AEOLUS PHARMACEUTICALS, INC.
Form 10-Q
August 14, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013.

¨ 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

0-50481

AEOLUS PHARMACEUTICALS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	56-1953785
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
26361 Crown Valley Parkway, Suite 150 Mission Viejo, California (Address of Principal Executive Offices)	92691 (Zip Code)

949-481-9825
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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

Large accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)
Accelerated filer ¨	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of August 4, 2013
Common Stock, par value $.01 per share	134,550,068 shares

AEOLUS PHARMACEUTICALS, INC.
FORM 10-Q
For the Quarter Ended June 30, 2013
Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AEOLUS PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except share and per share data)

	June 30, 2013	September 30, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$2,732	$281
Accounts receivable	343	882
Deferred subcontractor cost	935	—
Prepaid and other current assets	51	61
Total current assets	4,061	1,224
Investment in CPEC LLC	32	32
Total assets	$4,093	$1,256
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable and accrued expenses	$2,026	$2,272
Deferred revenue	972	—
Total current liabilities	2,998	2,272
Warrant liability	—	19,319
Total liabilities	2,998	21,591
Commitments and Contingencies (Note H)		
Stockholders' equity (deficit):		
Preferred stock, $.01 par value per share, 10,000,000 shares authorized:		
Series B nonredeemable convertible preferred stock, 1,600,000 and 1,600,000 shares authorized as of June 30, 2013 and September 30, 2012, respectively; 526,080 and 526,080 shares issued and outstanding as of June 30, 2013 and September 30, 2012, respectively	5	5
Common stock, $.01 par value per share, 200,000,000 shares authorized; 134,550,068 and 62,731,963 shares issued and outstanding as of June 30, 2013 and September 30, 2012, respectively	1,346	627
Additional paid-in capital	182,999	159,747
Accumulated deficit	(183,255)	(180,714)

Total stockholders' equity (deficit)	1,095	(20,335)
Total liabilities and stockholders' equity (deficit)	$4,093	$1,256

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

AEOLUS PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2013	2012	2013	2012
Revenue:				
Contract revenue	$844	$1,448	$3,045	$5,894
Costs and expenses:				
Research and development	727	1,226	2,514	5,223
General and administrative	903	824	2,562	2,545
Total costs and expenses	1,630	2,050	5,076	7,768
Loss from operations	(786)	(602)	(2,031)	(1,874)
Non-cash financing charges and change in fair value of warrants (Notes D, E and F)	—	3,666	(510)	10,678
Net income (loss)	$(786)	$3,064	$(2,541)	$8,804
Net income (loss) per weighted share attributable to common stockholders:				
Basic (Note G)	$(0.01)	$0.02	$(0.03)	$0.07
Diluted (Note G)	$(0.01)	$—	$(0.03)	$(0.02)
Weighted average common shares outstanding:				
Basic	134,550	62,678	97,120	61,210
Diluted	134,550	63,500	97,120	71,423

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

AEOLUS PHARMACEUTICALS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Nine Months Ended June 30,	
	2013	2012
Cash flows used in operating activities:		
Net income (loss)	$(2,541)	$8,804
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Stock-based compensation	584	505
Change in fair value of warrants	510	(10,695)
Noncash interest and warrant costs	—	17
Change in assets and liabilities:		
Accounts receivable	539	(688)
Deferred subcontractor cost	(935)	—
Prepaid and other assets	10	8
Accounts payable and accrued expenses	(246)	1,096
Deferred revenue	972	—
Net cash used in operating activities	(1,107)	(953)
Cash flows provided by financing activities:		
Proceeds from issuance of common stock and warrants	3,616	660
Costs related to the issuance of common stock and warrants	(58)	(18)
Net cash provided by financing activities	3,558	642
Net increase (decrease) in cash and cash equivalents	2,451	(311)
Cash and cash equivalents at beginning of period	281	518
Cash and cash equivalents at end of period	$2,732	$207

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

AEOLUS PHARMACEUTICALS, INC.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

A. Organization, Business and Summary of Significant Accounting Policies

Organization

The accompanying unaudited condensed consolidated financial statements include the accounts of Aeolus Pharmaceuticals, Inc. and its wholly-owned subsidiary, Aeolus Sciences, Inc. (collectively, "we," "us," "Company" or "Aeolus"). All significant intercompany accounts and transactions have been eliminated in consolidation. Aeolus is a Delaware corporation. The Company's primary operations are located in Mission Viejo, California.

Business

Aeolus is a biopharmaceutical company developing a platform of a new class of broad-spectrum, catalytic antioxidant compounds that protect healthy tissue from the damaging effects of radiation. Its first compound, AEOL 10150, is being developed for oncology indications, where it is used in combination with radiation and chemotherapy. Aeolus is also developing AEOL 10150 as a medical countermeasure against the pulmonary effects of radiation exposure under a contract ("BARDA Contract") valued at up to $118.4 million with the Biomedical Advanced Research and Development Authority ("BARDA"), a division of the Department of Health and Human Services ("HHS"). Aeolus is in its third year under the BARDA Contract. Additionally, Aeolus receives development support from the National Institutes of Health ("NIH") for development of the compound as a medical countermeasure against radiation and chemical exposure. Aeolus' strategy is to leverage the substantial investment in toxicology, manufacturing, and preclinical and clinical studies made by U.S. government agencies in AEOL 10150, including the BARDA Contract, to efficiently develop the compound for use in oncology.

Basis of Presentation

All significant intercompany activity has been eliminated in the preparation of the unaudited condensed consolidated financial statements. The unaudited condensed consolidated financial statements have been prepared in accordance with the requirements of Form 10-Q and Rule 10-01 of Regulation S-X. Some information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the consolidated financial position, results of operations and cash flows of the Company. The condensed balance sheet at September 30, 2012 was derived from the Company's audited financial statements included in the Company's Annual Report on Form 10-K/A for the fiscal year ended September 30, 2012, filed with the Securities and Exchange Commission (the "SEC") on May 14, 2013. As disclosed in the Company's Current Report on Form 8-K filed with the SEC on February 19, 2013, in connection with the preparation of the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2012, the Company determined that its basic and diluted net income (loss) per share calculations should have been prepared using the "two-class method." Under the two-class method, securities that participate in dividends are considered "participating securities." The Company's preferred shares, preferred warrants and most of its common stock warrants are considered "participating securities" because they include non-forfeitable rights to dividends. Additionally, the Company determined that the diluted net income (loss) per share calculations did not include the net income effect of changes in fair value related to dilutive, liability classified warrants. On February 12, 2013, the Audit Committee of the Company's Board of

Directors concluded, based on the recommendation of management, that the consolidated statements of operations for the fiscal years ended September 30, 2012 and 2011, and the consolidated statements of operations for the quarterly periods in the years ended September 30, 2012 and 2011, should no longer be relied upon because of the incorrect calculation of earnings per share. The Company's management and the Audit Committee discussed the matters relating to the restatements with Grant Thornton LLP, the Company's independent registered public accountants. On May 14, 2013, the Company filed an amendment to its Annual Report on Form 10-K for the year ended September 30, 2012 to reflect the revisions set forth above, and also reflected these revisions in the financial statements included in the Company's Post-Effective Amendment No. 1 to Form S-1 (Registration No. 333-181409) that was filed with the SEC on February 20, 2013. The unaudited condensed consolidated financial statements included herein should therefore be read in conjunction with the audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K/A and in the Company's other SEC filings. Results for the interim period are not necessarily indicative of the results for any other period.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company invests available cash in short-term bank deposits. Cash and cash equivalents include investments with maturities of three months or less at the date of purchase. The carrying value of cash and cash equivalents approximate their fair market value at June 30, 2013 and 2012 due to their short-term nature.

Significant customer and accounts receivable

For the nine months ended June 30, 2013 and 2012, the Company's primary customer was BARDA. For the nine months ended June 30, 2013 and 2012, revenues from BARDA comprised 100% of total revenues. As of June 30, 2013 and 2012, the Company's receivable balances were comprised 100% from this customer. Unbilled accounts receivable, included in accounts receivable, totaling $196,000 and $882,000 as of June 30, 2013 and September 30, 2012, respectively, relate to work that has been performed, though invoicing has not yet occurred. All of the unbilled receivables are expected to be billed and collected within the next 12 months. Accounts receivable are stated at invoice amounts and consist primarily of amounts due from BARDA. If necessary, the Company records a provision for doubtful receivables to allow for any amounts which may be unrecoverable. This provision is based upon an analysis of the Company's prior collection experience, customer creditworthiness and current economic trends. As of June 30, 2013 and September 30, 2012, an allowance for doubtful accounts was not recorded as the collection history from the Company's customers indicated that collection was probable.

Concentrations of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with high quality financial institutions. Management believes that the financial risks associated with its cash and cash equivalents and investments are minimal. Because accounts receivable consist primarily of amounts due from the U.S. federal government agencies, management deems there to be minimal credit risk.

Revenue Recognition

Aeolus recognizes revenue in accordance with the authoritative guidance for revenue recognition. Revenue is recognized when all of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery (or passage of title) has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable, and (iv) collectability is reasonably assured.

The BARDA Contract is classified as a "cost-plus-fixed-fee" contract. Aeolus recognizes government contract revenue in accordance with the authoritative guidance for revenue recognition including the authoritative guidance specific to federal government contracts. Reimbursable costs under the BARDA Contract primarily include direct labor, subcontract costs, materials, equipment, travel, and indirect costs. In addition, we receive a fixed fee under the BARDA Contract, which is unconditionally earned as allowable costs are incurred and is not contingent on success factors. Reimbursable costs under the BARDA Contract, including the fixed fee, are recognized as revenue in the period the reimbursable costs are incurred and become billable.

Fair Value of Financial Instruments

The carrying amounts of the Company's short-term financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate their fair values due to their short maturities.

Fair Value Measurements

The Company follows Accounting Standards Codification ("ASC") Topic 820, Fair Value Measurements and Disclosures, for financial and non-financial assets and liabilities.

ASC Topic 820 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The warrant liability is measured at fair market value on a recurring basis as of June 30, 2013 and September 31, 2012 and is summarized below (in thousands):

Fair value at June 30, 2013			Fair value at September 30, 2012		
Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
$ —	$ —	$ —	$ —	$ —	$ 19,319

The following table summarizes as of June 30, 2013 the warrant activity subject to Level 3 inputs which are measured on a recurring basis:

	Fair value measurements of warrants using significant unobservable inputs (Level 3)
Balance at September 30, 2012	$ 19,319
Change in fair value of warrant liability	(1,574)
Warrant repricing modification charge	2,084
Exercised	(19,829)
Balance at June 30, 2013	$ —

Research and Development

Research and development costs are expensed in the period incurred.

Leases

The Company leases office space and office equipment under month to month operating lease agreements. For the nine months ended June 30, 2013 and 2012, total rent expense was approximately $31,000 and $26,000, respectively.

Income Taxes

The Company recognizes liabilities or assets for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. A valuation allowance is established when management determines that it is more likely than not that all or a portion of a deferred tax asset will not be realized. Management evaluates the Company's ability to realize its net deferred tax assets on a quarterly basis and valuation allowances are provided, as necessary. During this evaluation, management reviews its forecasts of income in conjunction with other positive and negative evidence

surrounding the Company's ability to realize its deferred tax assets to determine if a valuation allowance is required. Adjustments to the valuation allowance will increase or decrease the Company's income tax provision or benefit. Management also applies the relevant guidance to determine the amount of income tax expense or benefit to be allocated among continuing operations, discontinued operations, and items charged or credited directly to stockholders' equity (deficit).

A tax position must meet a minimum probability threshold before a financial statement benefit is recognized. The minimum threshold is a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation process, based on the technical merits of the position. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense.

Net Income (Loss) Per Common Share

The Company computes net income attributable to common stockholders using the two-class method required for participating securities. Under the two-class method, securities that participate in dividends, such as the Company's outstanding preferred shares, preferred warrants, and most common stock warrants, are considered "participating securities." The Company's preferred shares, preferred warrants and common stock warrants are considered "participating securities" because they include non-forfeitable rights to dividends.

In applying the two-class method, (i) basic net income (loss) per share is computed by dividing net income (less any dividends paid on participating securities) by the weighted average number of shares of common stock and participating securities outstanding for the period and (ii) diluted earnings per share may include the additional effect of other securities, if dilutive, in which case the dilutive effect of such securities is calculated using the treasury stock method. The Company may have other securities with a dilutive effect outstanding, so the Company's basic net income (loss) per share uses the two-class method and diluted net income (loss) per share uses the treasury stock method.

Accounting for Stock-Based Compensation

The Company recognizes stock based compensation expense in the statement of operations based upon the fair value of the equity award amortized over the vesting period.

Segment Reporting

The Company currently operates in one segment.

Warrant Liability

The Company had warrants with an embedded feature that met the requirements of derivative accounting per ASC Topic 815, Derivatives and Hedging. The Company recorded these warrants at their fair value in accordance with ASC Topic 820. All the warrants subject to this accounting treatment were exercised in full on February 19, 2013 in connection with the financing. See Note D below for additional information.

Increases or decreases in fair value of the warrants were included as a component of other income (expense) in the accompanying statement of operations for the respective period. As of June 30, 2013 and 2012, the liability for warrants decreased to $0 and $19,717,000 from approximately $19,319,000 and $23,405,000 as of September 30, 2012 and 2011, respectively. The warrant liability and revaluations did not have any impact on the Company's working capital, liquidity or business operations.

Deferred Subcontractor Cost and Deferred Revenue

The Company has subcontracts that require advance payment prior to commencement of work under the BARDA Contract. The Company submits these advance billings from subcontractors to BARDA upon receipt. In the event that the Company has billings to BARDA in excess of earned revenue from BARDA activity, deferred revenue and accounts receivable are recorded to reflect advance billings submitted to BARDA. At the same time, the deferred subcontractor cost asset and accounts payable are recorded to reflect the payments that are owed to the subcontractors.

B. Liquidity

The Company had cash and cash equivalents of $2,732,000 on June 30, 2013, and $281,000 on September 30, 2012. The increase in cash was primarily due to the net impact of cash used in operations and cash raised in financings in February 2013 and March 2013. The Company had accounts receivable of $343,000 on June 30, 2013,

and $882,000 on September 30, 2012, and accounts payable and accrued expenses of $2,026,000 on June 30, 2013, and $2,272,000 on September 30, 2012.

The Company has incurred significant losses since its inception. At June 30, 2013, the Company's accumulated deficit was $183,255,000. This raises substantial doubt about Aeolus' ability to continue as a going concern, which will be dependent on the Company's ability to generate sufficient cash flows to meet the Company's obligations on a timely basis, obtain additional financing and, ultimately, achieve operating profits through product sales or BARDA procurements. The Company intends to explore strategic and financial alternatives, which may include a merger or acquisition with or by another company, the sale of shares of stock and/or convertible debentures, the establishment of new collaborations for current research programs that include initial cash payments and on-going research support and the out-licensing of the Company's compounds for development by a third party. The Company believes that without additional investment capital, it will not have sufficient cash to fund its activities in the near future, and will not be able to continue operating. As such, the Company's continuation as a going concern is dependent upon its ability to raise additional financing. If the Company is unable to obtain additional financing to fund operations, it will need to eliminate some or all of its activities, merge with another company, sell some or all of its assets to another company, or cease operations entirely. There can be no assurance that the Company will be able to obtain additional financing on acceptable terms or at all, or that the Company will be able to merge with another Company or sell any or all of its assets.

In its audit opinion issued in connection with the Company's consolidated balance sheets as of September 30, 2012 and 2011 and the Company's consolidated statements of operations, stockholders' equity and cash flows for the years ended September 30, 2012 and 2011, the Company's independent registered public accounting firm expressed substantial doubt about the Company's ability to continue as a going concern given the Company's recurring net losses, negative cash flows from operations and working capital. The Company's ability to continue as a going concern will be dependent on the Company's ability to generate sufficient cash flows to meet the Company's obligations on a timely basis, obtain additional financing and, ultimately, achieve operating profits through product sales or BARDA procurements. There can be no assurance that the Company will be able to obtain additional financing on acceptable terms or at all, or that the Company will be able to achieve operating profits.

C. Warrant Liability

Increases or decreases in fair value of the warrants are included as a component of other income (expenses) in the accompanying statement of operations for the respective period. As of June 30, 2013, the aggregate liability for warrants decreased to $0, resulting in a loss to the statements of operations for the three and nine months ended June 30, 2013 of $786,000 and $2,541,000, respectively. The warrant liability and revaluations have not had any impact on the Company's working capital, liquidity or business operations due to the non-cash nature of the liability. The Company previously had warrants with an embedded feature that met the requirements of derivative accounting per ASC Topic 815, Derivatives and Hedging. The Company recorded these warrants at their fair value in accordance with ASC Topic 820 and was required to revalue its liability for these warrants on a quarterly basis. All the warrants subject to this accounting treatment were exercised in full on February 19, 2013 in connection with the financing. See Note D below for additional information.

D. Stockholders' Equity (Deficit)

Preferred Stock

The Certificate of Incorporation of Aeolus authorizes the issuance of up to 10,000,000 shares of Preferred Stock, at a par value of $.01 per share. The Board of Directors has the authority to issue Preferred Stock in one or more series, to fix the designation and number of shares of each such series, and to determine or change the designation, relative rights, preferences, and limitations of any series of Preferred Stock, without any further vote or action by the stockholders of the Company.

Of the 10,000,000 shares of total authorized shares of Preferred Stock, 1,250,000 shares are designated as Series A Convertible Preferred Stock and 1,600,000 shares are designated as Series B Stock. The Series B Stock is not entitled to vote on any matter submitted to the vote of holders of the common stock except that the Company must obtain the approval of a majority of the outstanding shares of Series B Stock to either amend the Company's Certificate of Incorporation in a manner that would adversely affect the Series B Stock (including by creating an additional class or series of stock with rights that are senior or pari passu to the Series B Stock) or change the rights of the holders of the Series B Stock in any other respect. Each share of Series B Stock is convertible at any time by the holder thereof into one share of the Company's common stock, provided that no conversion may be effected that would result in the holders of Series B Stock owning more than 9.9% of the Company's common stock on a fully converted to common stock basis. If the Company pays a cash dividend on its common stock, it must also pay the same dividend on an as converted basis on the Series B Stock. Upon a liquidation, dissolution, bankruptcy or winding up of the Company or the sale of all or substantially all of the Company's assets, the holders of Series B Stock will be entitled to receive, together with the holders of common stock, the assets of the Company in proportion to the number of shares of common stock held (assuming conversion of the Series B Stock into shares of common stock).

As of June 30, 2013 and September 30, 2012, 526,080 shares of Series B Stock were outstanding, all of which were held by affiliates of Elan Corporation, plc. Each share of Series B Stock was convertible into one share of common stock as of June 30, 2013.

There were no shares of Series A Convertible Preferred Stock issued or outstanding as of June 30, 2013.

Common Stock

February/March 2013 Financing

On February 19, 2013 and March 4, 2013, the Company entered into Securities Purchase Agreements (the "Purchase Agreements") with certain accredited investors (the "Purchasers"). Under the terms of the agreements, the Company received approximately $3,616,000 in gross proceeds in exchange for the issuance of an aggregate of 14,462,000 units (the "Units"), consisting of 14,462,000 shares of common stock and 14,462,000 warrants, at a purchase price of $0.25 per unit. Each Unit consists of (i) one share of common stock (the "Common Shares") and (ii) a five -year warrant to purchase one share of the Company's common stock (the "Warrants"). The Warrants have an initial exercise price of $0.25 per share.

On February 19, 2013, the Company received $3,225,000 in gross proceeds in exchange for the issuance of an aggregate of 12,900,000 Units, which consisted of 12,900,000 shares of common stock and 12,900,000 warrants.

On March 4, 2013, the Company received approximately $390,000 in gross proceeds in exchange for the issuance of an aggregate of 1,562,000 Units, which consisted of 1,562,000 shares of common stock and 1,562,000 warrants.

Net cash proceeds from the February/March 2013 Financing, after deducting for expenses, were approximately $3,558,000. The Company also incurred non-cash expenses in the form of 365,000 warrants issued to consultants, at similar terms as the financing Warrants, for services provided. The Company issued a total of 14,827,000 warrants in connection with the February/March 2013 Financing.

The fair value of the February/March 2013 Financing warrants was estimated to be $4,791,000 using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 154.84%, risk free interest rate of 0.87% and an expected life of five years. The proceeds from the February/March 2013 Financing were allocated based upon the relative fair values of the February/March 2013 Financing Warrants and the February/March 2013 Common Shares.

The February/March 2013 Financing contains a registration rights agreement with an arrangement for liquidated damages in the event of a failure to maintain the effectiveness with the SEC of a registration statement covering the February/March 2013 Financing Units. The Company must use its commercially reasonable to maintain the registration statement continuously effective until the earlier to occur of (i) the date on which all securities covered by such registration statement have been sold, and (ii) the date on which all securities covered by such registration statement may be sold without volume restrictions pursuant to Rule 144 underthe Securities Act of 1933, as amended. In the event the Company fails to meet this obligation, subject to certain exceptions, the Company will be required to make a cash payment of 0.5% of the aggregate amount invested to the Purchasers of the February/March 2013 Financing Units. The 0.5% payment equaling $18,000 would be due for every 30-day period in which the registration statement is not continuously effective. The maximum liability would be $108,000 and no damages would accrue after August 19, 2013, the date that is six months from the closing of the February/March 2013 Financing. The registration statement was declared effective by the SEC as of June 13, 2013. As of June 30, 2013, no liability was recorded as the Company expects that the registration statement will remain continuously effective through August 19, 2013.

Modification to rights of Security Holders

Effective February 19, 2013, the Company and each of Xmark JV Investment Partners, LLC, Xmark Opportunity Fund, Ltd. and Xmark Opportunity Fund, L.P. (collectively, the "Xmark Entities") entered into a Warrant Repricing, Exercise and Lockup Agreement (the "Xmark Warrant Agreement") pursuant to which the Company agreed to reduce the exercise price of outstanding warrants to purchase an aggregate of up to 59,149,999 shares of Common Stock held by the Xmark Entities (the "Xmark Warrants") to $0.01 per share. In consideration for the reduction of the exercise price of the Xmark Warrants, each of the Xmark Entities agreed to immediately exercise all of the Xmark Warrants by cashless exercise. The Xmark Warrant Agreement also provides that the Xmark Entities will not transfer the shares issuable upon exercise of the Xmark Warrants (the "Xmark Warrant Shares") until the Company either (i) declares a cash dividend on its common stock or otherwise makes a cash distribution or (ii) effects a Change of Control, subject in each case to the terms of the Xmark Warrant Agreement.

Modifying the exercise price of the warrants to a fixed amount of $0.01 eliminated the requirement for warrant liability accounting treatment and resulted in a charge of $2,084,000, as described under “Warrant Liability” in Note A above.

March 2012 Financing

On March 30, 2012 and April 4, 2012, the Company entered into Securities Purchase Agreements (the “Purchase Agreements”) with certain accredited investors (the “Purchasers”) and completed a financing (the “March 2012 Financing”). Under the terms of the Purchase Agreements, the Company received $660,000 in gross proceeds in exchange for the issuance of an aggregate of 2,200,166 units (the “March 2012 Units”), consisting of 2,200,166 shares of common stock and 1,650,126 warrants, at a purchase price of $0.30 per Unit. Each Unit consisted of (i) one share of common stock (the “March 2012 Common Shares”) and (ii) a five -year warrant to purchase 0.75 of a share of the Company’s common stock (the “March 2012 Warrants”). The March 2012 Warrants have an initial exercise price of $0.40 per share.

On March 30, 2012, the Company received $530,000 in gross proceeds in exchange for the issuance of an aggregate of 1,766,833 March 2012 Units, which consisted of 1,766,833 shares of common stock and 1,325,126 warrants.

On April 4, 2012, the Company received $130,000 in gross proceeds in exchange for the issuance of an aggregate of approximately 433,333 March 2012 Units, which consisted of 433,333 shares of common stock and 325,000 warrants.

Net cash proceeds from the March 2012 Financing, after deducting for expenses, were $642,000. The Company also incurred non-cash expenses in the form of 12,501 warrants issued to consultants, at similar terms as the March 2012 Warrants, for services provided. Pursuant to the warrants, the Company was obligated to issue up to a total of 1,662,627 shares of common stock as of September 30, 2012 in connection with the March 2012 Financing.

The fair value of the March 2012 Warrants issued on March 30, 2012 was estimated to be $363,000 using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 150.74%, risk free interest rate of 1.04% and an expected life of five years. The proceeds from the March 2012 Financing were allocated based upon the relative fair values of the March 2012 Warrants and the March 2012 Common Shares.

The fair value of the March 2012 Warrants issued on April 4, 2012 was estimated to be $84,000 using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 149.36%, risk free interest rate of 1.05% and an expected life of five years. The proceeds from the March 2012 Financing were allocated based upon the relative fair values of the March 2012 Warrants and the March 2012 Common Shares.

Dividends

The Company has never paid a cash dividend on its common stock and does not anticipate paying cash dividends on its common stock in the foreseeable future. If the Company pays a cash dividend on its common stock, it also must pay the same dividend on an as converted basis on its outstanding Series B Stock.

Warrants

As of June 30, 2013, warrants to purchase an aggregate of 17,879,627 shares of common stock were outstanding with a weighted average exercise price of $0.29 per share. Details of the warrants for common stock outstanding at June 30, 2013 are as follows:

Number of Shares		Exercise Price	Expiration Date
100,000	$	0.50	May 2014
100,000	$	1.00	May 2014
100,000	$	1.50	May 2014
125,000	$	0.51	June 2014
125,000	$	1.00	June 2014
20,000	$	0.39	September 2014
15,000	$	0.50	September 2014
15,000	$	0.60	September 2014
50,000	$	0.38	April 2015
50,000	$	0.50	May 2016
50,000	$	0.50	July 2016
50,000	$	1.00	July 2016
50,000	$	1.50	July 2016
50,000	$	2.00	July 2016
50,000	$	2.50	July 2016
1,337,627	$	0.40	March 2017
325,000	$	0.40	April 2017
300,000	$	0.258	June 2017
140,000	$	0.35	October 2017
13,085,000	$	0.25	February 2018
1,742,000	$	0.25	March 2018
17,879,627	$	0.29	

As of June 30, 2013, one warrant to purchase an aggregate of 896,037 shares of preferred stock was outstanding. The warrant has an exercise price of $0.01 per share and expires in February 2016.

Below is a summary of warrant activity (“common and preferred”) for the nine months ended June 30, 2013:

	Number of Shares	Weighted Average Exercise Price	Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 9/30/2012	62,993,663	$0.30	4.21	$5,344,623
Granted	14,932,000	$0.25	4.64	$1,039,373
Exercised	(59,149,999)	$0.01	3.50	$19,519,500
Expired or Canceled	-	$-	-	$-
Forfeited	-	$-	-	$-
Vested	-	$-	-	$-
Outstanding at 6/30/2013	18,775,664	$0.29	4.30	$1,334,261

Below is a summary of warrant activity (“common and preferred”) for the nine months ended June 30, 2012:

	Number of Shares	Weighted Average Exercise Price	Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 9/30/2011	61,936,036	$0.30	5.13	$8,257,575
Granted	1,962,627	$0.38	4.79	$-
Exercised	(940,000)	$0.28	-	$-
Expired or Canceled	-	$-	-	$-
Forfeited	-	$-	-	$-
Vested	-	$-	-	$-
Outstanding at 6/30/2012	62,958,663	$0.30	4.46	$215,049

E. Stock-Based Compensation

Below is a summary of stock option activity for the nine months ended June 30, 2013:

	Number of Shares	Weighted Average Exercise Price	Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 9/30/2012	9,473,661	$0.70	5.81	$153,850
Granted	3,070,000	$0.40	9.69	$900
Exercised	-	$-	-	$-
Expired or Canceled	(72,744)	$0.85	-	$-
Forfeited	-	$-	-	$-
Vested (RSAs)	-	$-	-	$-
Outstanding at 6/30/2013	12,470,917	$0.62	6.23	$44,875

For the nine months ended June 30, 2013, all stock options were granted with an exercise price at or above the fair market value of the Company's common stock on the date of grant.

Below is a summary of stock option activity for the nine months ended June 30, 2012:

	Number of Shares	Weighted Average Exercise Price	Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 9/30/2011	8,942,628	$0.82	6.48	$258,555
Granted	362,500	$0.33	9.64	$-
Exercised	-	$-	-	$-
Expired or Canceled	(85,106)	$10.79	-	$-
Forfeited	(37,500)	$0.31	-	$-
Vested (RSAs)	-	$-	-	$-
Outstanding at 6/30/2012	9,182,522	$0.71	5.93	$-

For the nine months ended June 30, 2012, all stock options were granted with an exercise price at or above the fair market value of the Company's common stock on the date of grant.

The details of stock options for the nine months ended June 30, 2013 were as follows:

	Options Outstanding			Options Exercisable		
Range of Exercise Prices	Number Outstanding at June 30, 2013	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Number Exercisable At June 30, 2013	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)
$0.23-$0.30	1,612,500	$ 0.29	6.56	1,578,545	$ 0.29	6.50
$0.31-$0.40	6,351,500	$ 0.39	8.04	4,442,753	$ 0.39	7.33
$0.41-$0.50	502,000	$ 0.45	8.50	204,083	$ 0.46	6.51
$0.51-$0.60	963,750	$ 0.59	5.89	963,750	$ 0.59	5.89
$0.61-$0.70	66,500	$ 0.68	3.13	66,500	$ 0.68	3.13

$0.71-$0.80	382,250	$	0.75	3.92	382,250	$	0.75	3.92
$0.81-$0.90	697,091	$	0.88	3.26	697,091	$	0.88	3.26
$0.91-$1.00	44,500	$	0.94	2.24	44,500	$	0.94	2.24
$1.01-$1.50	1,337,519	$	1.48	0.18	1,337,519	$	1.48	0.18
$1.51-$5.00	363,307	$	2.77	1.01	363,307	$	2.77	1.01

Stock-based compensation expense recognized in the statement of operations is as follows (in thousands):

	For the three months ended June 30,		For the nine months ended June 30,	
	2013	2012	2013	2012
Research and Development Expenses	$5	$3	$14	$10
General and Administrative Expenses	270	156	570	495
	$275	$159	$584	$505

The total unrecognized compensation expense for outstanding and unvested stock options for the nine months ended June 30, 2013 was $753,000. The weighted average remaining recognition period for the total deferred compensation expense is approximately eight months. The fair value of the options associated with the above compensation expense was determined at the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	For the three months ended June 30,		For the nine months ended June 30,	
	2013	2012	2013	2012
Dividend yield	0 %	0 %	0 %	0 %
Expected volatility	167.39 %	140.93 %	156 %	150 %
Risk-free interest rate	0.84 %	1.78 %	0.86 %	1.03 %
Expected term	5.27 years	10.00 years	5.27 years	5.07 years

F. Net Income (Loss) Per Common Share

	For the three months ended June 30,		For the nine months ended June 30,	
	2013	2012	2013	2012
	(in thousands, except per share data)			
Numerator:				
Net income (loss)	$(786)	$3,064	$(2,541)	$8,804
Less net income (loss) attributable to participating securities	-	1,506	-	(4,379)
Net income (loss) attributable to common stockholders – basic	$(786)	$1,558	$(2,541)	$4,425
Net income (loss)	$(786)	$3,064	$(2,541)	$8,804
Less gain (loss) on warrant liability for participating common warrants	-	3,371	-	10,468
Net loss attributable to common stockholders – diluted	$(786)	$(307	$(2,541)	$(1,664)
Denominator:				
	134,550	62,678	97,120	61,210

Weighted-average shares used in computing net income per share attributable to common stockholders – basic				
Effect of potentially dilutive securities:				
Common stock warrants	-	822	-	10,213
Convertible preferred warrants**	-	-	-	-
Convertible preferred stock**	-	-	-	-
Common stock options**	-	-	-	-
Non-participating common stock warrants**	-	-	-	-
Weighted-average shares used in computing net income (loss) per share attributable to common stockholders - diluted	134,550	63,500	97,120	71,423
Basic net income per common share*	$(0.01)	$0.02	$(0.03)	$0.07
Diluted net income (loss) per common share*	$(0.01)	$0.00	$(0.03)	$(0.02)

* Prior period amounts have been restated, see note G below.

** Amounts do not apply as their effect is anti-dilutive

Diluted weighted average common shares excluded incremental shares of approximately 7,400,000 and 6,105,000, respectively, for the three and nine months ended June 30, 2013, due to their anti-dilutive effect. Diluted weighted average common shares excluded incremental shares of approximately 59,750,000 and 50,563,000, respectively, for the three and nine months ended June 30, 2012, due to their anti-dilutive effect.

G. Restated Net Income (Loss) Per Common Share

As referenced in note A “Basis of Presentation”, the Company identified an error in the calculation of net income (loss) per common share since the filing of the 10-K on December 31, 2012. All references or presentations of net income (loss) per common share have been restated from the original filing of the 10-Q on August 14, 2012.

Basic net income (loss) per share

The Company computes basic net income (loss) per weighted average share attributable to common stockholders using the two-class method. Previously the Company used the weighted average number of shares of common stock outstanding during the period.

The restatement to our calculation relates to an unaccounted term in our preferred shares, preferred warrants and the majority of our common warrants (59,149,999 warrants). Each of these shares and warrants would participate in any potential common stock dividends declared by the Company. Dividend participation by these shares and warrants requires the two-class method of net income (loss) per share calculation in accordance with ASC 260-10-45-60.

Our previous basic income (loss) per share calculation was as follows (in thousands, except per share data):

	Period ended June 30, 2012	
	Three months ended	Nine months ended
Numerator:		
Net income	$ 3,064	$ 8,804
Denominator:		
Weighted-average number of shares – basic	62,678	61,210
Net income (loss) per share – basic	$ 0.05	$ 0.14

Our restated basic income (loss) per share calculation is as follows (in thousands, except per share data):

	Period ended June 30, 2012			
	Three months ended		Nine months ended	
Net income	$3,064		$8,804	
	Weighted-average		Weighted-average	
	Number of	Net	Number of	Net
Common stock and participating shares	Shares	income	Shares	Income
Common stock	62,678	$1,558	61,210	$4,425
Participating common stock warrants	59,150	$1,471	59,150	$4,276
Participating series B preferred stock	526	$13	526	$38
Participating series B preferred warrants	896	$22	896	$65
	123,250	$3,064	121,782	$8,804
Numerator:				
Weighted-average net income (loss)		$1,558		$4,425
Denominator:				
Weighted-average number of basic shares	62,678		61,210	
Basic net income (loss) per share		$0.02		$0.07

Diluted net income (loss) per share

The Company computes diluted net income (loss) per weighted average share attributable to common stockholders using the two-class method, and when appropriate, the treasury method. Previously the Company used the weighted average number of shares of common and dilutive potential common shares outstanding during the applicable period. Potential common shares outstanding consist of stock options, warrants and convertible preferred stock using the treasury stock method and are excluded if their effect is anti-dilutive.

The restatement to our calculation relates to the required removal of fair value adjustments relating to our common stock warrants subject to warrant liability accounting from our calculation of net income (loss) available to diluted shareholders. Each of these warrants would participate in any potential common stock dividends in the future. The Company did not account for the removal of any non-cash gain (loss) from the fluctuation of the warrant liability associated with the incremental warrants in our calculation of net income (loss) per common share.

Our previous diluted income (loss) per share calculation was as follows:

	Period ended June 30, 2012	
	Three months ended	Nine months ended
Numerator:		
Net income	$ 3,064	$ 8,804
Denominator:		
Weighted-average number of shares – basic	62,678	61,210
Dilutive securities – equity awards	2,241	11,887
Weighted-average number of shares – diluted	64,919	73,097
Net income (loss) per share – diluted	$ 0.05	$ 0.12

Our restated diluted income (loss) per share calculation is as follows:

	Period ended June 30, 2012					
	Three months ended			Nine months ended		
Net income (loss)	$ 3,064			$ 8,804		
Less gain (loss) on warrant liability:						
Participating common warrants	3,371			10,468		
Undistributed net income (loss)	$ (307)			$ (1,664)		
Common stock and common stock equivalents in order of dilutive effect	Outstanding	Incremental Dilutive shares *	Diluted Shares	Outstanding	Incremental Dilutive shares *	Diluted shares
Common stock	62,678		62,678	61,210		61,210
Participating common warrants	59,150	822	822	59,150	10,213	10,213
Participating preferred warrants**	896	865	-	896	869	-
Series B preferred shares**	526	526	-	526	526	-
Common stock options**	9,183	-	-	9,183	203	-

Non-participating common stock warrants**	3,794	28	-	3,794	944	-
			63,500			71,423
Numerator:						
Weighted-average net income (loss)		$ (307)			$ (1,664)	
Denominator:						
Weighted-average number of basic shares		63,500			71,423	
Diluted net income (loss) per share		$ 0.00			$ (0.02)	

* Treasury method applied

** Excluded as the effect is anti-dilutive

H. Commitments

The Company acquires assets still in development and enters into research and development arrangements with third parties that often require milestone and royalty payments to the third party contingent upon the occurrence of certain future events linked to the success of the asset in development. Milestone payments may be required, contingent upon the successful achievement of an important point in the development life-cycle of the pharmaceutical product (e.g., approval of the product for marketing by a regulatory agency). If required by the arrangement, the Company may have to make royalty payments based upon a percentage of the sales of the pharmaceutical product in the event that regulatory approval for marketing is obtained. Because of the contingent nature of these payments, they are not included in the table of contractual obligations. No milestones have been met, nor have any payments been paid, as of June 30, 2013.

The Company is also obligated to pay patent filing, prosecution, maintenance and defense costs, if any, for the intellectual property it has licensed from National Jewish Health, National Jewish Medical and Research Center, the University of Colorado and Duke University.

These arrangements may be material individually, and in the unlikely event that milestones for multiple products covered by these arrangements were reached in the same period, the aggregate charge to expense could be material to the results of operations in any one period. In addition, these arrangements often give Aeolus the discretion to unilaterally terminate development of the product, which would allow Aeolus to avoid making the contingent payments; however, Aeolus is unlikely to cease development if the compound successfully achieves clinical testing objectives.

I. Subsequent Events

The Company has evaluated subsequent events through the issuance of these unaudited condensed consolidated financial statements and determined that no material subsequent events have occurred.

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

Introduction

Unless otherwise noted, the terms "we," "our" or "us" refer collectively to Aeolus Pharmaceuticals, Inc. and our wholly owned subsidiary, Aeolus Sciences, Inc.

This report contains, in addition to historical information, statements by us with respect to expectations about our business and future results which are "forward-looking" statements under the Private Securities Litigation Reform Act of 1995. These statements and other statements made elsewhere by us or by our representatives, which are identified or qualified by words such as "likely," "will," "suggests," "expects," "might," "believe," "could," "should," "may," "estimates," "predict," "continue," "would," "anticipates," "plans," or similar expressions, are based on a number of assumptions that are subject to risks and uncertainties. Such statements include, but are not limited to, those relating to our product candidates and funding options, as well as our proprietary technologies and uncertainties and other factors that may cause our actual results to be materially different from historical results or from any results expressed or implied by such forward-looking statements. Important factors that could cause results to differ include risks associated with uncertainties of progress and timing of clinical trials, scientific testing, obtaining regulatory approval, the need to obtain (and obtaining) funding for pre-clinical and clinical trials and operations, the scope and validity of intellectual property protection for our product candidates, proprietary technologies and their uses, new accounting and Securities and Exchange Commission ("SEC") requirements and competition from other biopharmaceutical companies. Certain of these factors and others are more fully described in our filings with the SEC, including, but not limited to, our Annual Report on Form 10-K for the fiscal year ended September 30, 2012, filed with the SEC on December 31, 2012. All forward-looking statements are based on information available as of the date hereof, and we do not assume any obligation to update such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof.

Operations Summary

Business

We are a biopharmaceutical company that is developing a platform of a new class of broad-spectrum, catalytic antioxidant compounds based on technology discovered at Duke University ("Duke") and National Jewish Health ("NJH"). These compounds, known as metalloporphyrins, scavenge reactive oxygen species ("ROS") at the cellular level, mimicking the effect of the body's own natural antioxidant enzyme, superoxide dismutase ("SOD"). While the benefits of antioxidants in reducing oxidative stress are well-known, research with our compounds indicates that metalloporphyrins can be used to affect signaling via ROS at the cellular level. In addition, there is evidence that high-levels of ROS can affect gene expression and this may be modulated through the use of metalloporphyrins. We believe this could have a profound beneficial impact on people who have been exposed, or are about to be exposed, to high-doses of radiation, whether from cancer therapy or a nuclear event.

Our lead compound, AEOL 10150, is a metalloporphyrin specifically designed to neutralize reactive oxygen and nitrogen species. The neutralization of these species reduces oxidative stress, inflammation, and subsequent tissue damage-signaling cascades resulting from radiation exposure. We are developing AEOL 10150 as a medical countermeasure for high-dose radiation exposure, chemical vesicant exposure, nerve gas exposure and for use in oncology.

On February 11, 2011, we signed a contract valued at up to $118.4 million (the "BARDA Contract") with the Biomedical Advanced Research and Development Authority ("BARDA"), a division of the Department of Health and Human Services, for the advanced development of AEOL 10150 as a medical countermeasure ("MCM") against the pulmonary effects of radiation exposure ("Lung-ARS"). The BARDA Contract is a five -year, cost-plus contract

divided into a base period of performance and a series of options exercisable by BARDA over four years following the base period of performance. We received $10.4 million from BARDA during the base period of performance. On April 16, 2012, we announced that BARDA had exercised two contract options worth approximately $9.1 million. We may receive up to an additional $98.9 million in funding under the remaining options.

The goal of the BARDA Contract is to obtain U.S. Food and Drug Administration ("FDA") 's approval of AEOL-10150 as a MCM for Lung-ARS under the Animal Rule. The Animal Rule allows for approval based solely on animal studies when there is no ethical way to conduct human efficacy trials. The BARDA Contract also requires the filing of a pre-Emergency Use Authorization ("EUA") application for AEOL-10150 following completion of the necessary pre-requisites. An EUA is a determination by the FDA that an unapproved drug may be used as if approved after a declaration of emergency by the Secretary of Health and Human Services. In the past, BARDA has procured MCMs for the Strategic National Stockpile (the "Stockpile") following the submission of a complete pre-EUA application. BARDA manages the Special Reserve Fund, created by Project BioShield, for the purpose of acquiring MCMs for the Stockpile. Procurements from BARDA may result in significant revenues and profitability for Aeolus.

The NIH-National Institute for Allergy and Infectious Disease ("NIAID") Radiation/Nuclear Medical Countermeasures development program is also currently funding the development of AEOL 10150 as a MCM for the effects of gastrointestinal acute radiation syndrome ("GI-ARS"). Funding for the NIH GI-ARS program flows directly to our research partners from the NIH, and is, therefore, not reflected on the Company's income statement, cash flow statement or balance sheet.

The NIH Countermeasures Against Chemical Threats ("CounterACT") program has tested, and continues to test, AEOL 10150 as a medical countermeasure for exposure to chemical vesicants such as mustard gas and nerve agents such as sarin gas. AEOL 10150 has already demonstrated efficacy in multiple studies in mustard gas and chlorine gas and models of sarin gas exposure. We intend to meet with the Division of Pulmonary and Allergy Products of the FDA to discuss a pathway to approval under the Animal Rule and the potential filing of an Investigational New Drug ("IND") application for the treatment of exposure to chemical vesicants. Funding for the NIH chemical and nerve gas programs flows directly to our research partners from the NIH, and is, therefore, not reflected on the Company's income statement, cash flow statement or balance sheet.

We are also leveraging the significant investment made by U.S. government agencies to develop this novel compound for use in oncology indications, where it would be used in combination with radiation and chemotherapy. Data have been published showing that AEOL 10150 does not interfere with the therapeutic benefit of radiation therapy in prostate and lung cancer preclinical studies. These studies also demonstrated increased tumor control when AEOL 10150 was used in combination with radiation and chemotherapy. Oxidative stress is a more potent stabilizer of the pro-angiogenic transcription factor, HIF-1a, than hypoxia (Dewhirst et al., Cycling hypoxia and free radicals regulate angiogenesis and radiotherapy response, Nature Reviews, Volume 8, June 2008). By reducing oxidative stress, AEOL10150 suppresses HIF-1a stabilization, thereby improving tumor vascularization and tissue oxygenation. Poorly perfused/oxygenated tumor tissue is resistant to radiation as oxygen is required for radiation-induced cell kill. Thus, by improving tumor oxygenation, AEOL10150 improves impact of radiation on tumors. Radiotherapy is a key therapy in non-small cell lung cancer. It is the treatment of choice for patients with unresectable Stage I-II disease, and is recommended, in combination with chemotherapy, for patients with unresectable stage IIIB disease (Pipeline Insight: Cancer Overview – Lung, Brain, Head and Neck, Thyroid; Datamonitor 2008, 37.).

We have an active IND on file with the FDA for AEOL 10150 as a potential treatment for amyotrophic lateral sclerosis ("ALS"). At the current time, we have no plans to conduct further clinical trials in ALS. We plan to file an IND for cancer with the oncology division of the FDA, an IND with the Division of Medical Imaging Products for Lung-ARS and an IND with the Division of Pulmonary and Allergy Products for exposure to chemical vesicants. Extensive toxicology and pharmacology packages are already in place. We have already completed two Phase I safety studies in 50 humans demonstrating the drug to be safe and well tolerated. Chemistry, Manufacturing, and Controls work has been completed, and pilot lots have been prepared.

AEOL 10150 has demonstrated efficacy in validated animal models for GI-ARS, chlorine gas exposure, and sulfur mustard gas exposure. Efficacy has been demonstrated in Lung-ARS in both mouse and non-human primate studies ("NHP"), with AEOL 10150 treated groups showing significantly reduced weight loss, inflammation, oxidative stress, lung damage, and most importantly, mortality in the mouse study. Therapeutic efficacy was demonstrated when delivered after exposure to radiation (24 hours after exposure for mice in the GI-ARS study and NHPs in the Lung-ARS studies, and two hours after exposure for mice in the Lung-ARS studies). Additionally, AEOL 10150 was shown to reduce lung damage after Neupogen® treatment (current standard of care for H-ARS) following radiation exposure, and to reduce oxidative stress and nerve damage following exposure to nerve agents.

We have two programs underway for the development of our second drug candidate, AEOL 11207, for the treatment of epilepsy and Parkinson's disease. These programs are being funded, in part, by private foundations, including the Michael J. Fox Foundation and Citizens United for Research in Epilepsy ("CURE"), and government grants. In February 2011, data were published in the Journal Neurobiology of Disease from the CURE study indicating AEOL

11207 significantly reduced both the frequency and duration of spontaneous seizures in a pre-clinical epilepsy model. Additionally, the study showed an increase in average life span, protection against neuronal death and no difference in seizure severity.

We were incorporated in the State of Delaware in 1994. Our common stock trades on the OTCQB Board under the symbol “AOLS.” Our principal executive offices are located at 26361 Crown Valley Parkway, Suite 150 Mission Viejo, California 92691, and our phone number at that address is (949) 481-9825. Our website address is www.aeoluspharma.com. However, the information on, or that can be accessed through, our website is not part of this report. We also make available free of charge through our website our most recent annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

We do not generate revenue from sales, only from development contracts and grants from the U.S. government. Therefore, we must rely on public or private equity offerings, debt financings, collaboration arrangements or grants to finance our operations. Our strategy is to use non-dilutive capital wherever possible to develop our exciting platform of broad-spectrum catalytic antioxidant compounds in important unmet indications of national strategic importance. We plan to continue to leverage that capital, including the investments made by U.S. government agencies, such as the NIAID's and NIH's CounterACT program, to develop these promising compounds for use in significant unmet medical indications, like oncology.

BARDA Contract

Since February 11, 2011, we have been actively developing AEOL 10150 under the BARDA Contract. Among the key deliverables accomplished in the program, we hired the necessary personnel required under the BARDA Contract, completed the radiation dose studies in mice and NHPs, completed development of animal models and received FDA concurrence on these models, manufactured two GMP (good manufacturing practice) batches for use in human safety studies and a non-GMP batch of material for use in animal efficacy studies, developed significant improvements to the process for manufacturing compound which will reduce the cost of producing the drug , made several discoveries related to the mechanism of damage of radiation and mechanism of action of AEOL 10150, filed an orphan drug status application and met twice with the FDA to discuss our IND filing for Lung-ARS and designed and initiated quality, reporting, risk management and project management programs required under the BARDA Contract. We have also initiated a number of animal efficacy studies for which we expect to report data during the later half of 2013 and 2014.

We recognized approximately $844,000 and $3,045,000 during the three and nine months ended June 30, 2013 related to the BARDA Contract, respectively. Revenues on reimbursable contracts are recognized as costs are incurred, generally based on allowable costs incurred during the period, plus any recognizable earned fee. We consider fixed fees under cost-plus fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract.

In the event BARDA exercises additional options to provide additional funding under the BARDA Contract, activities to be conducted would include, among other things, bulk drug and final drug product manufacturing, stability studies, animal pivotal efficacy studies, human clinical safety studies and Phase I, Phase II and pre-new drug application ("NDA") meetings and applications with the FDA.

On February 14, 2012, we presented the results and deliverables that had been produced during the first twelve months under the base period of the BARDA Contract at an "In-Progress Review" meeting with BARDA, and requested the exercise of additional contract options, which contain additional key items required in the advanced development of AEOL 10150.

On February 15, 2012, we announced that we entered into a contract modification and no-cost extension with BARDA. The modification and extension allowed us to continue operating under the base period of the BARDA Contract awarded in February 2011, and restructured the timing and components of the options that could be awarded under the remaining four years of the BARDA Contract. The changes did not impact the total potential value of the BARDA Contract, which remains at approximately $118.4 million. The contract restructure was driven by our ability to generate cost savings in the base year contract and to allow BARDA to better manage contract options to expedite the development program.

On April 16, 2012, we announced that BARDA had exercised two contract options worth approximately $9.1 million. BARDA's exercise of the options was in response to the presentation of the deliverables and progress made under the BARDA Contract at the meeting on February 14, 2012. Among the key items in the options BARDA exercised are animal efficacy studies, mechanism of action research and manufacturing and process validation work.

All of these items are based on work successfully completed during the contract base period. The BARDA Contract is designed to produce the data necessary for an approval under the FDA "Animal Rule" and for a potential EUA. An approval or EUA would allow the federal government to buy AEOL 10150 for the Stockpile under Project Bioshield. Project Bioshield is designed to accelerate the research, development, purchase and availability of effective medical countermeasures for the Stockpile.

On July 29, 2013, we presented the results and deliverables that had been produced since the last presentation on February 14, 2012 at an "In-Progress Review" meeting with BARDA, and requested the exercise of additional contract options, which contain additional key items required in the advanced development of AEOL 10150.

Following the commencement of the BARDA Contract, we entered into a series of agreements with various parties in furtherance of our efforts under the BARDA Contract, which are described below.

On February 18, 2011, we entered into a Research and Manufacturing Agreement with Johnson Matthey Pharmaceutical Materials, Inc. (d/b/a Johnson Matthey Pharma Services) ("JMPS"), pursuant to which we engaged JMPS to, among other things, assess and develop a reliable separations or manufacturing process for certain chemical compounds as required by us and to perform such additional work as may be required or agreed upon by the parties and to manufacture compounds for us. Each project performed by JMPS under the agreement will have a detailed project description and separate fee agreement based on the nature and duration of the project and the specific services to be performed by JMPS. The term of the agreement with JMPS will continue until February 16, 2016 or the date on which all projects under the agreement have been completed or terminated.

On March 16, 2011, we and the Office of Research and Development of the University of Maryland, Baltimore ("UMB") entered into a Sub-award Agreement, pursuant to which we engaged UMB to, among other things, develop a whole thorax lung irradiation model for use in studies supporting the licensure of AEOL 10150. The Sub-award Agreement is a fixed fee agreement inclusive of all direct and indirect costs. As a result of the contract modification and no-cost extension with BARDA mentioned below, the term of the Sub-award Agreement will continue through at least September, 2013. On April 12, 2011, we and Duke entered into a Sponsored Research Agreement (Non-Clinical), pursuant to which we engaged Duke to perform a program of scientific research entitled "Murine Studies for the Development of AEOL 10150 as a Medical Countermeasure Against ARS and DEARE" (Delayed Effects of Acute Radiation Exposure), which will include, among other things, studies and models of optimum dosing of AEOL 10150 in mice. We entered into the Sponsored Research Agreement in furtherance of our efforts under the BARDA Contract. The Sponsored Research Agreement is a cost -plus fee agreement inclusive of all direct and indirect costs.

Duke Licenses

Pursuant to our license agreements with Duke, we have obtained exclusive worldwide rights from Duke to products using antioxidant technology and compounds developed by Dr. Irwin Fridovich and other scientists at Duke. We are obligated under the licenses to pay Duke royalties ranging in the low single digits of net product sales during the term of the Duke licenses, and we must make payments upon the occurrence of certain development milestones in an aggregate amount of up to $2,000,000. In addition, we are obligated under the Duke licenses to pay patent filing, prosecution, maintenance and defense costs. The Duke licenses are terminable by Duke in the event of breach by us and otherwise expire when the last licensed patent expires.

National Jewish Medical and Research Center License ("NJMRC")

We have obtained an exclusive worldwide license from the NJMRC to develop, make, use and sell products using proprietary information and technology developed under a previous Sponsored Research Agreement within the field of antioxidant compounds and related discoveries. We must make milestone payments to the NJMRC in an aggregate amount of up to $250,000 upon the occurrence of certain development milestones. Our royalty payment obligations to the NJMRC under this license agreement are in the low single digits of net product sales. We are also obligated to pay patent filing, prosecution, maintenance and defense costs. This NJMRC license agreement is terminable by the NJMRC in the event of breach and otherwise expires when the last licensed patent expires.

National Jewish Health License

In 2009, we obtained an additional exclusive worldwide license from NJH to develop, make, use and sell products using proprietary information and technology developed at NJH related to certain compounds as a medical countermeasure against mustard gas exposure. Under this license agreement, we must make milestone payments to NJH in an aggregate amount of up to $500,000 upon the occurrence of certain development milestones. In addition, we must make royalty payments to NJH under this license agreement ranging in the low-single digits as a percentage of all sublicensing fees, milestone payments and sublicense royalties that we receive from sublicenses granted by us

pursuant to this license agreement. We are also obligated to pay patent filing, prosecution, maintenance and defense costs. This NJH license agreement is terminable by NJH in the event of breach and otherwise expires when the last licensed patent expires

Our lead compound, AEOL 10150, is expected to enter human clinical trials in oncology, where it will be used in combination with radiation therapy. AEOL 10150 has previously been tested in two Phase I clinical trials with no serious adverse events reported. The compound is also being developed as a medical countermeasure against Lung-ARS as well as GI-ARS, both caused by exposure to radiation due to a radiological or nuclear event. It is also being developed for use as a countermeasure for exposure to chemical vesicants such as chlorine gas and sulfur mustard gas. AEOL 10150 has already performed well in animal efficacy and safety studies in each of these potential indications. A significant portion of the funding for the medical countermeasure development programs to date has come from various government entities. Although we expect this funding to continue, there is no guarantee that it will.

February/March 2013 Financing

On February 19, 2013 and March 4, 2013, we entered into Securities Purchase Agreements (the "Purchase Agreements") with certain accredited investors (the "Purchasers"). Under the terms of the agreements, we received $3,616,000 in gross proceeds in exchange for the issuance of an aggregate of approximately 14,462,000 units (the "Units"), consisting of 14,462,000 shares of common stock and 14,462,000 warrants, at a purchase price of $0.25 per unit. Each Unit consists of (i) one share of common stock (the "Common Shares") and (ii) a five -year warrant to purchase one share of our common stock (the "Warrants"). The Warrants have an initial exercise price of $0.25 per share.

On February 19, 2013, we received $3,225,000 in gross proceeds in exchange for the issuance of an aggregate of 12,900,000 Units, which consisted of 12,900,000 shares of common stock and 12,900,000 warrants.

On March 4, 2013, we received $390,000 in gross proceeds in exchange for the issuance of an aggregate of approximately 1,562,000 Units, which consisted of 1,562,000 shares of common stock and 1,562,000 warrants.

Net cash proceeds from the February/March 2013 Financing, after deducting for expenses, were approximately $3,558,000. We also incurred non-cash expenses in the form of 365,000 warrants issued to consultants, at similar terms as the financing Warrants, for services provided. We issued a total of 14,827,000 warrants as of June 30, 2013 in connection with the February/March 2013 Financing.

The fair value of the February/March Financing warrants was estimated to be $4,791,000 using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 154.84%, risk free interest rate of 0.87% and an expected life of five years. The proceeds from the February/March 2013 Financing were allocated based upon the relative fair values of the February/March 2013 Financing Warrants and the February/March 2013 Common Shares.

Results of Operations

Three months ended June 30, 2013 versus three months ended June 30, 2012

We had net loss of $786,000 and net income of $3,064,000 (including a non-cash gain for decreases in valuation of liability classified warrants of $3,666,000), and cash inflows from operations of $806,000 and cash outflows of $440,000 for the three months ended June 30, 2013 and June 30, 2012, respectively.

Revenue for the three months ended June 30, 2013 was $844,000, which compares to $1,448,000 in revenue for the three months ended June 30, 2012. The decrease is primarily attributable to decreased cost of development work in progress under the BARDA Contract as of June 30, 2013 compared to June 30, 2012.

Research and Development ("R&D") expenses decreased $499,000, or 41%, to $727,000 for the three months ended June 30, 2013 from $1,226,000 for the three months ended June 30, 2012. The decrease is primarily attributable to work related to the BARDA Contract. R&D expenses for our antioxidant program have totaled $51,928,000 from inception through June 30, 2013. We currently have ten development programs in progress: studies of AEOL 10150 as a medical countermeasure against the effects of sulfur mustard gas, phosgene gas, chlorine gas on the lungs, against the effects of radiation on the lungs and on the gastro-intestinal tract, against the effects of nerve agents, and as a treatment for cancer, studies of AEOL 11207 and several other compounds as potential treatments for Parkinson's disease and epilepsy, and a study of Hexyl as protectant against radiation exposure. Because of the uncertainty of our research and development and clinical studies, we are unable to predict the total level of spending on the program or the program completion date. We expect R&D expenses during fiscal year 2013 will be similar to fiscal year 2012. Funding for the NIH programs flows directly to our research partners from the NIH, and is, therefore, not reflected on the Company's income statement, cash flow statement or balance sheet.

General and administrative ("G&A") expenses increased $79,000, or 10%, to $903,000 for the three months ended June 30, 2013 from $824,000 for the three months ended June 30, 2012. Consulting stock expense increased by $114,000 due to additional options issued to employees and new board members during the three months ended June 30, 2013.

Nine months ended June 30, 2013 versus nine months ended June 30, 2012

We had net loss of $2,541,000 (including a non-cash adjustment for increases in valuation of liability classified warrants of $510,000) and net income of $8,804,000 (including a non-cash gain for decreases in valuation of liability classified warrants of $10,678,000), and cash outflows from operations of $1,107,000 and cash outflows from operations of $953,000 for the nine months ended June 30, 2013 and June 30, 2012, respectively.

Revenue for the nine months ended June 30, 2013 was $3,045,000, which compares to $5,894,000 revenue for the nine months ended June 30, 2012. The decrease is primarily attributable to a decreased cost of development work in progress under the BARDA Contract as of June 30, 2013 compared to June 30, 2012.

R&D expenses decreased $2,709,000, or 52%, to $2,514,000 for the nine months ended June 30, 2013 from $5,223,000 for the nine months ended June 30, 2012. The decrease is primarily attributable to a decreased cost of development work in progress under the BARDA Contract as of June 30, 2013 to June 30, 2012.

G&A expenses remained relatively consistent with only an increase of $17,000, or 0.67%, to $2,562,000 for the nine months ended June 30, 2013 from $2,545,000 for the nine months ended June 30, 2012. Decreases in salaries and wages were offset by increases in consulting stock expense.

Liquidity and Capital Resources

We had cash and cash equivalents of $2,732,000 on June 30, 2013, and $281,000 on September 30, 2012. The increase in cash was primarily due to the net impact of cash used in operations and cash raised in the February/March 2013 Financing. We had accounts receivable of $343,000 on June 30, 2013, and $882,000 on September 30, 2012. We had accounts payable of $2,003,000 on June 30, 2013, and $2,272,000 on September 30, 2012. The decrease was primarily due to the payoff of accounts due after receipt of funds from the February/March 2013 Financing.

We had net loss of $2,541,000 (including a non-cash adjustment for increases in valuation of liability classified warrants of $510,000) for the nine months ended June 30, 2013. We had cash outflows from operations of $1,107,000. We expect to incur additional losses and negative cash flow from operations during the remainder of fiscal year 2013 and potentially for several more years.

On February 11, 2011, we were awarded the BARDA Contract to fund the development of AEOL 10150 as a medical countermeasure for Lung-ARS from its current status to FDA approval in response to Special Instructions Amendment 4 to a Broad Agency Announcement (BAA-BARDA-09-34) for advanced research and development of medical countermeasures for chemical, biological, radiological and nuclear threats. The contract value could be up to $118.4 million depending on options exercised by BARDA and the requirements for approval by the FDA. Under the BARDA Contract, substantially all of the costs of the development of AEOL 10150 as a medical countermeasure for pulmonary injuries resulting from an acute exposure to radiation from a radiological/nuclear accident or attack, particularly injuries associated with ARS or Delayed Effects of Acute Radiation Exposure would be paid for by the U.S. government through BARDA funding. We recognized $3,045,000 in revenue during the nine months ended June 30, 2013 related to the BARDA Contract. The BARDA Contract includes provisions to cover some, but not all, general corporate overhead as well as a small provision for profit. The net impact of the BARDA Contract on our liquidity is that our projected cash burn has been reduced. Certain costs, typically those of being a public company, like legal costs associated with being a public company, Investor Relations/Public Relations costs and patent-related costs, are not included in overhead reimbursement in the BARDA Contract.

We do not have any revenues from product sales and, therefore, we rely on investors, grants, collaborations and licensing of our compounds to finance our operations. We generate limited revenue from reimbursable, cost-plus R&D contracts and grants. Revenues on reimbursable contracts are recognized as costs are incurred, generally based on allowable costs incurred during the period, plus any recognizable earned fee. We consider fixed fees under cost-plus fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract.

Since the terms of the BARDA Contract include provisions to cover some general corporate overhead as well as a small provision for profit, the result on our liquidity is that our projected cash burn has been reduced. In order to fund on-going operating cash requirements or to accelerate or expand our oncology and other programs, we may need to raise significant additional funds.

We have incurred significant losses from operations to date. Our ongoing future cash requirements will depend on numerous factors, particularly the progress of our catalytic antioxidant program, potential government procurements for the national stockpile, clinical trials and/or ability to negotiate and complete collaborative agreements or out-licensing arrangements. In addition, we might sell additional shares of our stock and/or debt and explore other strategic and financial alternatives, including a merger or joint venture with another company, the sale of stock and/or debt, the establishment of new collaborations for current research programs, that include initial cash payments and ongoing research support and the out-licensing of our compounds for development by a third party.

There are significant uncertainties as to our ability to access potential sources of capital. We may not be able to enter into any collaboration on terms acceptable to us, or at all, due to conditions in the pharmaceutical industry or in the economy in general or based on the prospects of our catalytic antioxidant program. Even if we are successful in obtaining collaboration for our antioxidant program, we may have to relinquish rights to technologies, product candidates or markets that we might otherwise develop ourselves. These same risks apply to any attempt to out-license our compounds.

Similarly, due to market conditions, the illiquid nature of our stock and other possible limitations on equity offerings, we may not be able to sell additional securities or raise other funds on terms acceptable to us, if at all. Any additional equity financing, if available, would likely result in substantial dilution to existing stockholders.

Our forecast of the period of time through which our financial resources will be adequate to support our operations is forward-looking information, and actual results could vary.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies and Estimates

Revenue Recognition

We do not currently generate revenue from product sales, but do generate revenue from the BARDA Contract. We recognize revenue from the BARDA Contract in accordance with the authoritative guidance for revenue recognition. Revenue is recognized when all of the following criteria are met: (i) persuasive evidence of an arrangement exists, (ii) delivery (or passage of title) has occurred or services have been rendered, (iii) the seller's price to the buyer is fixed or determinable, and (iv) collectability is reasonably assured. We also comply with the authoritative guidance for revenue recognition regarding arrangements with multiple deliverables.

The BARDA Contract is classified as a "cost-plus-fixed-fee" contract. We recognize government contract revenue in accordance with the authoritative guidance for revenue recognition, including the authoritative guidance specific to federal government contracts. Reimbursable costs under the BARDA Contract primarily include direct labor, subcontract costs, materials, equipment, travel and indirect costs. In addition, we receive a fixed fee under the BARDA Contract, which is unconditionally earned as allowable costs are incurred and is not contingent on success factors. Reimbursable costs under this BARDA Contract, including the fixed fee, are recognized as revenue in the period the reimbursable costs are incurred and become billable.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk is presently limited to the interest rate sensitivity of our cash and cash equivalents, which is affected by changes in the general level of U.S. interest rates. However, we believe that we are not subject to any material market risk exposure and do not expect that changes in interest rates would have a material effect upon our financial position. A hypothetical 10% change in interest rates would not have a material effect on our Statements of Operations or Cash Flows for the nine months ended June 30, 2013. We do not have any foreign currency or other derivative financial instruments.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). In designing and evaluating our disclosure controls and procedures, our management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures 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.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of the end of the period covered by this Quarterly Report on Form 10-Q because of the material weakness discussed below.

In connection with the preparation of our Quarterly Report on Form 10-Q for the quarter ended December 31, 2012, we determined that our basic and diluted net income (loss) per share calculations should have been prepared using the "two-class method." Under the two-class method, securities that participate in dividends are considered "participating securities." Our preferred shares, preferred warrants and most of our common stock warrants are considered "participating securities" because they include non-forfeitable rights to dividends.

Additionally, we determined that the diluted net income (loss) per share calculations did not include the net income effect of changes in fair value related to dilutive, liability classified warrants.

Application of the two-class method and, for dilutive earnings per share, including the effect of changes in fair value for liability classified warrants resulted in a modification to our previously reported basic and diluted net income (loss) per share for the fiscal years ended September 30, 2012 and 2011, and the quarterly periods included therein.

On February 12, 2013, the Audit Committee of our Board of Directors concluded, based on the recommendation of management, that the consolidated statements of operations for the fiscal years ended September 30, 2012 and 2011, and the consolidated statements of operations for the quarterly periods in the years ended September 30, 2012 and 2011 (collectively, the "Prior Financial Statements"), should no longer be relied upon because of the incorrect calculation of earnings per share. Management and the Audit Committee discussed the matters relating to the restatements with Grant Thornton LLP, our independent registered public accountants.

We filed a Current Report on Form 8-K on February 19, 2013 to reflect the revisions to our Annual Report on Form 10-K for the year ended September 30, 2012 described above. On May 14, 2013, we filed an amendment to our Annual Report on Form 10-K/A for the year ended September 30, 2012 to reflect the revisions set forth above, and we also included these revisions in our post-effective amendment to registration statement on Form S-1 (File No. 333-181409) filed on February 20, 2013. We do not intend to amend our previously filed Quarterly Reports on Form 10-Q for the periods ended December 31, 2010, March 31, 2011, June 30, 2011, December 31, 2011, March 31, 2012 or June 30, 2012, or our Annual Report on Form 10-K for the year ended September 30, 2011, to reflect the revisions described above.

A material weakness is a significant deficiency, or combination of deficiencies, in internal control over financial reporting that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As a result of the determination that our diluted net income (loss) per share calculations did not include the net income effect of changes in fair value related to dilutive, liability classified warrants for the fiscal years ended September 30, 2012 and 2011, and the quarterly periods included therein, management has determined that a material weakness existed as of June 30, 2013.

Management believes the material weakness is due to a deficiency in technical resources over financial reporting. As a result of the material weakness, management is evaluating mitigating controls to minimize the potential for incorrect calculations of earnings per share in our future financial statements.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

As of June 30, 2013, there have not been any material changes from the risk factors previously disclosed in Part 1, Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2012, which was filed with the SEC on December 31, 2012.

Item 6. Exhibits

Exhibit #		Description
2.1	(1)	Agreement and Plan of Merger and Reorganization dated September 16, 2003 between Incara, Inc. and Incara Pharmaceuticals Corporation
3.1	(2)	Amended and Restated Certificate of Incorporation
3.2	(3)	Bylaws
4.1	(4)	Form of Common Stock Certificate
4.2	(1)	Form of Series B Preferred Stock Certificate
4.3	(5)	Form of Warrant to Purchase Common Stock dated June 5, 2006.
4.4	(6)	Registration Rights Agreement dated May 22, 2007 by and among the Company and each of the Purchasers whose names appear on the Schedule attached thereto.
4.5	(7)	Registration Rights Agreement dated October 6, 2009 by and among the Company and the investors whose names appear on the signature pages thereof.
4.6	(6)	Form of Warrant to Purchase Common Stock dated May 22, 2007.
4.7	(7)	Form of Warrant to Purchase Common Stock
4.8	(1)	Registration Rights Agreement dated September 16, 2003 among Incara Pharmaceuticals Corporation, Incara, Inc. and Goodnow Capital, L.L.C.
4.9	(8)	Registration Rights Agreement dated August 11, 2010 by and among Aeolus Pharmaceuticals, Inc. and the investors listed therein
31.1		Certification of the Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
31.2		Certification of the Interim Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a).
32.1		Certification by the Chief Executive Officer and Interim Chief Financial Officer pursuant to 18 U.S.C. §1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	+	XBRL Instance Document
101.SCH	+	XBRL Taxonomy Extension Schema Document
101.CAL	+	XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF	+	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	+	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	+	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Incorporated herein by reference to the Registrant's Registration Statement on Form S-4 filed with the SEC on 09/19/03.

(2) Incorporated herein by reference to the Registrant's Annual Report on Form 10-K filed with the SEC on 12/31/12.

(3) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 10/27/05.

(4) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 08/11/04.

(5) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 06/06/06.

(6) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 5/23/07.

(7) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 10/06/09.

(8) Incorporated herein by reference to the Registrant's Current Report on Form 8-K filed with the SEC on 8/12/10.

+ Attached as Exhibit 101 to this report are documents formatted in XBRL (Extensible Business Reporting Language).

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.

Date: August 14, 2013

AEOLUS PHARMACEUTICALS, INC.

By /s/ John L. McManus
John L. McManus
President and Chief Executive Officer
(Principal Executive Officer)

By /s/ David Cavalier
David Cavalier
Interim Chief Financial Officer
(Principal Financial and Accounting Officer)