RXi Pharmaceuticals Corp
Form 10-Q
August 14, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2014

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number: 000-54910

RXi Pharmaceuticals Corporation

(Exact name of registrant as specified in its charter)

Delaware	**45-3215903**
(State of incorporation)	**(I.R.S. Employer**
	Identification No.)

257 Simarano Drive, Suite 101, Marlborough, MA 01752

(Address of principal executive office) (Zip code)

Registrant s telephone number: (508) 767-3861

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 time 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. (Check one):

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

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of August 8, 2014, RXi Pharmaceuticals Corporation had 16,103,317 shares of common stock, $0.0001 par value, outstanding.

Table of Contents

RXi PHARMACEUTICALS CORPORATION

FORM 10-Q QUARTER ENDED JUNE 30, 2014

INDEX

Table of Contents

PART I

ITEM 1. FINANCIAL STATEMENTS

RXi PHARMACEUTICALS CORPORATION

CONDENSED BALANCE SHEETS

(Amounts in thousands, except share and per share data)

(Unaudited)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,911	$ 11,390
Restricted cash	50	50
Short-term investments		3,000
Prepaid expenses and other current assets	367	303
Total current assets	12,328	14,743
Equipment and furnishings, net	204	177
Other assets	18	18
Total assets	$ 12,550	$ 14,938
LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 293	$ 163
Accrued expenses and other current liabilities	682	1,795
Deferred revenue	78	118
Total current liabilities	1,053	2,076
Commitments and contingencies		
Series A convertible preferred stock, $0.0001 par value, 15,000 shares authorized; 4,935 and 7,920 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively (at liquidation value)	4,935	7,920
Stockholders equity:		
Preferred stock, $0.0001 par value; 10,000,000 authorized		
Series A-1 convertible preferred stock, $0.0001 par value, 10,000 shares authorized; 4,347 and 2,054 issued and outstanding at June 30, 2014 and December 31, 2013, respectively (at liquidation value)	4,347	2,054

Common stock, $0.0001 par value, 1,500,000,000 shares authorized; 14,899,159 and 11,788,045 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	1	1
Additional paid-in capital	44,586	40,969
Accumulated deficit	(42,372)	(38,082)
Total stockholders equity	6,562	4,942
Total liabilities, convertible preferred stock and stockholders equity	$ 12,550	$ 14,938

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

Table of Contents

RXi PHARMACEUTICALS CORPORATION

CONDENSED STATEMENTS OF OPERATIONS

(Amounts in thousands, except share and per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenues:				
Grant revenues	$ 12	$ 225	$ 41	$ 278
Operating expenses:				
Research and development expenses (1)	1,183	1,213	2,659	14,985
General and administrative expenses (1)	850	977	1,693	1,652
Total operating expenses	2,033	2,190	4,352	16,637
Loss from operations	(2,021)	(1,965)	(4,311)	(16,359)
Interest income, net	5	4	11	4
Other income (expense), net	10		10	(3)
Net loss	(2,006)	(1,961)	(4,290)	(16,358)
Series A and Series A-1 convertible preferred stock dividends	(1,213)	(2,399)	(2,968)	(5,946)
Net loss applicable to common stockholders	$ (3,219)	$ (4,360)	$ (7,258)	$ (22,304)
Net loss per common share applicable to common stockholders (Note 1):				
Basic and diluted	$ (0.23)	$ (0.39)	$ (0.54)	$ (2.52)
Weighted average common shares: basic and diluted	14,015,451	11,168,144	13,319,634	8,845,026

(1) Non-cash stock-based compensation expenses included in operating expenses are as follows:

Research and development	$ 206	$ 136	$ 416	$ 561
General and administrative	251	293	532	496

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

Table of Contents

RXi PHARMACEUTICALS CORPORATION

CONDENSED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

(Unaudited)

	For the Six Months Ended June 30, 2014	For the Six Months Ended June 30, 2013
Cash flows from operating activities:		
Net loss	$ (4,290)	$ (16,358)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	42	53
Gain on disposal of equipment	(10)	
Non-cash share-based compensation	948	1,057
Fair value of common stock issued in exchange for patent and technology rights		12,250
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(64)	5
Accounts payable	130	(58)
Accrued expenses and other current liabilities	(1,113)	146
Deferred revenue	(40)	(279)
Net cash used in operating activities	(4,397)	(3,184)
Cash flows from investing activities:		
Purchases of short-term investments		(9,000)
Maturities of short-term investments	3,000	
Cash paid for purchase of equipment and furnishings	(71)	(2)
Proceeds from disposal of equipment and furnishings	12	
Net cash provided by (used in) investing activities	2,941	(9,002)
Cash flows from financing activities:		
Net proceeds from the issuance of common stock	1,947	15,651
Proceeds from issuance of common stock in connection with employee stock purchase plan	30	
Repayments of capital lease obligations		(5)
Net cash provided by financing activities	1,977	15,646
Net increase in cash and cash equivalents	521	3,460
Cash and cash equivalents at the beginning of period	11,390	5,127

Cash and cash equivalents at the end of period	$	11,911	$	8,587

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

Table of Contents

RXi PHARMACEUTICALS CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Business and Basis of Presentation

RXi Pharmaceuticals Corporation (**RXi** or the **Company**) is a biotechnology company focused on discovering, developing and commercializing innovative therapies based on its proprietary, next-generation RNAi platform. Therapeutics that use RNA interference, or RNAi, have great promise because of their ability to silence, or down-regulate, the expression of a specific gene that may be overexpressed in a disease condition. The Company s first RNAi product candidate, RXI-109, commenced human clinical trials in 2012. RXI-109 targets connective tissue growth factor (**CTGF**), a key regulator of fibrosis and scar formation, and is initially being developed to reduce or inhibit scar formation in the skin following surgery. The Company s pipeline includes a clinical program in anti-scarring, a pre-clinical program in ophthalmology and a discovery program to identify other potential sd-rxRNA® lead compounds and targets, as well as those that target other key enzymes in dermatology and ophthalmology, from the RNAi-related assets acquired from OPKO Health, Inc.

Basis of Presentation

The accompanying condensed financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America (**GAAP**). Certain information and footnote disclosures included in the Company s annual financial statements have been condensed or omitted. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation of the condensed financial statements have been included. Interim results are not necessarily indicative of results for a full year.

Uses of estimates in preparation of financial statements

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents. Cash equivalents consist primarily of amounts invested in money market accounts and certificates of deposit.

Restricted Cash

Restricted cash consists of certificates of deposit held by financial institutions as collateral for the Company s corporate credit cards.

Short-term Investments

The Company s short-term investments consisted of certificates of deposit with original maturities ranging from 6 months to 1 year.

Revenue Recognition

Principal sources of revenue consist of government research grants. Revenue from government grants is recognized over the respective contract periods as the services are performed, provided there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the related receivable is reasonably assured, and no contingencies remain outstanding. Monies received prior to the recognition of revenue are recorded as deferred revenue.

Research and Development Expenses

Research and development costs are charged to expense as incurred and relate to salaries, employee benefits, facility-related expenses, supplies, stock-based compensation related to employees and non-employees involved in the Company s research and development, external services, other operating costs and overhead related to our research and development departments, costs to acquire technology licenses and expenses associated with preclinical activities and our clinical trials. Payments made by the Company in advance for research and development services not yet provided and/or for materials not yet received are recorded as prepaid expenses. Accrued liabilities are recorded related to those expenses for which vendors have not yet billed us with respect to services provided and/or materials that we have received.

Preclinical and clinical trial expenses relate to third-party services, patient-related fees at the sites where our clinical trials are being conducted, laboratory costs, analysis costs, toxicology studies and investigator fees. Costs associated with these expenses are generally payable on the passage of time or when certain milestones are achieved. Expense is recorded during the period incurred or in the period in which a

Table of Contents

milestone is achieved. In order to ensure that we have adequately provided for preclinical and clinical expenses during the proper period, we maintain an accrual to cover these expenses. These accruals are assessed on a quarterly basis and are based on such assumptions as expected total cost, the number of patients and clinical trial sites and length of the study. Actual results may differ from these estimates and could have a material impact on our reported results. Our historical accrual estimates have not been materially different from our actual costs.

Stock-based Compensation

The Company follows the provisions of the Financial Accounting Standards Board (**FASB**) Accounting Standards Codification (**ASC**) Topic 718, *Compensation Stock Compensation* (**ASC 718**), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees, officers and non-employee directors, including stock options. Stock compensation expense based on the grant date fair value estimated in accordance with the provisions of ASC 718 is recognized as an expense over the requisite service period.

Net loss per share

The Company accounts for and discloses net loss per common share in accordance with FASB ASC Topic 260, *Earnings per Share* . Basic and diluted net loss per common share is computed by dividing net loss attributable to common stockholders by the weighted average number of common shares outstanding. When the effects are not anti-dilutive, diluted earnings per share is computed by dividing the Company s net earnings by the weighted average number of common shares outstanding and the impact of all dilutive potential common shares. There were no potential dilutive common shares for all periods presented.

The following table sets forth the potential common shares excluded from the calculation of net loss per common share because their inclusion would be anti-dilutive:

	June 30,	
	2014	**2013**
Options to purchase common stock	2,928,932	2,548,264
Common stock underlying Series A and Series A-1 convertible preferred stock	22,626,163	23,817,544
Warrants to purchase common stock	4,615	4,615
Total	25,559,710	26,370,423

Comprehensive Loss

The Company s net loss is equal to its comprehensive loss for all periods presented.

2. Recent Accounting Pronouncements

In June 2014, the FASB issued Accounting Standards Update (**ASU**) No. 2014-10, *Development Stage Entities (Topic 915) Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation* . ASU 2014-10 eliminates the concept of a development stage entity in its entirety from current accounting guidance. Under current guidance, development stage entities are required to present inception-to-date financial information in their annual statements. The new standard eliminates the concept of

a development stage entity from generally accepted accounting principles. Therefore, the current incremental reporting requirements for a development stage entity, including inception-to-date information, will no longer apply. For public companies, the new standard is effective for reporting periods beginning after December 15, 2014, and interim periods therein. The Company adopted this standard in June 2014. Other than the exclusion of the presentation of inception-to-date financial information, the adoption of this standard did not have a material impact on the Company s financial statements.

3. Fair Value Measurements

The Company follows the provisions of FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* for the Company s financial assets and liabilities that are re-measured and reported at fair value at each reporting period and are re-measured and reported at fair value at least annually using a fair value hierarchy that is broken down into three levels. Level inputs are as defined as follows:

Level 1 quoted prices in active markets for identical assets or liabilities.

Level 2 other significant observable inputs for the assets or liabilities through corroboration with market data at the measurement date.

Level 3 significant unobservable inputs that reflect management s best estimate of what market participants would use to price the assets or liabilities at the measurement date.

The Company categorized its restricted cash, cash equivalents and short-term investments as Level 2 hierarchy. The assets classified as Level 2 have initially been valued at transaction price and subsequently valued, at the end of each reporting period, using other market observable data. Observable market data points include quoted prices, interest rates, reportable trades and other industry and economic events. Financial assets measured at fair value on a recurring basis are summarized as follows, in thousands:

Table of Contents

Description	June 30, 2014	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 4,000	$	$ 4,000	$
Restricted cash	50		50	
Total	$ 4,050	$	$ 4,050	$

Description	December 31, 2013	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Assets:				
Cash equivalents	$ 9,500	$	$ 9,500	$
Restricted cash	50		50	
Short-term investments	3,000		3,000	
Total	$ 12,550	$	$ 12,550	$

Fair Value of Financial Instruments

The carrying amounts reported in the balance sheet for cash equivalents, restricted cash, short-term investments and accounts payable approximate their fair values due to their short-term nature.

4. Preferred Stock

The Company currently has authorized a total of 15,000 shares of Series A convertible preferred stock (**Series A Preferred Stock**), $0.0001 par value per share, for issuance.

The following table summarizes the Series A Preferred Stock activity for the six months ended June 30, 2014:

	June 30, 2014
Issued and Outstanding at January 1, 2014	7,920
Conversions of Series A Preferred Stock into common stock	(166)
Exchange of Series A Preferred Stock into Series A-1 Preferred Stock	(3,000)
Dividends issued on Series A Preferred Stock	181
Issued and Outstanding at June 30, 2014	4,935

Accounting Treatment

The Series A Preferred Stock has been classified outside of permanent equity (within the mezzanine section between liabilities and equity on the condensed balance sheets) as the Company may not be able to control the actions necessary to issue the maximum number of common shares needed to provide for a conversion in full of the then outstanding Series A Preferred Stock, at which time a holder of the Series A Preferred Stock may elect to redeem their preferred shares outstanding in the amount equal to the face value per share, plus unpaid accrued dividends. The Company s Series A-1 convertible preferred stock (the **Series A-1 Preferred Stock**) has the same rights, privileges and preferences as the Series A Preferred Stock, but does not provide for any potential payment in cash in the event that the Company has insufficient shares of common stock authorized to honor conversions. Accordingly, the Series A-1 Preferred Stock is classified within permanent equity. The Series A-1 Preferred Stock is discussed further in Note 5 to the notes of the financial statements.

Dividends

Holders of Series A Preferred Stock are entitled to receive cumulative mandatory dividends at the rate per share of seven percent (7%) of the face amount ($1,000 per share) per annum, payable quarterly on each March 31, June 30, September 30 and December 31. Dividends shall be payable in additional shares of Series A Preferred Stock valued for this purpose at the face amount. In the event there are not sufficient authorized Series A Preferred Shares available to pay such a dividend, the dividend shall instead accrete to and increase the value of the outstanding Series A Preferred Stock. The fair value of the Series A Preferred Stock dividend, which is included in the Company s net loss applicable to common shareholders, is calculated by multiplying the number of common shares that a preferred holder would receive upon conversion by the closing price of the Company s common stock on the dividend payment date.

Included in the Company s net loss applicable to common shareholders related to the fair value of the Series A Preferred Stock dividends was $625,000 and $2,399,000 for the three months ended June 30, 2014 and 2013, respectively. Included in the Company s net loss applicable to common shareholders related to the fair value of the Series A Preferred Stock dividends was $1,635,000 and $5,946,000 for the six months ended June 30, 2014 and 2013, respectively.

Table of Contents

Conversion

Each holder of shares of Series A Preferred Stock may, at any time and from time to time, convert each of its shares into a number of fully paid and non-assessable shares of common stock at the defined conversion rate. Initially, each share of Series A Preferred Stock is convertible into 2,437.57 shares of common stock. In no event shall any holder of shares of Series A Preferred Stock have the right to convert shares of Series A Preferred Stock into shares of common stock to the extent that, after giving effect to such conversion, the holder, together with any of its affiliates, would beneficially own more than 9.999% of the then-issued and outstanding shares of common stock.

During the three months ended June 30, 2013, 295 shares of Series A Preferred Stock were converted into 719,082 shares of common stock.

During the six months ended June 30, 2014 and 2013, 166 and 295 shares of Series A Preferred Stock were converted into 405,720 and 719,082 shares of common stock, respectively.

Exchange Transaction

On January 24, 2014, the Company entered into an exchange agreement (the **Exchange Agreement**) with Tang Capital Partners, L.P. (**TCP**) pursuant to which TCP exchanged a total of 3,000 shares of Series A Preferred Stock for a like number of shares of Series A-1 Preferred Stock. As result of this transaction, the face value of the Series A Preferred Stock was reclassified as Series A-1 Preferred Stock in the Company s condensed balance sheet as of March 31, 2014, which resulted in a corresponding increase in stockholder s equity as of the same date.

Liquidation Preference

The Liquidation Preference with respect to a share of Series A Preferred Stock means an amount equal to the face amount of the shares plus all accrued and unpaid dividends on the Series A Preferred Stock (as adjusted for any stock dividends, combinations, splits, recapitalizations and the like with respect to such shares). In the event of a liquidation, dissolution, or winding up, whether voluntary or involuntary, no distribution shall be made to the holders of any shares of capital stock of the Corporation (other than Senior Securities pursuant to the rights, preferences and privileges thereof) unless prior thereto the holders of shares of Series A Preferred Stock have received the Liquidation Preference with respect to each share then outstanding.

Voting

The holders of Series A Preferred Stock do not have any right to elect directors and have only limited voting rights, which consist primarily of the right to vote under certain protective provisions set forth in the Certificate of Designations, regarding: (i) any proposed amendment to the Series A Preferred Stock or its right and preferences; and (ii) any proposed Deemed Liquidation Event as defined in the Certificate of Designations.

5. Stockholder s Equity

Series A-1 Preferred Stock

The Company currently has authorized a total of 10,000 shares of Series A-1 Preferred Stock, $0.0001 par value per share, for issuance. On January 24, 2014, the Company filed a Certificate of Increase with the Secretary of State of the State of Delaware amending the Company s previously filed Certificate of Designation for the Series A-1 Preferred Stock to increase the total number of shares of Series A-1 Preferred Stock authorized from 5,000 shares to 10,000

shares.

The following table summarizes the Series A-1 Preferred Stock activity for the six months ended June 30, 2014:

	June 30, 2014
Issued and Outstanding at January 1, 2014	2,054
Conversion of Series A-1 Preferred Stock	(859)
Exchange of Series A Preferred Stock into Series A-1 Preferred Stock	3,000
Dividends issued on Series A-1 Preferred Stock	152
Issued and Outstanding at June 30, 2014	4,347

Accounting Treatment

The Series A-1 Preferred Stock has been classified as permanent equity as the Company is not required to effect a net cash settlement in the instance that the Company does not have enough shares of common stock available to permit the conversion of Series A-1 Preferred Stock into common stock.

Dividends

Holders of Series A-1 Preferred Stock are entitled to receive cumulative mandatory dividends at the rate per share of seven percent (7%) of the face amount ($1,000 per share) per annum, payable quarterly on each March 31, June 30, September 30 and December 31. Dividends shall be payable in additional shares of Series A-1 Preferred Stock valued for this purpose at the face amount. In the event there are not sufficient

Table of Contents

authorized Series A-1 Preferred Shares available to pay such a dividend, the dividend shall instead accrete to and increase the value of the outstanding Series A-1 Preferred Stock. The fair value of the Series A-1 Preferred Stock dividend, which is included in the Company s net loss applicable to common shareholders, is calculated by multiplying the number of common shares that a preferred holder would receive upon conversion by the closing price of the Company s common stock on the dividend payment date.

Included in the Company s net loss applicable to common shareholders related to the fair value of the Series A-1 Preferred Stock dividends was $588,000 for the three months ended June 30, 2014. Included in the Company s net loss applicable to common shareholders related to the fair value of the Series A-1 Preferred Stock dividends was $1,333,000 for the six months ended June 30, 2014.

Conversion

Each holder of shares of Series A-1 Preferred Stock may, at any time and from time to time, convert each of its shares into a number of fully paid and non-assessable shares of common stock at the defined conversion rate. Initially, each share of Series A-1 Preferred Stock is convertible into 2,437.57 shares of common stock. In no event shall any holder of shares of Series A-1 Preferred Stock have the right to convert shares of Series A-1 Preferred Stock into shares of common stock to the extent that such issuance or sale or right to effect such conversion would result in the holder or any of its affiliates together beneficially owning more than 9.999% of the then issued and outstanding shares of common stock.

During the three months ended June 30, 2014, 353 shares of Series A-1 Preferred Stock were converted into 860,457 shares of common stock.

During the six months ended June 30, 2014, 859 shares of Series A-1 Preferred Stock were converted into 2,093,859 shares of common stock.

Exchange Transaction

On January 24, 2014, the Company entered into the Exchange Agreement with TCP pursuant to which TCP exchanged a total of 3,000 shares of Series A Preferred Stock for a like number of shares of Series A-1 Preferred Stock. As result of this transaction, the face value of the Series A-1 Preferred Stock was increased in the Company s condensed balance sheet as of March 31, 2014, which resulted in a corresponding increase in stockholder s equity as of the same date.

Liquidation Preference

The Liquidation Preference with respect to a share of Series A-1 Preferred Stock means an amount equal to the face amount of the shares plus all accrued and unpaid dividends on the Series A-1 Preferred Stock (as adjusted for any stock dividends, combinations, splits, recapitalizations and the like with respect to such shares). In the event of a liquidation, dissolution, or winding up, whether voluntary or involuntary, no distribution shall be made to the holders of any shares of capital stock of the Corporation (other than Senior Securities pursuant to the rights, preferences and privileges thereof) unless prior thereto the holders of shares of Series A-1 Preferred Stock have received the Liquidation Preference with respect to each share then outstanding. The liquidation preference of the Series A Preferred Stock is *pari passu* with the liquidation preference of the Series A-1 Preferred Stock.

Voting

The holders of Series A-1 Preferred Stock do not have any right to elect directors and have only limited voting rights, which consist primarily of the right to vote under certain protective provisions set forth in the Certificate of Designations, regarding: (i) any proposed amendment to the Series A-1 Preferred Stock or its right and preferences; and (ii) any proposed Deemed Liquidation Event as defined in the Certificate of Designations.

Common Stock

At June 30, 2014, the Company had authorized a total of 1,500,000,000 shares of common stock, $0.0001 par value per share, for issuance. On July 10, 2014, the Company filed a Certificate of Amendment with the Secretary of State of the State of Delaware amending the Company s previously filed Amended and Restated Certificate of Incorporation to decrease the total number of shares of common stock authorized to 100,000,000. The decrease in the total number of shares of common stock authorized was approved by the Company s shareholders at the Company s Annual Meeting of Stockholders held on June 2, 2014.

On April 22, 2014, the Company entered into a purchase agreement (the **Purchase Agreement**) with Lincoln Park Capital Fund, LLC (**LPC**), pursuant to which the Company has the right to sell to LPC up to $20,000,000 in shares of the Company s common stock, subject to certain limitations and conditions set forth therein, over the 30-month term of the Purchase Agreement. Pursuant to the Purchase Agreement, on April 22, 2014, LPC purchased 500,000 shares of the Company s common stock at $4.00 per share and the Company issued 100,000 shares of common stock at $4.00 per share to LPC as a commitment fee, which was recorded as a cost of capital. As a result of this issuance, the Company received initial net proceeds of approximately $1.9 million, after deducting commissions and other offering expenses of approximately $0.1 million. The Company intends to use the proceeds received from the Purchase Agreement for working capital to support the advancement of the Company s ophthalmology franchise and for other general corporate purposes.

During the three months ended June 30, 2014 and 2013, the Company issued 860,457 and 719,082 shares of common stock, respectively, upon the conversion of Series A and Series A-1 Preferred Stock.

During the six months ended June 30, 2014 and 2013, the Company issued 2,499,579 and 719,082 shares of common stock, respectively, upon the conversion of Series A and Series A-1 Preferred Stock.

Table of Contents

6. Stock-Based Compensation

The Company follows the provisions of the FASB ASC Topic 718, *Compensation Stock Compensation* (**ASC 718**), which requires the measurement and recognition of compensation expense for all stock-based payment awards made to employees and non-employee directors including employee stock options. Stock compensation expense based on the grant date fair value estimated in accordance with the provisions of ASC 718 is recognized as an expense over the requisite service period.

For stock options granted as consideration for services rendered by non-employees, the Company recognizes compensation expense in accordance with the requirements of FASB ASC Topic 505-50, *Equity Based Payments to Non-Employees* . Non-employee option grants that do not vest immediately upon grant are recorded as an expense over the requisite service period of the underlying stock options. At the end of each financial reporting period prior to vesting, the value of these options, as calculated using the Black-Scholes option-pricing model, will be re-measured using the fair value of the Company s common stock and the non-cash compensation recognized during the period will be adjusted accordingly. Since the fair market value of options granted to non-employees is subject to change in the future, the amount of the future compensation expense will include fair value re-measurements until the stock options are fully vested.

Stock-Based Compensation

The Company is currently using the Black-Scholes option-pricing model to determine the fair value of all its option grants. For options granted during the three and six months ended June 30, 2014 and 2013, the following assumptions were used:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Weighted average risk-free interest rate	1.85%	1.25%	1.91%	1.25%
Weighted average expected volatility	100.77%	75.53%	100.95%	75.53%
Weighted average expected lives (years)	5.96	5.92	6.20	5.92
Weighted average expected dividend yield	0.00%	0.00%	0.00%	0.00%

The weighted average fair value of options granted during the three month periods ended June 30, 2014 and 2013 was $2.26 and $3.90, respectively. The weighted average fair value of options granted during the six month periods ended June 30, 2014 and 2013 was $2.42 and $3.90, respectively.

The risk-free interest rate used for each grant was based upon the yield on zero-coupon U.S. Treasury securities with a term similar to the expected life of the related option. The Company s expected stock price volatility assumption is based upon the volatility of a composition of comparable companies. The expected life assumption for employee grants was based upon the simplified method provided for under ASC 718-10 and the expected life assumptions for non-employees was based upon the contractual term of the option. The dividend yield assumption of zero is based upon the fact that the Company has never paid cash dividends and presently has no intention of paying cash dividends.

The following table summarizes the activity of Company s stock option plan for the period January 1, 2014 to June 30, 2014:

	Total Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Balance at January 1, 2014	2,556,269	$ 3.47		
Granted	372,663	3.00		
Exercised				
Cancelled				
Balance at June 30, 2014	2,928,932	$ 3.41	8.32 years	$ 780,000
Exercisable at June 30, 2014	1,427,676	$ 3.41	8.04 years	$ 415,000

Stock-based compensation expense for the three months ended June 30, 2014 and 2013 was approximately $457,000 and $429,000, respectively. Of this, the Company recognized approximately $9,600 of expense and $8,400 of income related to non-employee stock options for the same period.

Stock-based compensation expense for the six months ended June 30, 2014 and 2013 was approximately $948,000 and $1,057,000, respectively. Of this, the Company recognized approximately $46,600 and $44,000 of expense related to non-employee stock options for the same period.

Employee Stock Purchase Plan

The Company s Employee Stock Purchase Plan (**ESPP**) allows employees to contribute a percentage of their cash earnings, subject to certain maximum amounts, to be used to purchase shares of the Company s common stock on each of two semi-annual purchase dates. The purchase price is equal to 90% of the market value per share on either (a) the date of grant of a purchase right under the ESPP or (b) the date on which such purchase right is deemed exercised, whichever is lower. The maximum number of shares available for issuance pursuant to the ESPP is equal to 113,333 shares.

Table of Contents

The Company is currently using the Black-Scholes option-pricing model to determine the fair value of the ESPP stock rights. There were no stock rights issued during the three and six months ended June 30, 2013. For stock rights issued in the three and six months ended June 30, 2014, the following assumptions were used:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2014	2013	2014	2013
Weighted average risk-free interest rate	0.09%	N/A	0.09%	N/A
Weighted average expected volatility	94.99%	N/A	94.99%	N/A
Weighted average expected lives (years)	0.50	N/A	0.50	N/A
Weighted average expected dividend yield	0.00%	N/A	0.00%	N/A

The weighted average fair value of stock rights issued during the three and six month periods ended June 30, 2014 was $0.88. No stock rights were issued during the three and six month periods ended June 30, 2013.

The risk-free interest rate used was based upon the prevailing short-term interest rates. The Company s expected volatility is based upon the volatility of a composition of comparable companies for the expected term. The expected life assumption was based upon the purchase period and the dividend yield assumption of zero is based upon the fact that the Company has never paid cash dividends and presently has no intention of paying cash dividends.

The Company recorded $6,600 and $13,200 of stock-based compensation expense for the three and six months ended June 30, 2014 related to the ESPP.

7. Subsequent Events

From July 1, 2014 to August 8, 2014 there were 494 shares of Series A-1 Preferred Stock converted into 1,204,158 shares of common stock.

On July 10, 2014, the Company filed a Certificate of Amendment with the Secretary of State of the State of Delaware amending the Company s previously filed Amended and Restated Certificate of Incorporation to decrease the total number of shares of common stock authorized to 100,000,000. The decrease in the total number of shares of common stock authorized was approved by the Company s shareholders at the Company s Annual Meeting of Stockholders held on June 2, 2014.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In this document, we, our, ours, us, RXi and the Company refer to RXi Pharmaceuticals Corporation.

This management s discussion and analysis of financial condition as of June 30, 2014 and results of operations for the three and six months ended June 30, 2014 and 2013 should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2013 which was filed with the SEC on March 28, 2014.

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements can be identified by words such as intend, believe, indicate, plan, expect, may, should, designed to, will and similar references. Such statements include, but are not limited to, statements about: our ability to successfully develop RXI-109 and our other product candidates; the timing and future success of our clinical trials with RXI-109; our expectation that we will complete our Phase 2 clinical trials for RXI-109 within anticipated time periods and budgets; our ability to implement cost-saving measures and statements about other future expectations. Forward-looking statements are neither historical facts nor assurances of future performance. These statements are based only on our current beliefs, expectations and assumptions regarding the future of our business, future plans and strategies, projections, anticipated events and trends, the economy and other future conditions. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Our actual results and financial condition may differ materially from those indicated in the forward-looking statements. Therefore, you should not rely on any of these forward-looking statements. Important factors that could cause our actual results and financial condition to differ materially from those indicated in the forward-looking statements include, among others: the risk that our clinical trials with RXI-109 may not be successful in evaluating the safety and tolerability of RXI-109 or providing preliminary evidence of the reduction of formation of surgical scars; the successful and timely completion of clinical trials; uncertainties regarding the regulatory process; the availability of funds and resources to pursue our research and development projects, including our clinical trials with RXI-109; and those identified in our Annual Report on Form 10-K for the year ended December 31, 2013 under the heading Risk Factors, and in other filings the Company periodically makes with the Securities and Exchange Commission. Forward-looking statements contained in this Quarterly Report on Form 10-Q speak as of the date hereof and the Company does not undertake to update any of these forward-looking statements to reflect a change in its views or events or circumstances that occur after the date of this report.

Overview

We are a biotechnology company focused on discovering, developing and commercializing innovative therapies based on our proprietary, next-generation RNAi platform. Therapeutics that use RNA interference, or RNAi, have great promise because of their ability to silence, or

Table of Contents

down-regulate, the expression of a specific gene that may be over-expressed in a disease condition. The Company s first RNAi product candidate, RXI-109, commenced human clinical trials in 2012. RXI-109 targets connective tissue growth factor (**CTGF**), a key regulator of fibrosis and scar formation, and is initially being developed to reduce or inhibit scar formation in the skin following surgery. The Company s pipeline includes a clinical program in anti-scarring, a pre-clinical program in ophthalmology and a discovery program to identify other potential sd-rxRNA® lead compounds and targets, as well as those that target other key enzymes in dermatology and ophthalmology, from the RNAi-related assets acquired from OPKO Health, Inc. (**OPKO**).

By utilizing the expertise in RNAi and the comprehensive RNAi platform that we have established, we believe that we have discovered and will be able to discover and develop lead compounds and progress them into and through clinical development for potential commercialization. Our proprietary therapeutic platform is comprised of novel RNAi compounds, referred to as rxRNA® compounds, that are distinct from, and we believe convey significant advantages over, conventional siRNA (conventionally-designed small interfering RNA compounds), and offer many of the properties that we believe are important to the clinical development of RNAi-based drugs. We have developed a number of unique forms of rxRNA compounds, all of which have been shown to be highly potent both *in vitro* and in preclinical *in vivo* models. These RNAi compounds include rxRNAori® and sd-rxRNA, or self-delivering RNA. Based on our research, we believe that these different, novel siRNA configurations have various potential advantages for therapeutic use. These potential advantages include high potency, increased resistance to nucleases and modifications to eliminate off-target effects, and, in the case of the sd-rxRNA compounds, access to cells and tissues with no additional formulation required, and, hence, reduced toxicity, which is known to be an issue with unmodified siRNAs.

Clinical Development Program

Our lead clinical product candidate is RXI-109, a self-delivering RNAi compound (sd-rxRNA) being developed for the reduction of dermal scarring. RXI-109 is designed to reduce the expression of CTGF, a critical regulator of several biological pathways involved in scarring and fibrotic diseases. RXI-109 is being developed to prevent or reduce dermal scarring following surgery or trauma, as well as for the management of hypertrophic scars and keloids.

In June 2012, we initiated our first clinical trial of RXI-109, known as Study 1201. Study 1201 was designed to evaluate the safety and tolerability of several single-dose levels of RXI-109 in humans. Study 1201 enrolled fifteen subjects in a single-center, randomized, single-dose, double-blind, ascending dose, within-subject controlled study of RXI-109 for the treatment of incision scars, during which single, intradermal injections of escalating doses were administered. Subjects received an injection of RXI-109 in two separate areas on the abdomen and placebo injections in two other areas of the abdomen, followed by a small incision at each injection site. RXI-109 was well tolerated by intradermal injection. No serious local or systemic side effects were observed in the subjects at any of the doses administered, and maximum systemic exposure after intradermal administration was assessed at approximately 5% of the total dose administered. In this study, RXI-109 showed excellent safety and tolerability with ascending single doses and significantly reduced the expression of CTGF protein in the wounded area in a dose-dependent manner 84 days after a single dose, suggesting a potent and long lasting effect on this key biomarker for abnormal scarring.

In December 2012, we initiated a second Phase 1 clinical trial with RXI-109, known as Study 1202. Study 1202 was designed to evaluate the safety and tolerability of multi-dose administration of RXI-109 in healthy volunteers, including an evaluation of surrogate end points of clinical efficacy. In total, Study 1202 enrolled fifteen subjects (5 cohorts of 3 subjects each) in a single-center, randomized, multi-dose, double-blind, ascending dose, within-subject controlled study of RXI-109 for the treatment of incision scars. Eight small skin incisions were made in their abdomen and subjects received treatment with RXI-109 at the four incision sites on one side of the abdomen and placebo treatment at the four incision sites on the other side of the abdomen. Treatments were given by three intradermal

injections over a 2-week period. Subjects were monitored for safety and local and systemic effects over a total study period of 84 days. Multiple dermal injections were well tolerated at all dose levels. Treatment with RXI-109 demonstrated a trend for dose-dependent silencing of CTGF mRNA in the treated areas, resulting in 43-50% reduction of CTGF mRNA levels compared to the placebo when measured three days after the last dose. In one of two highest-dose cohorts, the dosing period was delayed by two weeks after the incisions were made. No additional benefit was seen on mRNA reduction.

Based on the safety profile shown in our two Phase 1 clinical trials, we initiated a Phase 2 clinical trial for RXI-109 in November 2013 known as Study 1301. In this study, patients with a long hypertrophic scar in the lower abdominal area are eligible to receive scar revision surgery and subsequent treatment with RXI-109 in one of two treatment regimens. Hypertrophic scars are abnormal scars that are raised above the normal skin surface and can be reddened or darker than the existing skin tone. These scars result in part from an increased level of collagen and are less elastic than the surrounding skin. With this study, patients receive RXI-109 and placebo on a blinded basis at the distal ends of their revised scar, leaving a central untreated section of the scar. Each patient s revised scar area will provide the opportunity to compare the appearance of the revised areas after treatment with RXI-109 or placebo or when left untreated. This design allows for intra-subject comparison of the three revised scar segments, thereby increasing the power of the study. The Company expects to get an early read-out, on the first two cohorts, of possible clinical effect of RXI-109 on a blinded basis before the end of 2014.

The Company initiated a second Phase 2 clinical trial for RXI-109 in April 2014 for treatment to prevent keloid recurrence in patients undergoing keloidectomy (removal of a keloid). Keloids are raised and reddened or darkened scars resulting from increased collagen production, but keloids often spread beyond the original site of skin injury and may continue to grow in size. Keloids can result from skin trauma as common as an ear piercing or vaccination and may grow to cover large areas. Keloids are sometimes removed by surgical revision, but recurrence rates are as high as 50-80%. In this study, known as Study 1401, patients with two keloids of similar size and location are selected for keloidectomy. After this procedure, the lesions are closed and one is treated with RXI-109, and the other is treated with placebo. This second Phase 2 study will follow patients for six months to evaluate the clinical evolution of the lesions, which, in these patients, have a high risk for recurrence of keloids.

The Company further expanded its clinical program with the initiation of a third Phase 2 clinical trial with RXI-109 for the treatment of hypertrophic scars in July 2014. This study, called Study 1402, will enroll patients with either one long hypertrophic scar, or two scars comparable in length, anatomical location and characteristics for scar revision surgery. For a single scar, a portion of the revised scar segment will be treated with RXI-109 and a comparable sized length on the opposite end of the excised scar segment will be left untreated. If two scars are revised, a portion of one revised scar segment will be treated with RXI-109 and one scar will be left untreated after revision surgery. Study 1402 will follow patients for nine months to evaluate the effectiveness of RXI-109 in preventing scar formation.

Table of Contents

Ophthalmology Preclinical Programs

While focusing our efforts on our RXI-109 development program, we also intend to continue to advance our ophthalmology franchise both on our own and through collaborations with academic and corporate third parties. The current areas of focus for the Company are retinal scarring and other ocular fibrosis disorders, neovascularization and retinoblastoma. For example, retinal scarring in proliferative vitreoretinopathy (**PVR**) occurs in approximately 8-10% of patients as a complication of retinal detachment. In age-related macular degeneration (**AMD**), a leading cause of severe visual impairment in people over age 50, blood vessels grow into the retina (neovascularization) and disrupt vision. Current available therapies for AMD rely on suppression of vascular endothelial growth factor (**VEGF**) to address the neovascularization component of AMD, but not the subsequent retinal scarring that often occurs over time. Treatment with RXI-109 to reduce retinal scarring along with current standard of care options or our own VEGF sd-rxRNA could provide benefit to these patients. Retinoblastoma is a childhood cancer that originates in the retina. If not detected early, retinoblastoma can lead to loss of the affected eye or death. Early intervention often involves the use of chemotherapy and can be successful in preserving the eye. Development of an sd-rxRNA that could block the growth of the retinoblastoma tumor is underway and could potentially be of great benefit.

Current programs in the discovery and preclinical stages include:

- a Small Business Innovation Research grant to evaluate and develop sd-rxRNAs as potential therapeutics for the treatment of retinoblastoma; and

- a collaboration evaluating the potential to use a CTGF-targeting sd-rxRNA as a therapeutic to reduce or inhibit retinal scarring, which often occurs as a consequence of some retinal diseases and following retinal detachment.

We have preclinical data *in vivo* in retinal scarring and retinoblastoma and have completed a dose-range finding ocular toxicity study for RXI-109 in non-human primates. In May 2014, we announced results from the assessment of CTGF protein levels following intravitreal injection of RXI-109 in the eyes of cynomolgus monkeys as part of a dose-range finding study. Intravitreal administration of RXI-109 resulted in a reduction of CTGF protein levels in a dose-dependent manner in the retina, as well as in the cornea. The Company s projected next steps are to file an investigational new drug application (**IND**) for the use of RXI-109 as an ocular therapy to reduce the formation of retinal scarring after we obtain the results of the upcoming ocular toxicity studies. The new IND will cross-reference the current RXI-109 anti-scarring IND.

Discovery Program

In March 2013, the Company entered into an asset purchase agreement with OPKO pursuant to which we acquired substantially all of OPKO s RNAi-related assets, including patents, licenses, clinical and preclinical data and other related assets. The assets purchased from OPKO are at an early stage of development and the Company has established a program to identify potential sd-rxRNA lead compounds and targets from the assets acquired, as well as those that target other key enzymes in dermatology and ophthalmology, with a focus on Bevasiranib. Development of Bevasiranib, a VEGF-targeting siRNA for the treatment of wet age-related macular degeneration, was halted by OPKO in Phase 3. Wet age-related macular degeneration is a late form of age-related macular degeneration and is the leading cause of severe visual impairment in people over age 50. We are working to improve Bevasiranib by converting it to our proprietary sd-rxRNA format which would allow effective cellular uptake and activity in the retina. Reduction of VEGF in the retina of the eye is known to reduce the neovascularization in wet age-related

macular degeneration. We also intend to pursue evaluation of other targets and compounds in the acquired OPKO portfolio.

Future Potential Applications of RXI-109

Overexpression of CTGF is implicated in dermal scarring and fibrotic disease, and because of this, we believe that RXI-109 or other CTGF-targeting RNAi compounds may be able to treat other fibrotic indications, including pulmonary fibrosis, liver fibrosis, acute spinal injury, ocular scarring, joint fibrosis and vascular restenosis. If the current clinical trials of RXI-109 produce successful results in dermal anti-scarring, we may explore opportunities in these additional indications, as well as other possible dermatology applications (e.g., cutaneous scleroderma).

Market Opportunity

There are currently no FDA-approved therapeutics in the United States for the treatment and prevention of scars in the skin. However, there are over 42 million procedures in the United States each year that could potentially benefit from a therapeutic treatment that could successfully reduce or prevent scarring; thus, the market potential is quite large. According to the American Society for Plastic Surgery, there were 177,000 scar revision surgeries alone in 2013[1]. In addition to cosmetic and reconstructive surgeries, medical interventions which could incorporate an anti-scarring agent include scarring that results from trauma, surgery or burns (especially relating to raised or hypertrophic scarring or contracture scarring), surgical revision of existing unsatisfactory scars, and in the treatment, removal and inhibition of keloids (scars which extend beyond the original skin injury).

In November 2013, we signed a distribution agreement with Ethicor Ltd. (**Ethicor**), a UK-based unlicensed medicinal products (**Specials**) pharmaceutical company. The agreement provides Ethicor with the distribution rights to RXI-109 in the European Union, with the possibility to negotiate in the future to extend such rights to other regions of the world, excluding the United States, Canada and Mexico. If approved for commercialization, Ethicor will pay us a double-digit percentage of any gross profits from its sales of RXI-109. Ethicor s distribution rights continue until the agreement is terminated; provided, however, that should we obtain marketing authorization for RXI-109 in any of the countries covered by the agreement, we have the option to terminate the agreement with respect to each such country in which marketing authorization has been obtained. Under the European medicines legislation (Directive 2001/83/EC, Article 5(1)), we expect that Ethicor will be able to supply, prior to regulatory approval, RXI-109 as a Special drug. A Special drug may be requested by an authorized

Table of Contents

health-care professional to meet the special needs of an individual patient under their direct responsibility. The collaboration is important for health-care professionals and patients who can get safe controlled early access to a development drug and is a significant milestone for the Company, not only in possible early revenue, but as increased exposure to RXI-109 may be key in accelerating the development of our drug. The Company has not yet generated product revenue and expects minimal revenue during the early stages of the distribution agreement with Ethicor.

Research and Development

To date, our research programs have focused on identifying product candidates and optimizing the delivery technology necessary to make RNAi compounds available by local administration for diseases for which we intend to develop an RNAi therapeutic. Since we commenced operations, research and development has comprised a significant proportion of our total operating expenses and is expected to comprise the majority of our spending for the foreseeable future.

There are risks in any new field of drug discovery that preclude certainty regarding the successful development of a product. We cannot reasonably estimate or know the nature, timing and costs of the efforts necessary to complete the development of, or the period in which material net cash inflows are expected to commence from, any product candidate. Our inability to make these estimates results from the uncertainty of numerous factors, including but not limited to:

Our ability to advance product candidates into preclinical research and clinical trials;

The scope and rate of progress of our preclinical program and other research and development activities;

The scope, rate of progress and cost of any clinical trials we commence;

The cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights;

Clinical trial results;

The terms and timing of any collaborative, licensing and other arrangements that we may establish;

The cost and timing of regulatory approvals;

The cost of establishing clinical and commercial supplies of our product candidates and any products that we may develop;

The cost and timing of establishing sales, marketing and distribution capabilities;

The effect of competing technological and market developments; and

The effect of government regulation and insurance industry efforts to control healthcare costs through reimbursement policy and other cost management strategies.

Failure to complete any stage of the development of our product candidates in a timely manner could have a material adverse effect on our operations, financial position and liquidity.

Critical Accounting Policies and Estimates

There have been no significant changes to our critical accounting policies since the beginning of this fiscal year. Our critical accounting policies are described in the Management s Discussion and Analysis of Financial Condition and Results of Operations section of our Annual Report on Form 10-K for the year ended December 31, 2013, which we filed with the SEC on March 28, 2014.

Results of Operations

The following data summarizes the results of our operations for the periods indicated, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	**2013**	**2014**	**2013**
Revenues	$ 12	$ 225	$ 41	$ 278
Research and development expenses	(1,183)	(1,213)	(2,659)	(14,985)
General and administrative expenses	(850)	(977)	(1,693)	(1,652)
Operating loss	(2,021)	(1,965)	(4,311)	(16,359)
Net loss	(2,006)	(1,961)	(4,290)	(16,358)
Net loss applicable to common stockholders	$ (3,219)	$ (4,360)	$ (7,258)	$ (22,304)

[1] American Society of Plastic Surgeons Reports 15.1 Million Cosmetic Procedures in 2013; Marks Fourth Consecutive Year of Growth, American Society of Plastic Surgeons press release, February 26, 2014 on the American Society of Plastic Surgeons Website, http://www.plasticsurgery.org/news/plastic-surgery-procedures-continue-steady-growth-in-us.html.

Table of Contents

Comparison of the Three and Six Months Ended June 30, 2014 and 2013

Revenues

To date, we have generated revenues through government grants. The following table summarizes our total revenues from government grants, for the periods indicated, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Grant revenues	$ 12	$ 225	$ 41	$ 278

Total revenues were approximately $12,000 for the three months ended June 30, 2014, compared with $225,000 for the three months ended June 30, 2013. The decrease of $213,000, or 95%, was due to the number of the Company s outstanding government grants and a reduction of work related to the grants during the three months ended June 30, 2014 as compared with the same period in the prior year.

Total revenues were approximately $41,000 for the six months ended June 30, 2014, compared with $278,000 for the six months ended June 30, 2013. The decrease of $237,000, or 85%, was due to the number of the Company s outstanding government grants and a reduction of work related to the grants during the six months ended June 30, 2014 as compared with the same period in the prior year.

The Company had $78,000 of deferred revenue at June 30, 2014, which consists of receipt of grant awards from the government, but which we have not yet recognized, pursuant to our revenue recognition policies, as the work has not been completed.

For the foreseeable future, we expect our revenue to continue to be derived primarily from government grants and we expect the amount of our grant revenue to fluctuate period to period.

Operating Expenses

The following table summarizes our total operating expenses, for the periods indicated, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Research and development expenses	$ 1,183	$ 1,213	$ 2,659	$ 14,985
General and administrative expenses	850	977	1,693	1,652
Total operating expenses	$ 2,033	$ 2,190	$ 4,352	$ 16,637

Research and Development Expenses

Research and development expenses consist of compensation-related costs for our employees dedicated to research and development activities, fees related to our Scientific Advisory Board members, expenses related to our ongoing research and development efforts primarily related to our clinical trials, drug manufacturing, outside contract services, licensing and patent fees and laboratory supplies and services for our research programs. We expect research and development expenses to increase as we expand our clinical, development and discovery activities.

Total research and development expenses were approximately $1,183,000 for the three months ended June 30, 2014, compared with $1,213,000 for the three months ended June 30, 2013. The decrease of $30,000, or 2%, was due to a decrease of $100,000 related to research and development expenses primarily due to costs for the manufacture of RXI-109 incurred during this period in 2013 offset by an increases of $18,000 in non-employee stock-based compensation expense related to the change in the fair value of options and $52,000 in employee stock-based compensation expense.

Total research and development expenses were approximately $2,659,000 for the six months ended June 30, 2014, compared with $14,985,000 for the six months ended June 30, 2013. The decrease of $12,326,000, or 82%, was primarily due to a decrease of $12,250,000 related to the one-time charge for the fair value of common stock issued in exchange for patent and technology rights acquired from OPKO in March 2013, a decrease of $138,000 in employee stock-based compensation expense and a decrease of $7,000 in non-employee stock-based compensation related to the change in the fair value of options offset by an increase of $69,000 in research and development expense primarily due to a one-time milestone payment to Advirna, LLC upon the issuance of our first patent on March 4, 2014.

General and Administrative Expenses

General and administrative expenses consist primarily of compensation-related costs for our employees dedicated to general and administrative activities, legal fees, audit and tax fees, consultants, professional services and general corporate expenses.

General and administrative expenses were approximately $850,000 for the three months ended June 30, 2014, compared with $977,000 for the three months ended June 30, 2013. The decrease of $127,000, or 13%, was primarily due to decreases of $85,000 in general and administrative expenses due to decreases in legal and consulting fees as compared with the same period in the prior year and $42,000 in employee stock-based compensation expense.

General and administrative expenses were approximately $1,693,000 for the six months ended June 30, 2014, compared with $1,652,000 for the six months ended June 30, 2013. The increase of $41,000, or 2%, was primarily due to an increase in employee stock-based compensation expense.

Table of Contents

Series A and Series A-1 Preferred Stock Dividends

The following table summarizes our Series A and Series A-1 Preferred Stock dividends for the periods indicated, in thousands:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Series A and Series A-1 Preferred Stock dividends	$ 1,213	$ 2,399	$ 2,968	$ 5,946

Series A and Series A-1 Preferred Stock dividends were approximately $1,213,000 for the three months ended June 30, 2014, compared with $2,399,000 for the three months ended June 30, 2013. The decrease of $1,186,000, or 49%, was due to changes in the Company s closing common stock price on the dividend payment dates and the number of preferred shares earning dividends each quarter.

Series A and Series A-1 Preferred Stock dividends were approximately $2,968,000 for the six months ended June 30, 2014, compared with $5,946,000 for the six months ended June 30, 2013. The decrease of $2,978,000, or 50%, was due to changes in the Company s closing common stock price on the dividend payment dates and the number of preferred shares earning dividends each quarter.

The rights and preferences of the Series A and Series A-1 Preferred Stock and the calculation of the dividend payable, are described further in Notes 4 and 5 of the financial statements.

Liquidity and Capital Resources

We expect to incur significant operating losses as we advance our product candidates through the drug development and regulatory process. We have generated significant losses to date, have not generated any product revenue to date and may not generate significant product revenue in the foreseeable future, if ever. In the future, we will be dependent on obtaining funding from third parties, such as proceeds from the issuance of debt, sale of equity, funded research and development programs and payments under partnership and collaborative agreements, in order to maintain our operations and meet our obligations to licensors. There is no guarantee that debt, additional equity or other funding will be available to the Company on acceptable terms, or at all. If we fail to obtain additional funding when needed, we may be forced to scale back or terminate operations or to seek to merge with or to be acquired by another company.

We had cash and cash equivalents of approximately $11.9 million as of June 30, 2014, compared with approximately $14.4 million in cash, cash equivalents and short-term investments as of December 31, 2013.

On April 22, 2014, the Company entered into a purchase agreement with Lincoln Park Capital Fund, LLC (**LPC**), pursuant to which the Company has the right to sell to LPC up to $20 million in shares of our common stock over the 30-month term of the agreement. Under the agreement, LPC purchased $2,000,000 in shares of our common stock on April 22, 2014 at $4.00 per share.

The Company believes that its existing cash and cash equivalents will be sufficient to fund the Company s operations, including the current and the planned Phase 2 programs for RXI-109, into fiscal 2015.

Net Cash Flow from Operating Activities

Net cash used in operating activities was approximately $4,397,000 for the six months ended June 30, 2014 and was primarily due to the Company s net loss and a decrease in accrued expenses and other current liabilities. Net cash used in operating activities was approximately $3,184,000 for the six months ended June 30, 2013 and was primarily due to the Company s net loss as adjusted for non-cash expense for the fair value of common stock issued in exchange for technology rights. In addition, net cash used in operating activities is adjusted for other non-cash items to reconcile net loss to net cash used in operating activities. These other non-cash adjustments consist primarily of share-based compensation and depreciation and amortization.

Net Cash Flow from Investing Activities

For the six months ended June 30, 2014, net cash of $2,941,000 provided by investing activities was primarily due to the maturity of $3,000,000 of the Company s short-term investments. Net cash used in vesting activities of $9,002,000 for the six months ended June 30, 2013 was primarily due to the purchase of $9,000,000 in short-term investments.

Net Cash Flow from Financing Activities

Net cash provided by financing activities was approximately $1,977,000 for the six months ended June 30, 2014 and was primarily due to net proceeds of $1,947,000 for the issuance of 600,000 shares of our common stock to LPC. For the six months ended June 30, 2013, net cash provided by financing activities was approximately $15,646,000 and was primarily due to net proceeds of $15,651,000 received from the issuance of approximately 3.8 million shares of our common stock in a private offering during the prior year period.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements or relationships.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-Q, Dr. Geert Cauwenbergh, our Chief Executive Officer and acting Chief Financial Officer (the **Certifying Officer**), evaluated the effectiveness of our disclosure controls and procedures. Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 (the **Exchange Act**), such as this Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms. Disclosure controls and procedures are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Certifying Officer, as appropriate to allow timely decisions regarding required disclosure. Based on these evaluations, the Certifying Officer has concluded, that, as of the end of the period covered by this quarterly report on Form 10-Q:

(a) our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports we file or submit under the Exchange Act was recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms; and

(b) our disclosure controls and procedures were effective to provide reasonable assurance that material information required to be disclosed by us in the reports we file or submit under the Exchange Act was accumulated and communicated to our management, including the Certifying Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There has not been any change in our internal control over financial reporting that occurred during the quarterly period ended June 30, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 1A. RISK FACTORS

You should consider the Risk Factors included under Item 1A. of our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on March 28, 2014.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

EXHIBIT INDEX

Exhibit Number	Description
31.1	Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer and Chief Financial Officer.
32.1	Sarbanes-Oxley Act Section 906 Certification of Chief Executive Officer and Chief Financial Officer.
101	The following financial information from the Quarterly Report on Form 10-Q of RXi Pharmaceuticals Corporation for the quarter ended June 30, 2014, formatted in XBRL (eXtensible Business Reporting Language): (1) Condensed Balance Sheets as of June 30, 2014 and December 31, 2013; (2) Condensed Statements of Operations for the three and six months ended June 30, 2014 and 2013; (3) Condensed Statements of Cash Flows for the six months ended June 30, 2014 and 2013; and (4) Notes to Condensed Financial Statements (Unaudited).*

* In accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 and 12 of the Securities Act, is deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections, is not part of any registration statement or prospectus to which it relates and is not incorporated by reference into any registration statement, prospectus or other document.

Table of Contents

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.

RXi Pharmaceuticals Corporation (Registrant)

By: /s/ Geert Cauwenbergh
Geert Cauwenbergh, Dr. Med. Sc.
President, Chief Executive Officer and
Chief Financial Officer

Date: August 14, 2014