does not expect the adoption of this guidance to have a material impact on its financial statements.

Net Loss Per Share

Net loss per share of common stock is computed by dividing net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted net loss per share excludes the potential impact of common stock options and unvested shares of restricted stock because their effect would be anti-dilutive due to the Company's net loss. Since the Company had a net loss in each of the periods presented, basic and diluted net loss per common share are the same.

The table below provides potential shares outstanding that were not included in the computation of diluted net loss per common share, as the inclusion of these securities would have been anti-dilutive:

| | <u>As of June 30,</u> | |
|---|-----------------------|-------------|
| | <u>2019</u> | <u>2018</u> |
| Shares issuable upon exercise of stock options | 1,950,701 | 1,383,582 |
| Non-vested shares under restricted stock grants | 848,859 | 848,859 |

Note 3—Investments in Marketable Securities

Investments in marketable securities consisted of the following as of June 30, 2019 and December 31, 2018 (in thousands):

| | <u>June 30, 2019</u> | | | |
|-----------------------------|---------------------------|-----------------------------------|------------------------------------|-----------------------|
| | <u>Amortized Cost</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Fair Value</u> |
| U.S. treasury securities | \$ 10,933 | \$ 15 | \$ — | \$ 10,948 |
| Commercial paper | 33,072 | 10 | — | 33,082 |
| Asset-backed securities | 14,859 | 13 | — | 14,872 |
| Total marketable securities | <u>\$ 58,864</u> | <u>\$ 38</u> | <u>\$ —</u> | <u>\$ 58,902</u> |

| | <u>December 31, 2018</u> | | | |
|-----------------------------|---------------------------|-----------------------------------|------------------------------------|-----------------------|
| | <u>Amortized Cost</u> | <u>Gross Unrealized Gains</u> | <u>Gross Unrealized Losses</u> | <u>Fair Value</u> |
| U.S. treasury securities | \$ 17,028 | \$ — | \$ (2) | \$ 17,026 |
| Commercial paper | 48,623 | 5 | (4) | 48,624 |
| Asset-backed securities | 13,904 | — | (16) | 13,888 |
| Total marketable securities | <u>\$ 79,555</u> | <u>\$ 5</u> | <u>\$ (22)</u> | <u>\$ 79,538</u> |

There were no marketable securities with a maturity of greater than one year for either period presented. Unrealized gains and losses on marketable debt securities are recorded as a separate component of accumulated other comprehensive gain (loss) included in stockholders' equity.

Fair value is 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. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1 — Quoted market prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

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

The following tables presents fair value of the Company's marketable securities (in thousands):

| | Fair Value Measurement as of June 30, 2019 | | | |
|--------------------------|--|------------------|-------------|------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| U.S. treasury securities | \$ 10,948 | \$ — | \$ — | \$ 10,948 |
| Commercial paper | — | 33,082 | — | 33,082 |
| Asset-backed securities | — | 14,872 | — | 14,872 |
| Total assets | \$ 10,948 | \$ 47,954 | \$ — | \$ 58,902 |

| | Fair Value Measurement as of December 31, 2018 | | | |
|--------------------------|--|------------------|-------------|------------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| U.S. treasury securities | \$ 17,026 | \$ — | \$ — | \$ 17,026 |
| Commercial paper | — | 48,624 | — | 48,624 |
| Asset-backed securities | — | 13,888 | — | 13,888 |
| Total assets | \$ 17,026 | \$ 62,512 | \$ — | \$ 79,538 |

Note 4—Property, Plant and Equipment

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

| | As of June 30, 2019 | As of December 31, 2018 |
|---|---------------------------|-------------------------------|
| Leasehold improvements | \$ 68 | \$ 68 |
| Office furniture and fixtures | 48 | 48 |
| Office equipment | 28 | 28 |
| Construction in process | 1,150 | 131 |
| | 1,294 | 275 |
| Accumulated depreciation | (42) | (20) |
| Total property, plant and equipment, net | \$ 1,252 | \$ 255 |

The Company has recorded an asset classified as construction in process associated with the construction of a product packaging line that would be placed into service for commercial manufacturing upon future regulatory product approval.

Note 5—Related Party Transactions

In December 2015, the Company entered into a services agreement (“SA”) with PBM Capital Group, LLC (“PBM”) an affiliate of PBM Capital Investments, LLC, to engage PBM for certain business development, operations, technical, contract, accounting and back office support services. Paul B. Manning, who is the Chairman and Chief Executive Officer of PBM and the current chairman of the Company's Board of Directors, and certain entities affiliated with Mr. Manning, continue to be the Company's largest stockholder on a collective basis. The Company agreed to pay PBM a fee of \$2,500 per month for these services. The SA had an initial term of 12 months and automatically renewed monthly thereafter.

In March 2018, the Company entered into an amendment to the SA with PBM effective as of April 1, 2018, which extended the term of the SA until March 31, 2019 (and is automatically renewable for successive monthly periods) and increased the management fee the Company is obligated to pay to PBM to \$50,000 per month. On January 1, 2019, the SA was amended to reduce the monthly management fee to \$26,333 as a result of a reduction in services provided by PBM. The SA, as amended, provides for termination by the Company with 30 days advance notice or a mutually agreed upon effective date for transition as individual services are cancelled with a corresponding reduction in the monthly management fee.

For the three months ended June 30, 2019 and 2018, the Company incurred expenses under the SA of \$79,000 and \$150,000, respectively. For the six months ended June 30, 2019 and 2018, the Company incurred expenses under the SA of \$158,000 and \$157,500, respectively.

As of June 30, 2019 and December 31, 2018, the Company had a payable due to PBM of \$6,000 and \$38,000, respectively. These balances include amounts for other miscellaneous expenses incurred by PBM and its affiliates.

Note 6—Accrued Expenses

Accrued expenses consisted of the following (in thousands):

| | As of June 30, 2019 | As of December 31, 2018 |
|--|---------------------------|-------------------------------|
| Compensation and related costs | \$ 840 | \$ 1,261 |
| Clinical and development | 1,708 | — |
| Construction in process | 21 | — |
| Consulting - former Chief Scientific Officer | — | 190 |
| Professional fees | 58 | 56 |
| Other | 57 | 10 |
| Total accrued expenses | <u>\$ 2,684</u> | <u>\$ 1,517</u> |

Note 7—Stock-Based Compensation

In June 2018, the Board adopted and approved the 2018 Equity Incentive Plan (the “IPO Plan”), which amended and restated the Company’s prior 2013 Equity Incentive Plan (the “2013 Plan”) and became effective in connection with the IPO pricing on June 14, 2018. Prior to the effectiveness of the IPO Plan, the 2013 Plan provided for the grant of share-based awards to employees, directors and consultants of the Company. As a result of the effectiveness of the IPO Plan, no further grants may be made under the 2013 Plan.

The IPO Plan provides for the grant of incentive stock options to employees, and for the grant of nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance-based stock awards and other forms of stock awards to employees, including officers, consultants and directors. The IPO Plan also provides for the grant of performance-based cash awards to employees, including officers, consultants and directors. The Company has initially reserved 3,738,199 shares of common stock for issuance under the IPO Plan, which is the sum of (1) 2,198,198 new shares, plus (2) the number of shares reserved for issuance under the 2013 Plan at the time the IPO Plan became effective, plus (3) any shares subject to outstanding stock options or other stock awards that would have otherwise returned to the 2013 Plan (such as upon the expiration or termination of a stock award prior to exercise). The number of shares of common stock reserved for issuance under the IPO Plan will automatically increase on January 1 each year, for a period of ten years, from January 1, 2019 through January 1, 2028, by 4% of the total number of shares of the Company’s common stock outstanding on December 31 of the preceding calendar year, or a lesser number of shares as may be determined by the Board. As of June 30, 2019, 2,529,864 shares were available for grant under the IPO Plan.

Stock-based compensation expense, which includes expense for both employees and non-employees, has been reported in the Company’s condensed statements of operations for the three and six months ended June 30, 2019 and 2018 as follows (in thousands):

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--------------------------------|--|---------------|-----------------------------------|---------------|
| | 2019 | 2018 | 2019 | 2018 |
| Research and development | \$ 144 | \$ 255 | \$ 284 | \$ 370 |
| General and administrative | 702 | 524 | 1,342 | 544 |
| Total stock-based compensation | <u>\$ 846</u> | <u>\$ 779</u> | <u>\$ 1,626</u> | <u>\$ 914</u> |

Stock Options

The grant date fair value of stock option awards is determined using the Black-Scholes option-pricing model. The following weighted-average assumptions were used during the three and six months ended June 30, 2019 and 2018 to estimate the fair value of stock option awards granted during the period:

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|--|-------------------------------------|---------|-----------------------------------|--------|
| | 2019 | 2018 | 2019 | 2018 |
| Exercise price | \$9.88 | \$10.01 | \$10.80 | \$7.64 |
| Risk-free rate of interest | 2.12% | 2.86% | 2.50% | 2.68% |
| Expected term (years) | 5.7 | 6.1 | 6.0 | 6.1 |
| Expected stock price volatility | 75.24% | 75.31% | 77.42 | 72.65% |
| Weighted average grant date fair value | \$6.48 | \$7.52 | \$7.36 | \$6.53 |
| Dividend yield | — | — | — | — |

The following table summarizes the Company's stock option activity under the 2013 Plan and the IPO Plan for the six months ended June 30, 2019:

| | Number of shares | Weighted average exercise price | Weighted average remaining contractual life (in years) | Aggregate intrinsic value |
|--|------------------|---------------------------------|--|---------------------------|
| Outstanding as of December 31, 2018 | 1,529,883 | \$ 8.03 | | |
| Granted | 607,575 | 10.80 | | |
| Exercised | (35,541) | 6.07 | | |
| Forfeitures | (151,216) | 8.87 | | |
| Outstanding as of June 30, 2019 | <u>1,950,701</u> | \$ 8.86 | 8.9 | \$ 6,386,375 |
| Options vested and exercisable as of June 30, 2019 | <u>474,727</u> | \$ 6.66 | 8.4 | \$ 2,490,858 |

As of June 30, 2019, the total unrecognized compensation related to unvested stock option awards granted was \$9.9 million, which the Company expects to recognize over a weighted-average period of 3.0 years.

Restricted Stock

Pursuant to an Amended and Restated Stock Purchase Agreement (the "Amended and Restated Agreement") between the Company and the former Chief Scientific Officer ("CSO"), 848,859 shares held by the former CSO are subject to repurchase at \$0.0001 per share in the event the CSO ceases to be a consultant. These shares will be released from the repurchase option on the earliest to occur of (i) a change in control, (ii) regulatory approval of the Company's new drug application for cantharidin, (iii) commercial sale of products and (iv) a covered termination, as defined in the Amended and Restated Agreement.

As of June 30, 2019, the total unrecognized compensation expense related to the nonvested shares was \$0.3 million. No compensation expense has been recognized for these nonvested shares as these shares are performance-based and the triggering event was not determined to be probable as of June 30, 2019. There was no activity related to restricted stock during the six months ended June 30, 2019.

Note 8—Leases

Effective January 1, 2019, the Company accounts for its leases under ASC 842, *Leases (Topic 842)*. Under this guidance, arrangements meeting the definition of a lease are classified as operating or financing leases and are recorded on the balance sheet as both a right of use asset and lease liability, calculated by discounting fixed lease payments over the lease term at the rate implicit in the lease, if available, otherwise at the Company's incremental borrowing rate. Lease liabilities are increased by interest and reduced by payments each period, and the right of use asset is amortized over the lease term. For operating leases, interest on the lease liability and the amortization of the right of use asset result in straight-line rent expense over the lease term. Variable lease expenses, if any, are recorded when incurred.

In calculating the right of use asset and lease liability, the Company elects to combine lease and non-lease components. The Company excludes short-term leases having initial terms of 12 months or less from the new guidance as an accounting policy election and recognizes rent expense on a straight-line basis over the lease term. The Company continues to account for leases in the prior period financial statements under the previous guidance in ASC 840, *Leases*.

The Company leases office space in West Chester, Pennsylvania under an agreement classified as an operating lease that expires in May 2021. The Company does not act as a lessor or have any leases classified as financing leases.

As of June 30, 2019, the Company had an operating lease liability of \$248,000 of which \$124,000 was classified as current and an operating right-of-use asset of \$245,000, which were included in the condensed balance sheet.

The components of lease expense are as follows (in thousands):

| | For the Three Months Ended June 30, 2019 | For the Six Months Ended June 30, 2019 |
|------------------------|---|--|
| Operating lease: | | |
| Operating lease costs | \$ 47 | \$ 81 |
| Short-term lease costs | 5 | 10 |
| Total rent expense | <u>\$ 52</u> | <u>\$ 91</u> |

The following summarizes additional information about the Company's operating lease (dollars in thousands):

| | For the Six Months Ended June 30, 2019 |
|--|---|
| Operating cash outflows from operating lease | \$ 68 |
| Operating lease right-of-use asset exchanged for operating lease liability | \$ 306 |
| Weighted-average remaining lease term – operating lease | 1.9 |
| Weighted-average discount rate – operating lease | 6.75% |

Maturities of the Company's operating lease, excluding short-term leases, as of June 30, 2019 are as follows (in thousands):

| | |
|---------------------------|---------------|
| Remainder of 2019 | \$ 68 |
| 2020 | 139 |
| 2021 | 58 |
| Total lease payments | <u>265</u> |
| Less imputed interest | <u>(17)</u> |
| Operating lease liability | <u>\$ 248</u> |

The following table presents the Company's operating lease commitments as of December 31, 2018 under ASC 840 (in thousands):

| | |
|-------|---------------|
| 2019 | \$ 136 |
| 2020 | 139 |
| 2021 | 58 |
| Total | <u>\$ 333</u> |

Note 9—Subsequent Event

On July 1, 2019, the Company entered into a lease for 5,829 square feet of office space located in West Chester, Pennsylvania that is expected to serve as the Company's new headquarters beginning in mid-2020. The initial term of the lease is seven years with one five-year renewal option and an ongoing right of first offer to lease up to approximately 5,000 square feet of additional space on the same floor of the building. Base rent over the initial lease term is \$1.3 million, and the Company is also responsible for its share of the landlord's operating expenses.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with (i) our unaudited interim condensed financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and (ii) our audited condensed financial statements and notes thereto and management’s discussion and analysis of financial condition and results of operations for the years ended December 31, 2017 and 2018 included in our Annual Report on Form 10-K for the year ended December 31, 2018, filed with the Securities and Exchange Commission (the “SEC”) on March 7, 2019. Our financial statements have been prepared in accordance with U.S. GAAP.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the “Exchange Act”), including, without limitation, statements regarding our expectations, beliefs, intentions or future strategies that are signified by the words “expect,” “anticipate,” “intend,” “believe,” “may,” “plan,” “seek” or similar language. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our business and financial performance are subject to substantial risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements. In evaluating our business, you should carefully consider the information set forth in this Quarterly Report under Part II - Item 1A “Risk Factors,” and in our other filings with the SEC.

Overview

We are a medical dermatology company committed to the development and commercialization of novel treatments that provide meaningful benefit for people living with skin diseases. Our lead product candidate, VP-102, is a proprietary drug-device combination of our novel topical solution of cantharidin, a widely recognized, naturally sourced agent to treat topical dermatological conditions, administered through our single-use precision applicator. We are initially developing VP-102 for the treatment of molluscum contagiosum, or molluscum, a highly contagious and primarily pediatric viral skin disease, and common warts. There are currently no products approved by the U.S. Food and Drug Administration, or FDA, nor is there an established standard of care for either of these diseases, resulting in significant undertreated populations in two of the largest unmet needs in dermatology. In addition to patent protection we are seeking, VP-102 has the potential to be the first FDA-approved product for molluscum and for its active pharmaceutical ingredient, or API, to be characterized as a new chemical entity, or NCE, with the five years of non-patent regulatory exclusivity associated with that designation. We also believe VP-102 has the potential to qualify for pediatric exclusivity, which would provide for an additional six months of non-patent exclusivity.

In January 2019, we reported positive top-line results from our Phase 3 CAMP-1 and CAMP-2 pivotal trials with VP-102 for the treatment of molluscum. Both clinical trials evaluated the safety and efficacy of VP-102 compared to placebo. In each trial, we observed that a clinically and statistically significant proportion of subjects treated with VP-102 achieved complete clearance of all treatable molluscum lesions compared to subjects treated with placebo. VP-102 was well-tolerated in both trials, with no serious adverse events reported in VP-102 treated subjects. We plan to submit a new drug application, or NDA, to the FDA for VP-102 for the treatment of molluscum in the second half of 2019. CAMP-1 was conducted under a special protocol assessment, or SPA, agreement with the FDA.

In June 2019, we reported positive topline results from our Phase 2 COVE-1 open label clinical trial of VP-102 in patients with common warts. COVE-1 included two cohorts that evaluated the safety and efficacy of VP-102 in subjects with up to six warts. In both cohorts, VP-102 achieved positive results on both the primary endpoint of complete clearance of all treatable warts at Day 84 and the secondary endpoint of the percentage reduction of warts. VP-102 was well-tolerated with no serious adverse events reported. We intend to request an End of Phase 2 meeting with the FDA for VP-102 for the treatment of common warts. We also initiated a Phase 2 clinical trial evaluating the optimal dose regimen, efficacy, safety and tolerability of VP-102 in patients with external genital warts in June 2019. We expect to report topline results from this trial in the second half of 2020. In addition, we also expect to submit an investigational new drug application, or IND, for VP-103 in plantar warts in the second half of 2019. We retain exclusive, royalty-free rights to our product candidates across all indications.

Our strategy is to advance VP-102 through regulatory approval and self-commercialize in the United States for the treatment of several skin diseases. We intend to build a specialized sales organization in the United States focused on pediatric dermatologists, dermatologists and select pediatricians. In the future, we also intend to develop VP-102 for commercialization in additional geographic regions, either alone or together with a strategic partner.

We have a limited operating history. Since our inception in 2013, our operations have focused on developing VP-102, organizing and staffing our company, business planning, raising capital, establishing our intellectual property portfolio and conducting clinical trials. We do not have any product candidates approved for sale and have not generated any revenue from product sales. We have funded our operations primarily through the sale of equity and equity-linked securities. On June 19, 2018, we completed an IPO of common stock, which resulted in the issuance and sale of 5,750,000 shares of common stock at a public offering price of \$15.00 per share, generating net proceeds of \$78.4 million after deducting underwriting discounts and other offering costs. We believe that our existing cash, cash equivalents and marketable securities will enable us to fund our operations in the normal course of business at least through the end of 2020.

Since inception, we have incurred significant operating losses. For the six months ended June 30, 2019 and 2018, our net loss was \$14.5 million and \$7.2 million, respectively. As of June 30, 2019, we had an accumulated deficit of \$47.5 million. We expect to continue to incur significant expenses and operating losses for the foreseeable future. We anticipate that our expenses will increase significantly in connection with our ongoing activities, as we:

- continue our ongoing clinical programs evaluating VP-102 for the treatment of molluscum, common warts and external genital warts as well as initiate and complete additional clinical trials, as needed;
- pursue an IND and initiate clinical trials evaluating VP-103 for the treatment of plantar warts;
- pursue regulatory approvals for VP-102 for the treatment of molluscum, and eventually for the treatment of common warts, external genital warts or any other indications we may pursue for VP-102, as well as for VP-103;
- seek to discover and develop additional product candidates;
- ultimately establish a commercialization infrastructure and scale up external manufacturing and distribution capabilities to commercialize any product candidates for which we may obtain regulatory approval, including VP-102 and VP-103;
- seek to in-license or acquire additional product candidates for other dermatological conditions;
- adapt our regulatory compliance efforts to incorporate requirements applicable to marketed products;
- maintain, expand and protect our intellectual property portfolio;
- hire additional clinical, manufacturing and scientific personnel;
- add operational, financial and management information systems and personnel, including personnel to support our product development and planned future commercialization efforts; and
- incur additional costs associated with operating as a public company.

Services Agreement with PBM Capital Group, LLC

In December 2015, we entered into a services agreement, or SA, with PBM Capital Group, LLC, or PBM, an affiliate of PBM Capital Investments, LLC, to engage PBM for certain business development, operations, technical, contract, accounting and back office support services. Paul B. Manning, who is the Chairman and Chief Executive Officer of PBM and the current chairman of our Board of Directors, and certain entities affiliated with Mr. Manning, continue to be our largest stockholder on a collective basis. We agreed to pay a fee of \$2,500 per month for these services. The SA had an initial term of 12 months and automatically renewed monthly thereafter.

In March 2018, we entered into an amendment to the SA with PBM effective as of April 1, 2018, which extended the term of the SA until March 31, 2019 (and the SA is automatically renewable for successive monthly periods) and increased the management fee we are obligated to pay to PBM to \$50,000 per month. On January 1, 2019, the SA was amended to reduce the monthly management fee to \$26,333 as a result of a reduction in services provided by PBM. The SA, as amended, provides for termination by us with 30 days advance notice or a mutually agreed upon effective date for transition as individual services are cancelled with a corresponding reduction in the monthly management fee.

Critical Accounting Policies and Significant Judgments and Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of expenses during the reporting periods. In accordance with GAAP, we evaluate our estimates and judgments on an ongoing basis.

There have been no material changes in our significant accounting policies to those previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 other than the adoption of the FASB Accounting Standard Update (“ASU”) 2016-02, *Leases (Topic 842)*, and ASU 2018-07, *Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. See Note 2 to our condensed financial statements for a description of recent accounting pronouncements applicable to our condensed financial statements.

Components of Results of Operations

Revenue

We have not generated any revenue since inception and do not expect to generate any revenue from the sale of products in the near future.

Operating Expenses

Research and Development Expenses

Research and development expenses consist of expenses incurred in connection with the discovery and development of our product candidates. We expense research and development costs as incurred. These expenses include:

- expenses incurred under agreements with contract research organizations, or CROs, as well as investigative sites and consultants that conduct our clinical trials and preclinical studies;
- manufacturing and supply scale-up expenses and the cost of acquiring and manufacturing preclinical and clinical trial supply and commercial supply, including manufacturing validation batches;
- outsourced professional scientific development services;
- employee-related expenses, which include salaries, benefits and stock-based compensation;
- expenses relating to regulatory activities; and
- materials and supplies used to support our research and development activities.

Research and development activities are central to our business model. Product candidates in later stages of clinical development generally have higher development costs than those in earlier stages of clinical development, primarily due to the increased size and duration of later-stage clinical trials. We expect our research and development expenses to increase over the next several years as we increase personnel costs, including stock-based compensation, pursue regulatory approval for VP-102 for the treatment of molluscum, conduct our ongoing clinical development of VP-102 in patients with common warts and external genital warts, submit an IND for VP-103 in plantar warts and conduct other clinical trials and prepare regulatory filings for our product candidates.

The successful development of our product candidates is highly uncertain. At this time, we cannot reasonably estimate or know the nature, timing and costs of the efforts that will be necessary to complete the remainder of the development of, or when, if ever, material net cash inflows may commence from our product candidates. This uncertainty is due to the numerous risks and uncertainties associated with the duration and cost of clinical trials, which vary significantly over the life of a project as a result of many factors, including:

- the number of clinical sites included in the trials;
- the length of time required to enroll suitable patients;
- the number of patients that ultimately participate in the trials;
- the number of doses patients receive;
- the duration of patient follow-up; and
- the results of our clinical trials.

Our expenditures are subject to additional uncertainties, including the manufacturing process for our product candidates, the terms and timing of regulatory approvals, and the expense of filing, prosecuting, defending and enforcing any patent claims or other intellectual property rights. We may never succeed in achieving regulatory approval for our product candidates. We may obtain unexpected results from our clinical trials. We may elect to discontinue, delay or modify clinical trials of our product candidates. A change in the outcome of any of these variables with respect to the development of a product candidate could mean a significant change in the costs and timing associated with the development of that product candidate. For example, if the FDA or other regulatory authorities were to require us to conduct clinical trials beyond those that we currently anticipate, or if we experience significant delays in enrollment in any of our clinical trials, we could be required to expend significant additional financial resources and time on the completion of clinical development. Product commercialization will take several years and millions of dollars in development costs.

General and Administrative Expenses

General and administrative expenses consist principally of salaries and related costs for personnel in executive and administrative functions, including stock-based compensation, travel expenses and recruiting expenses. Other general and administrative expenses include market research costs, insurance costs, and professional fees for audit, tax and legal services.

We anticipate that our general and administrative expenses, including payroll and related expenses, will increase in the future as we continue to increase our headcount to support the expected growth in our business, expand our operations and organizational capabilities, and prepare for potential commercialization of VP-102 for the treatment of molluscum, if successfully developed and approved. We also anticipate increased expenses associated with general operations, including costs related to audit, tax and legal services, director and officer insurance premiums, and investor relations costs.

Results of Operations for the three months ended June 30, 2019 and 2018

The following table summarizes our results of operations for the three months ended June 30, 2019 and 2018 (in thousands):

| | <u>For the Three Months Ended June 30,</u> | | <u>Change</u> |
|--------------------------------|--|-------------------|-------------------|
| | <u>2019</u> | <u>2018</u> | |
| Operating expenses: | | | |
| Research and development | \$ 3,928 | \$ 3,515 | \$ 413 |
| General and administrative | 3,593 | 1,955 | 1,638 |
| Total operating expenses | 7,521 | 5,470 | 2,051 |
| Loss from operations | (7,521) | (5,470) | (2,051) |
| Other income (expense): | | | |
| Interest income | 523 | 153 | 370 |
| Other expense | (3) | — | (3) |
| Total other income (expense) | 520 | 153 | 367 |
| Net loss | \$ (7,001) | \$ (5,317) | \$ (1,684) |

Research and Development Expenses

Research and development expenses were \$3.9 million for the three months ended June 30, 2019, compared to \$3.5 million for the three months ended June 30, 2018. The increase of \$0.4 million was primarily attributable to costs associated with manufacturing scale-up activities and consulting fees associated with the preparation of the NDA for VP-102 for the treatment of molluscum, partially offset by a decrease in costs associated with the clinical development of VP-102 for the treatment of molluscum and a charge recorded during the three months ended June 30, 2018 related to a consulting agreement with our former Chief Scientific Officer.

General and Administrative Expenses

General and administrative expenses were \$3.6 million for the three months ended June 30, 2019, compared to \$2.0 million for the three months ended June 30, 2018. The increase of \$1.6 million was primarily a result of increased headcount and associated salary, bonus and stock-based compensation expenses, increased insurance, professional fees and other operating costs as a result of operating as a public company and an increase in market research expenses related to pre-commercial activities for VP-102.

Other Income (Expense)

Other income (expense) for the periods presented consisted primarily of interest earned on our cash, cash equivalents and marketable securities.

Results of Operations for the six months ended June 30, 2019 and 2018

The following table summarizes our results of operations for the six months ended June 30, 2019 and 2018 (in thousands):

| | For the Six Months Ended June 30, | | Change |
|--------------------------------|-----------------------------------|-------------------|-------------------|
| | 2019 | 2018 | |
| Operating expenses: | | | |
| Research and development | \$ 8,415 | \$ 4,442 | \$ 3,973 |
| General and administrative | 7,132 | 2,916 | 4,216 |
| Total operating expenses | 15,547 | 7,358 | 8,189 |
| Loss from operations | (15,547) | (7,358) | (8,189) |
| Other income (expense): | | | |
| Interest income | 1,070 | 194 | 876 |
| Other expense | (3) | — | (3) |
| Total other income (expense) | 1,067 | 194 | 873 |
| Net loss | \$ (14,480) | \$ (7,164) | \$ (7,316) |

Research and Development Expenses

Research and development expenses were \$8.4 million for the six months ended June 30, 2019, compared to \$4.4 million for the six months ended June 30, 2018. The increase of \$4.0 million was primarily attributable to costs associated with manufacturing scale-up activities, an increase in costs associated with increased headcount and associated salary, bonus and stock-based compensation expense, and consulting fees associated with the preparation of the NDA for VP-102 for the treatment of molluscum, partially offset by a charge recorded during the six months ended June 30, 2018 related to a consulting agreement with our former Chief Scientific Officer.

General and Administrative Expenses

General and administrative expenses were \$7.1 million for the six months ended June 30, 2019, compared to \$2.9 million for the six months ended June 30, 2018. The increase of \$4.2 million was primarily a result of increased headcount and associated salary, bonus and stock-based compensation expenses, increased insurance, professional fees and other operating costs as a result of operating as a public company and an increase in market research expenses related to pre-commercial activities for VP-102.

Other Income (Expense)

Other income (expense) for the periods presented consisted primarily of interest earned on our cash, cash equivalents and marketable securities.

Liquidity and Capital Resources

Since our inception, we have not generated any revenue and have incurred net losses and negative cash flows from our operations. We have financed our operations since inception through sales of our convertible preferred stock and the sale of our common stock in our IPO, receiving aggregate gross proceeds of \$123.2 million and net proceeds of \$114.9 million.

As of June 30, 2019, we had cash, cash equivalents and marketable securities of \$78.8 million. Cash in excess of immediate requirements is invested in accordance with our investment policy, primarily with a view to liquidity and capital preservation. We expect our existing cash, cash equivalents and marketable securities, will enable us to fund our operating expenses and capital expenditure requirements at least through the end of 2020.

We currently have no ongoing material financing commitments, such as lines of credit or guarantees, that are expected to affect our liquidity over the next five years.

Cash Flows

The following table summarizes our cash flows for the six months ended June 30, 2019 and 2018 (in thousands):

| | For the Six Months Ended June 30, | |
|---|--|------------------|
| | 2019 | 2018 |
| Net cash used in operating activities | \$ (11,967) | \$ (5,834) |
| Net cash provided by (used in) investing activities | 21,333 | (111) |
| Net cash provided by financing activities | 215 | 100,431 |
| Net increase in cash and cash equivalents | <u>\$ 9,581</u> | <u>\$ 94,486</u> |

Operating Activities

During the six months ended June 30, 2019, operating activities used \$12.0 million of cash, primarily resulting from a net loss of \$14.5 million partially offset by non-cash stock-based compensation of \$1.6 million, and cash provided by changes in operating assets and liabilities of \$1.4 million. Net cash provided by changes in operating assets and liabilities consisted primarily of an increase in accrued expenses of \$1.1 million and a decrease in prepaid expenses and other assets of \$0.4 million.

During the six months ended June 30, 2018, operating activities used \$5.8 million of cash, primarily resulting from a net loss of \$7.2 million, partially offset by non-cash stock-based compensation of \$0.9 million, and cash provided by changes in operating assets and liabilities of \$0.4 million. Net cash provided by changes in operating assets and liabilities consisted primarily of increases in accounts payable and accrued expenses of \$1.4 million, partially offset by an increase in prepaid expenses and other assets of \$1.0 million.

Investing Activities

During the six months ended June 30, 2019, net cash provided by investing activities of \$21.3 million was due to sales and maturities of marketable securities of \$70.6 million partially offset by purchases of marketable securities of \$49.2 million. During the six months ended June 30, 2018, net cash of \$111,000 used in investing activities was primarily related to the purchase of computer hardware.

Financing Activities

During the six months ended June 30, 2019, net cash provided by financing activities of \$215,000 was the result of proceeds from exercises of common stock options.

During the six months ended June 30, 2018, net cash provided by financing activities was \$100.4 million consisting of the net proceeds from the issuance of common stock in connection with the IPO and from the issuance of shares of Series C preferred stock in February and March 2018.

Funding Requirements

We expect our expenses to increase in connection with our ongoing activities, particularly as we continue the research and development of, continue or initiate clinical trials of, and seek marketing approval for, our product candidates. In addition, if we obtain marketing approval for any of our product candidates, we expect to incur significant commercialization expenses related to sales, marketing, manufacturing and distribution. Accordingly, we may need to obtain additional funding in connection with our continuing operations. If we are unable to raise capital when needed or on attractive terms, we would be forced to delay, reduce or eliminate our research and development programs or future commercialization efforts.

We expect our existing cash, cash equivalents and marketable securities will enable us to fund our operating expenses and capital expenditure requirements at least through the end of 2020. Our future capital requirements will depend on many factors, including:

- the scope, progress, results and costs of our clinical trials;
- the scope, prioritization and number of our research and development programs;
- the costs, timing and outcome of regulatory review of our product candidates;
- the costs of preparing, filing and prosecuting patent applications, maintaining and enforcing our intellectual property rights and defending intellectual property-related claims;
- the extent to which we acquire or in-license other product candidates and technologies;
- the costs to scale up and secure manufacturing arrangements for commercial production; and
- the costs of establishing or contracting for sales and marketing capabilities if we obtain regulatory approvals to market our product candidates.

Identifying potential product candidates and conducting preclinical studies and clinical trials is a time-consuming, expensive and uncertain process that takes many years to complete, and we may never generate the necessary data or results required to obtain marketing approval and achieve product sales. In addition, our product candidates, if approved, may not achieve commercial success. Our commercial revenues, if any, will be derived from sales of a product candidate that we do not expect to be commercially available in the near term, if at all. We may not achieve significant revenue from product sales prior to the use of the net proceeds from our IPO. Accordingly, we may need to continue to rely on additional financing to achieve our business objectives. Adequate additional financing may not be available to us on acceptable terms, or at all.

Until such time, if ever, as we can generate substantial product revenues, we expect to finance our cash needs through a combination of equity offerings, debt financings, collaborations, strategic alliances and licensing arrangements. To the extent that we raise additional capital through the sale of equity or convertible debt securities, ownership interests of existing stockholders may be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect our existing stockholders' rights. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends.

If we raise funds through additional collaborations, strategic alliances or licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies, future revenue streams, research programs or product candidates or to grant licenses on terms that may not be favorable to us. If we are unable to raise additional funds through equity or debt financings when needed, we may be required to delay, limit, reduce or terminate our product development or future commercialization efforts or grant rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves.

Off-Balance Sheet Arrangements

We are not party to any off-balance sheet transactions. We have no guarantees or obligations other than those which arise out of normal business operations.

Contractual Obligations and Commitments

As of June 30, 2019, there have been no material changes to our contractual obligations and commitments as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

On July 1, 2019, we entered into a lease for 5,829 square feet of office space located West Chester, Pennsylvania that is expected to serve as our new headquarters beginning in mid-2020. The initial term of the lease is seven years with one five-year renewal option and an ongoing right of first offer to lease up to approximately 5,000 square feet of additional space on the same floor of the building. Base rent over the initial lease term is \$1.3 million, and we are also responsible for our share of the landlord's operating expenses.

JOBS Act Transition Period

In April 2012, the Jumpstart Our Business Startups Act of 2012, or the JOBS Act, was enacted. Section 107 of the JOBS Act provides that an "emerging growth company" can take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. Thus, an emerging growth company can delay the

adoption of certain accounting standards until those standards would otherwise apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, as a result, we will adopt new or revised accounting standards on the relevant dates on which adoption of such standards is required for other public companies.

We are in the process of evaluating the benefits of relying on other exemptions and reduced reporting requirements under the JOBS Act. Subject to certain conditions, as an emerging growth company, we may rely on certain of these exemptions, including without limitation, (i) providing an auditor's attestation report on our system of internal controls over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act and (ii) complying with any requirement that may be adopted by the Public Company Accounting Oversight Board regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements, known as the auditor discussion and analysis. We will remain an emerging growth company until the earlier to occur of (1) the last day of the fiscal year (a) December 31, 2023, which is the end of the fiscal year following the fifth anniversary of the completion of our IPO, (b) in which we have total annual gross revenues of at least \$1.07 billion or (c) in which we are deemed to be a "large accelerated filer" under the rules of the U.S. Securities and Exchange Commission, which means the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the prior June 30th, and (2) the date on which we have issued more than \$1.0 billion in non-convertible debt during the prior three-year period.

Item 3. Quantitative and Qualitative Disclosures About Market Risks

There have been no material changes to our quantitative and qualitative disclosures about market risk as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

In designing and evaluating our disclosure controls and procedures, management recognizes that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and not be detected.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2019, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended June 30, 2019 which have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

Our business is subject to risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our securities. In addition to the other information set forth in this quarterly report on Form 10-Q, you should carefully consider the factors described in Part I, Item 1A. "Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, filed with the Securities and Exchange Commission on March 7, 2019. There have been no material changes to the risk factors described in that report.

Item 2. Recent Sales of Unregistered Securities and Use of Proceeds

(a) Recent Sales of Unregistered Equity Securities

None.

(b) Use of Proceeds from Initial Public Offering of Common Stock

On June 14, 2018, our Registration Statement on Form S-1, as amended (File No. 333-225104) was declared effective in connection with our IPO, pursuant to which we sold 5,750,000 shares of our common stock, including the full exercise of the underwriters' option to purchase additional shares, at a price to the public of \$15.00 per share. The IPO closed on June 19, 2018. We received net proceeds from the IPO of \$78.4 million (after deducting underwriters' discounts and commissions and additional offering related costs of \$7.9 million). The joint book-running underwriters of the offering were Merrill Lynch, Pierce, Fenner & Smith Incorporated, Jefferies LLC and Cowen and Company, LLC.

No expenses incurred by us in connection with our IPO were paid directly or indirectly to (i) any of our officers or directors or their associates, (ii) any persons owning 10% or more of any class of our equity securities, or (iii) any of our affiliates, other than payments in the ordinary course of business to officers for salaries and to non-employee directors as compensation for board or board committee service.

There has been no material change in the planned use of proceeds from our IPO from those disclosed in the final prospectus for our IPO dated as of June 14, 2018 and filed with the SEC on June 15, 2018 pursuant to Rule 424(b)(4).

(c) Issuer Purchases of Equity Securities

None.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

EXHIBIT INDEX

| <u>Exhibit No.</u> | <u>Description</u> |
|--------------------|---|
| 3.1 (1) | Amended and Restated Certificate of Incorporation |
| 3.2 (2) | Amended and Restated Bylaws |
| 31.1 | Certification of Chief Executive Officer and President (Principal Executive Officer), pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 31.2 | Certification of Chief Financial Officer (Principal Financial Officer), pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith). |
| 32.1* | Certifications of Chief Executive Officer and President (Principal Executive Officer) and Chief Financial Officer (Principal Financial Officer), pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith). |
| 101 | The following financial information from the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2019, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Balance Sheets, (ii) the Condensed Statements of Operations, (iii) the Condensed Statement of Stockholders' Equity, (iv) the Condensed Statements of Cash Flows, and (v) Notes to the Condensed Financial Statements (filed herewith). |
| (1) | Previously filed as Exhibit 3.3 to the Company's Registration Statement on Form S-1 (File No. 333-225104), filed with the Securities and Exchange Commission on May 22, 2018, and incorporated herein by reference. |
| (2) | Previously filed as Exhibit 3.4 to the Company's Registration Statement on Form S-1 (File No. 333-225104), filed with the Securities and Exchange Commission on May 22, 2018, and incorporated herein by reference. |
| * | These certifications are being furnished solely to accompany this quarterly report pursuant to 18 U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and are not to be incorporated by reference into any filing of the registrant, whether made before or after the date hereof, regardless of any general incorporation language in such filing. |

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.

August 7, 2019

VERRICA PHARMACEUTICALS INC.

By: /s/ Ted White
Ted White
Chief Executive Officer and President
(Principal Executive Officer)

By: /s/ Chris Degnan
Chris Degnan
Chief Financial Officer
(Principal Financial Officer)

VERRICA PHARMACEUTICALS INC.
CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Ted White, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended June 30, 2019 of Verrica Pharmaceuticals Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 7, 2019

/s/ Ted White

Ted White

President and Chief Executive Officer
(principal executive officer)

VERRICA PHARMACEUTICALS INC.
CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Chris Degnan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the period ended June 30, 2019 of Verrica Pharmaceuticals Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (c) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 7, 2019

/s/ Chris Degnan

Chris Degnan
Chief Financial Officer
(principal financial officer)

**VERRICA PHARMACEUTICALS INC.
 PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
 PURSUANT TO 18 U.S.C. SECTION 1350,
 AS ADOPTED PURSUANT TO
 SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Ted White, President and Chief Executive Officer of Verrica Pharmaceuticals Inc. (the "Company"), and Chris Degnan, Chief Financial Officer of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended June 30, 2019, to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act; and
2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 7th day of August, 2019.

/s/ Ted White

 Ted White
 President and Chief Executive Officer
 (principal executive officer)

/s/ Chris Degnan

 Chris Degnan
 Chief Financial Officer
 (principal financial officer)

- * This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Exchange Act (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.