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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended December 31, 2004.

☐ **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 Number)**
P.O. Box 14287 **79 T.W. Alexander Drive** **4401 Research Commons, Suite 200** **Research Triangle Park, NC** **(Address of Principal Executive Office)**	**27709** **(Zip Code)**

Registrant's Telephone Number, Including Area Code 919-558-8688

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

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 February 7, 2005**
Common Stock, par value $.01	13,975,760 Shares

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AEOLUS PHARMACEUTICALS, INC.

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

	December 31, 2004	September 30, 2004
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 5,047	$ 7,381
Accounts receivable	78	131
Prepaids and other current assets	113	118
Total current assets	5,238	7,630
Property and equipment, net	12	15
Other assets	211	211
Total assets	$ 5,461	$ 7,856
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 775	$ 1,185
Accrued expenses	58	102
Liabilities of discontinued operations	215	250
Total current liabilities	1,048	1,537
Long-term note payable	806	787
Total liabilities	1,854	2,324
Stockholders' equity:		
Preferred stock, $.01 par value per share, 3,000,000 shares authorized: Series B nonredeemable convertible preferred stock, 600,000 shares authorized; 503,544 shares issued and outstanding	5	5
Common stock, $.01 par value per share, 50,000,000 shares authorized; 13,947,303 shares issued and outstanding	139	139
Additional paid-in capital	145,608	145,576
Accumulated deficit	(142,145)	(140,188)
Total stockholders' equity	3,607	5,532
Total liabilities and stockholders' equity	$ 5,461	$ 7,856

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

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AEOLUS PHARMACEUTICALS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share data)

	Three Months Ended December 31,	
	2004	2003
Revenue:		
Grant income	$ 109	$ 47
Costs and expenses:		
Research and development	1,620	1,628
General and administrative	450	713
Total costs and expenses	2,070	2,341
Loss from operations	(1,961)	(2,294)
Interest expense, net	(2)	(49)
Other income	6	—
Net loss	(1,957)	(2,343)
Preferred stock dividend accreted	—	(135)
Net loss attributable to common stockholders	$ (1,957)	$(2,478)
Net loss per weighted share attributable to common stockholders:		
Basic and diluted	$ (0.14)	$ (0.86)
Weighted average common shares outstanding:		
Basic and diluted	13,947	2,877

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

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AEOLUS PHARMACEUTICALS, INC.

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

	Three Months Ended December 31,	
	2004	2003
Cash flows from operating activities:		
Net loss	$(1,957)	$ (2,343)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3	3
Noncash compensation	23	104
Noncash consulting fees	9	64
Noncash interest expense	19	50
Amortization of debt issuance costs	—	15
Change in assets and liabilities:		
Accounts receivable	53	—
Prepaids and other assets	5	34
Accounts payable and accrued expenses	(489)	604
Net cash used in operating activities	(2,334)	(1,469)
Cash flows from financing activities:		
Proceeds from notes payable	—	1,000
Net cash provided by financing activities	—	1,000
Net decrease in cash and cash equivalents	(2,334)	(469)
Cash and cash equivalents at beginning of period	7,381	586
Cash and cash equivalents at end of period	$ 5,047	$ 117
Supplemental disclosure of noncash activities:		
Series C preferred stock dividend accreted	$ —	$ 135
Common stock issued in exchange for note payable and accrued interest	$ —	$ 3,095
Common stock issued in exchange for Series C preferred stock	$ —	$14,637

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

AEOLUS PHARMACEUTICALS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. Basis of Presentation

The Company is developing catalytic antioxidant molecules to protect against the damaging effects of reactive oxygen-derived molecules, commonly referred to as free radicals. In October 2004, the Company initiated a Phase 1 clinical trial for amyotrophic lateral sclerosis ("ALS", also known as Lou Gehrig's disease).

The "Company" refers collectively to Aeolus Pharmaceuticals, Inc., a Delaware corporation ("Aeolus") and its wholly owned subsidiary, Aeolus Sciences, Inc., a Delaware corporation. The Company also has a 35.0% equity interest in CPEC LLC, a Delaware limited liability company, which had minimal activity during the three months ended December 31, 2004. The Company uses the equity method to account for its investment in CPEC. The Company's primary operations are located in Research Triangle Park, North Carolina. On July 16, 2004, the Company effected a one-for-ten reverse stock split of its common stock and changed its name from Incara Pharmaceuticals Corporation to Aeolus Pharmaceuticals, Inc. All common stock amounts in these financial statements have been adjusted for the reverse stock split.

All significant intercompany activity has been eliminated in the preparation of the consolidated financial statements. The unaudited 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 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 consolidated balance sheet at September 30, 2004 was derived from the Company's audited financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2004. The unaudited consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and the notes thereto included in that Annual Report on Form 10-K and in the Company's other SEC filings. Results for the interim period are not necessarily indicative of the results for any other period.

B. Liquidity

The Company incurred operating losses of $1,961,000 and $11,977,000 for the three months ended December 31, 2004 and for the fiscal year ended September 30, 2004, respectively. The Company expects to incur additional losses in fiscal 2005 and for several more years.

Management believes it has adequate financial resources to fund its operations through fiscal 2005, but in order to fund on-going operating cash requirements beyond fiscal 2005, or to accelerate or expand its programs, the Company needs to raise significant additional funds. The

Company intends to explore strategic and financial alternatives, including the sale of shares of stock, the establishment of new collaborations for current research programs that include initial cash payments and on-going research support and the out-licensing of our compounds for development by a third party.

If the Company is unable to obtain additional financing to fund operations beyond fiscal 2005, 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.

C. Recent Accounting Pronouncements

In 2003, the Financial Accounting Standards Board (the "FASB") Emerging Issues Task Force ("EITF") reached a tentative conclusion on Issue 03-06, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share" that the two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common stockholders, but does not require the presentation of basic and diluted EPS for securities other than common stock. However, the EITF observed that the presentation of basic and diluted earnings per share for a participating security other than common stock is not precluded. The Company believes that this EITF conclusion will not have any effect on its current presentation of earnings per share.

In December 2004, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123R requires companies to expense the value of employee stock options and similar awards. Share-based payments will be measured at fair value on the grant date, based on the estimated number of awards that are expected to vest. SFAS 123R applies to all unvested share-based awards outstanding at the company's adoption date. SFAS 123R eliminates the exception to account for such awards using the intrinsic method previously allowable under Accounting Principals Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). SFAS 123R will be effective for the Company for interim and annual periods beginning after June 15, 2005. The Company is currently evaluating the effect of this pronouncement.

D. Net Loss Per Common Share

The Company computes basic net loss per weighted average share attributable to common stockholders using the weighted average number of shares of common stock outstanding during the period. The Company computes diluted net loss per weighted average shares attributable to common stockholders using the weighted average number of shares of common and dilutive potential common shares outstanding during the period. Potential common shares consist of stock options, restricted common stock, convertible debt, warrants and convertible preferred stock, using the treasury stock method and are excluded if their effect is antidilutive. Diluted weighted average common shares excluded incremental shares of approximately 4,764,000 as of December 31, 2004 related to stock options to purchase common stock, convertible preferred stock, convertible debt and warrants to purchase common and preferred stock. These shares were excluded due to their antidilutive effect as a result of the Company's net loss.

E. Stock-Based Compensation

Under the principles of APB 25, "Accounting for Stock Issued to Employees", the Company does not recognize compensation expense associated with the grant of stock options to employees unless an option is granted with an exercise price at less than fair market value. SFAS No. 123, "Accounting for Stock Based Compensation" ("SFAS 123"), requires the use of option valuation models to recognize as expense stock option grants to consultants and to provide supplemental information regarding options granted to directors and employees.

For the three months ended December 31, 2004 and 2003, all stock options were issued at or above the fair market value of a share of common stock. During the three months ended December 31, 2004 and 2003, fully vested stock options with a fair market value of $9,000 and $64,000, respectively, were granted to consultants and expensed.

The Company's pro forma information utilizing the Black-Scholes option valuation model is as follows (in thousands, except for net loss per share information):

	Three Months Ended December 31,	
	2004	2003
Net loss attributable to common stockholders as reported	$(1,957)	$(2,478)
Pro forma adjustment for stock-based compensation	(202)	(382)
Pro forma net loss attributable to common stockholders	$(2,159)	$(2,860)
Basic and diluted net loss per weighted share attributable to common stockholders:		
As reported	$ (0.14)	$ (0.86)
Pro forma - adjusted for stock-based compensation	$ (0.15)	$ (0.99)

Pro forma information regarding the Company's net loss was determined as if the Company had accounted for its employee stock options under the fair value method of SFAS 123. The fair value of each option grant for employees and consultants is estimated on the date of the grant using the Black-Scholes option valuation model with the following weighted-average assumptions used for grants:

	Three Months Ended December 31,	
	2004	2003
Dividend yield	0%	0%
Expected volatility	195%	274%
Risk-free interest rate	2.9% - 4.3%	1.2% - 4.7%
Expected option life (in years from vesting)	3	3

F. Commitments and Contingencies

At December 31, 2004, the Company had future contractual operating lease commitments of $699,000 primarily for its administrative office and laboratory facilities, of which $215,000 was accrued as liabilities of discontinued operations on the balance sheet. In December 1999, the Company sold its anti-infectives division ("IRL") to a private pharmaceutical company. The Company remains contingently liable through May 2007 for a lease obligation of approximately $2,369,000 assumed by the purchaser on the former IRL facility in Cranbury, New Jersey.

G. Subsequent Events

Effective December 31, 2004, upon the expiration of his employment agreement, James D. Crapo ceased to be the Chief Executive Officer of the Company. Effective January 5, 2005, Aeolus appointed Richard P. Burgoon, Jr. as its Chief Executive Officer.

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

Introduction

Unless otherwise noted, the phrase "we" or "our" refers 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 our representatives, which are identified or qualified by words such as "likely," "will," "suggests," "expects," "might," "believe," "could," "should," "may," "estimates," "potential," "predict," "continue," "would," "anticipates," "plans," or similar expressions, are based on a number of assumptions that are subject to risks and uncertainties. Actual results could differ materially from those currently anticipated or suggested due to a number of factors, including those set forth herein, those set forth in our Annual Report on Form 10-K for the fiscal year ended September 30, 2004 and in our other SEC filings, and including risks relating to the need to conserve and obtain funds for operations, uncertainties relating to clinical trials, the early stage of products under development and regulatory reviews, new accounting requirements and competition. 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.

Operations Summary

We are developing a new class of small molecule catalytic antioxidants that destroy oxygen-derived free radicals, believed to be an important contributor to the pathogenesis of many diseases. Our catalytic antioxidants have been shown to reduce damage to tissue in animal studies of neurological disorders such as amyotrophic lateral sclerosis (ALS, also known as Lou Gehrig's disease) and stroke, and in other non-neurological indications such as cancer radiation therapy, chronic bronchitis and asthma. In October 2004, we began a Phase 1 clinical trials with our lead compound, AEOL 10150, as a treatment for ALS.

We do not have any revenue, other than grant income, and therefore we must rely on outside investors, grants, collaborations or out-licensing of our compounds to finance our operations.

Effective December 31, 2004, upon the expiration of his employment agreement, James D. Crapo ceased to be our Chief Executive Officer. Effective January 5, 2005, we appointed Richard P. Burgoon, Jr. as our Chief Executive Officer.

Results of Operations

We had a net loss of $1,957,000 for the three months ended December 31, 2004 versus a net loss attributable to common stockholders of $2,478,000 for the three months ended December 31, 2003.

In August 2003, we were awarded a $100,000 Small Business Innovation and Research, or SBIR, Phase I grant from the National Cancer Institute, a division of the National Institutes of Health, or NIH, and in March 2004, we were awarded $375,000 for the first year of a SBIR Phase II grant. Pursuant to the grants, we are studying the antitumor and radiation-protective effects of our catalytic antioxidants. The study is a collaboration between us and the Department of Radiation Oncology at Duke University Medical Center. We recognized $109,000 and $47,000 of grant income during the three months ended December 31, 2004 and 2003, respectively.

Our R&D expenses of $1,620,000 for the three months ended December 31, 2004 were essentially the same as the R&D expenses of $1,628,000 for the three months ended December 31, 2003. Our primary operational focus and R&D spending during the three months ended December 31, 2004 was on conducting our Phase 1 clinical trial for the treatment of ALS while our primary operational focus and R&D spending during the three months ended December 31, 2003 was on preclinical pharmacology and toxicology tests on our lead compound. Therefore, we incurred greater expenses for clinical trial and sponsored research costs in the first three months of fiscal 2005, versus the same period in fiscal 2004, while we incurred less expenses associated with preclinical activities. R&D expenses for our antioxidant program have totaled $25,778,000 from inception through December 31, 2004. Because of the uncertainty of our research and development and clinical studies, we are unable to predict the level of spending and the anticipated program completion date, if any.

General and administrative, or G&A, expenses decreased $263,000, or 37%, to $450,000 for the three months ended December 31, 2004 from $713,000 for the three months ended December 31, 2003. Legal, accounting and filing fees were higher than normal during the three months ended December 31, 2003 due to financing and reorganization activities that occurred during the those months.

We accreted $135,000 of dividends on our Series C preferred stock during the three months ended December 31, 2003. As part of a reorganization effected on November 20, 2003, all shares of Series C preferred stock were converted into common stock.

Liquidity and Capital Resources

At December 31, 2004, we had $5,047,000 of cash, a decrease of $2,334,000 from September 30, 2004. The decrease in cash was primarily due to the $1,957,000 net loss for the three months ended December 31, 2004 and a $489,000 decrease in accounts payable and accrued expenses due to less payables for preclinical activities at December 31, 2004. We believe we have adequate financial resources to conduct operations at least through fiscal 2005.

We incurred operating losses of $1,961,000 and $11,977,000 for the three months ended December 31, 2004 and for the fiscal year ended September 30, 2004, respectively. Due to the nonrecurring charges for financing, reorganization and stock options recognized in fiscal 2004, we anticipate our quarterly operational costs will continue to be lower during fiscal 2005 than they were in fiscal 2004. Our ongoing cash requirements will depend on numerous factors, particularly the progress of our catalytic antioxidant program and clinical trials and our ability to negotiate and complete collaborative agreements or out-licensing arrangements. In order to help

fund our on-going operating cash requirements, we intend to seek new collaborations for our antioxidant research program that include initial cash payments and on-going research support. In addition, we might sell additional shares of our stock and explore other strategic and financial alternatives, including a merger with another company. We also might out-license one or more of our compounds for development by a third party.

There are uncertainties as to these potential sources of capital. Our access to capital might be restricted because we might not be able to enter into any collaboration on terms acceptable or favorable to us 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 a collaboration for our antioxidant program, we might 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 stock offerings, we might not be able to sell additional securities or raise other funds on terms acceptable or favorable to us. It can be difficult for small biotechnology companies such as us to raise funds in the equity markets. Any additional equity financing, if available, would likely result in substantial dilution to existing stockholders.

Recently Issued Accounting Standards

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment”, or SFAS 123R, which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. SFAS 123R requires companies to expense the value of employee stock options and similar awards. Share-based payments will be measured at fair value on the grant date, based on the estimated number of awards that are expected to vest. SFAS 123R applies to all unvested share-based awards outstanding at the company’s adoption date. SFAS 123R eliminates the exception to account for such awards using the intrinsic method previously allowable under Accounting Principals Board Opinion No. 25 “Accounting for Stock Issued to Employees”. SFAS 123R will be effective for interim and annual periods beginning after June 15, 2005. We are currently evaluating the effect of this pronouncement.

Item 4. Controls and Procedures.

(a) As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e)) pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective.

(b) No change in the Company's internal control over financial reporting occurred during the Company's last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 6. Exhibits.

Exhibit #	Description
10.115	Form of incentive stock option agreement
10.116	Form of nonqualified stock option agreement
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

AEOLUS PHARMACEUTICALS, INC.

Date: February 8, 2005

By: /s/ RICHARD P. BURGOON, JR.

Richard P. Burgoon, Jr.
Chief Executive Officer
(Principal Executive Officer)

Date: February 8, 2005

By: /s/ RICHARD W. REICHOW

Richard W. Reichow
Executive Vice President, Chief Financial
Officer and Treasurer
(Principal Financial and Accounting Officer)

Exhibit 10.115

Aeolus Pharmaceuticals, Inc.

Notice of Grant of Stock Options
and Option Agreement

ID: 56-1953785
P.O. Box 14287, 79 T.W. Alexander Dr.
4401 Research Commons, Suite 200
Research Triangle Park, NC 27709-4287

[Optionee Name & address]

Option Number: _____
Plan: **2004**
ID: _____

Effective [option date], you have been granted a(n) Incentive Stock Option to buy _____ shares of Aeolus Pharmaceuticals, Inc. (the Company) stock at [exercise price] per share.

The total option price of the shares granted is $_____.

Shares in each period will become fully vested on the date shown.

Shares	Vest Type	Full Vest	Expiration

By your signature and the Company's signature below, you and the Company agree that these options are granted under and governed by the terms and conditions of the Company's Stock Option Plan as amended and the Option Agreement, all of which are attached and made a part of this document.

Aeolus Pharmaceuticals, Inc.	Date
[Optionee Name]	Date

AEOLUS PHARMACEUTICALS, INC.

1994 STOCK OPTION PLAN

INCENTIVE STOCK OPTION AGREEMENT

AEOLUS PHARMACEUTICALS, INC., a Delaware corporation (the "Company") has adopted the 1994 Stock Option Plan, as amended, (the "Plan"), a copy of which has been provided to Optionee. The Company has granted the Optionee an Incentive Stock Option in accordance with the terms of the Notice of Grant of Stock Options ("Grant Notice") issued to the Optionee. This Option is subject to the terms and conditions of the Plan. Capitalized terms used herein and not defined have the same meanings as set forth in the Plan.

IT IS AGREED as follows:

1. Grant of Option. The Company hereby grants to the Optionee as of the date of the Grant Notice the right and option to purchase (subject to adjustment pursuant to Section 15 of the Plan) the number of shares specified in the Grant Notice of its Common Stock, $.01 par value, ("Common Stock") at an option exercise price per share equal to the exercise price per share specified in the Grant Notice.

2. Option Period. The option granted hereby shall expire on the tenth anniversary of the date of the Option grant, subject to earlier termination as provided in the Plan or this Option Agreement.

3. Exercise of Option.

A. The Optionee may exercise the Option hereby granted to the extent vested, from and after the dates set forth in the Grant Notice on a cumulative basis.

B. The Optionee may exercise all or a portion of the Option (to the extent then exercisable) by delivering to the Company a written notice duly signed by the Optionee stating the number of shares that the Optionee has elected to purchase and accompanied by (i) payment of an amount equal to the full purchase price for the shares to be purchased, or (ii) any other method of payment provided for in the Plan to which the Committee of the Company's Board of Directors administering the Plan may consent. Within twenty days after receipt by the Company of such notice and payment, the Company shall issue the shares in the name of the Optionee and deliver the certificate therefor to the Optionee. No shares shall be issued until full payment therefor has been made, and the Optionee shall have none of the rights of a stockholder with respect to such shares until they are issued.

4. Termination. Nothing contained in this Option Agreement shall confer upon the Optionee any right to remain an employee or consultant of the Company. If the Optionee's position with the Company as an employee or consultant is terminated for any reason, this Option shall be exercisable only as to those shares immediately purchasable by Optionee at the date of termination for the remaining term of the option as specified in the Grant Notice.

5. Non-Transferability of Option. This Option shall not be transferable, other than by will or by the laws of descent and distribution, and may be exercised during the Optionee's lifetime only by the Optionee.

6. Tax Status. The Option hereby granted is intended to qualify as an incentive stock option within the meaning of Section 422 of the Code. If Optionee ceases to be an employee of the Company, this option will cease to be an incentive stock option in accordance with the time frame set forth in the Code.

7. Incorporation of Plan. This Option is subject to, and governed by, all the terms and conditions of the Plan, which are hereby incorporated by reference. The Grant Notice and this Option Agreement, including the Plan incorporated by reference herein, represents the entire agreement among the parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings. In the case of any conflict between the terms of this Agreement and the Plan, the provisions of the Plan shall control.

8. Purchase for Investment. To the extent that the Shares underlying this Option are not registered, as a condition to the exercise in whole or in part of the option hereby granted, each written notice of election shall include a representation by the Optionee that the shares are being purchased for investment and not for distribution or resale.

9. Notices. Any notice to be given by the Optionee hereunder shall be sent to the Company at its principal executive offices, and any notice from the Company to the Optionee shall be sent to the Optionee at Optionee's address set forth in the Grant Notice; all such notices shall be in writing and shall be delivered in person or by registered or certified mail. Either party may change the address to which notices are to be sent by notice in writing given to the other in accordance with the terms hereof.

10. Governing Law. The parties hereto hereby acknowledge and agree that the Option granted hereby is granted in the State of North Carolina and any shares issued upon exercise of the Option will be issued in the State of North Carolina. This Agreement, as well as the grant of such Option and issuance of such shares, is and shall be governed by and construed in accordance with the laws of the State of North Carolina applicable to the agreements made and to be performed entirely within such State.

11. Signatures. The signatures of the Optionee and the Company on the Grant Notice indicate both parties' acceptance to abide by the terms of this Option Agreement and the Plan.

PURCHASE FORM

(To be signed and delivered to
Aeolus Pharmaceuticals, Inc.
upon exercise of the Option)

The undersigned, the holder of the foregoing Option, hereby irrevocably elects to exercise the Stock Option for the purchase of _____ shares of Common Stock of Aeolus Pharmaceuticals, Inc. ("Shares") and herewith makes payment of $_____ ($_____ per share) therefor, plus $_____ ($ per share) for withholding tax, if any, required in connection with the exercise of the Stock Option, and requests that the Certificates for the Shares be issued in the name(s) of, and delivered to the address(es) set forth below.

_____

Signature

_____

Print Name

Dated: , 20__

Issue Certificates in
Following Name:

_____

_____

_____

Address

Exhibit 10.116

Aeolus Pharmaceuticals, Inc.

Notice of Grant of Stock Options
and Option Agreement

ID: 56-1953785
P.O. Box 14287, 79 T.W. Alexander Dr.
4401 Research Commons, Suite 200
Research Triangle Park, NC 27709-4287

[Optionee Name & address]

Option Number: _____
Plan: **2004**
ID: _____

Effective [option date], you have been granted a(n) Non-Qualified Stock Option to buy _____ shares of Aeolus Pharmaceuticals, Inc. (the Company) stock at [exercise price] per share.

The total option price of the shares granted is $_____.

Shares in each period will become fully vested on the date shown.

Shares	Vest Type	Full Vest	Expiration

By your signature and the Company's signature below, you and the Company agree that these options are granted under and governed by the terms and conditions of the Company's Stock Option Plan as amended and the Option Agreement, all of which are attached and made a part of this document.

Aeolus Pharmaceuticals, Inc. Date

[Optionee Name] Date

AEOLUS PHARMACEUTICALS, INC.

2004 STOCK OPTION PLAN

STOCK OPTION AGREEMENT

AEOLUS PHARMACEUTICALS, INC., a Delaware corporation (the "Company") has adopted the 2004 Stock Option Plan (the "Plan"), a copy of which has been provided to Optionee. The Company has granted the Optionee a nonqualified stock option in accordance with the terms of the Notice of Grant of Stock Options ("Grant Notice") issued to the Optionee. This Option is subject to the terms and conditions of the Plan. Capitalized terms used herein and not defined have the same meanings as set forth in the Plan.

IT IS AGREED as follows:

1. Grant of Option. The Company hereby grants to the Optionee as of the date of the Grant Notice the right and option to purchase (subject to adjustment pursuant to Section 15 of the Plan) the number of shares specified in the Grant Notice of its Common Stock, $.01 par value, ("Common Stock") at an option exercise price per share equal to the exercise price per share specified in the Grant Notice.

2. Option Period. The option granted hereby shall expire on the date specified in the Grant Notice, subject to earlier termination as provided in the Plan or this Option Agreement.

3. Exercise of Option.

A. The Optionee may exercise the Option hereby granted to the extent vested, from and after the dates set forth in the Grant Notice on a cumulative basis.

B. The Optionee may exercise all or a portion of the Option (to the extent then exercisable) by delivering to the Company a written notice duly signed by the Optionee stating the number of shares that the Optionee has elected to purchase and accompanied by (i) payment of an amount equal to the full purchase price for the shares to be purchased, or (ii) any other method of payment provided for in the Plan to which the Committee of the Company's Board of Directors administering the Plan may consent. Within twenty days after receipt by the Company of such notice and payment, the Company shall issue the shares in the name of the Optionee and deliver the certificate therefor to the Optionee. No shares shall be issued until full payment therefor has been made, and the Optionee shall have none of the rights of a stockholder with respect to such shares until they are issued.

4. Termination. Nothing contained in this Option Agreement shall confer upon the Optionee any right to remain an employee or consultant of the Company. If the Optionee's position with the Company as an employee or consultant is terminated for any reason, this Option shall be exercisable only as to those shares immediately purchasable by Optionee at the date of termination for the remaining term of the option as specified in the Grant Notice.

5. Limited Transferability of Option. This Option shall be transferable by the Optionee to members of his or her family and otherwise by will or by the laws of descent and distribution. For purposes hereof, family members shall be deemed to include the Optionee's spouse, parents, children, grandparents, grandchildren and any trusts created for the benefit of such individuals. The Optionee shall consummate any such transfer of the Option by the execution of an assignment in writing on a form provided by the Company for such purpose. A copy of any such assignment will be promptly delivered to the Company.

6. Tax Status. The Option hereby granted is not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

7. Incorporation of Plan. This Option is subject to, and governed by, all the terms and conditions of the Plan, which are hereby incorporated by reference. The Grant Notice and this Option Agreement, including the Plan incorporated by reference herein, represents the entire agreement among the parties hereto with respect to the subject matter hereof and supersedes all prior agreements and understandings. In the case of any conflict between the terms of this Agreement and the Plan, the provisions of the Plan shall control.

8. Purchase for Investment. To the extent that the Shares underlying this Option are not registered, as a condition to the exercise in whole or in part of the option hereby granted, each written notice of election shall include a representation by the Optionee that the shares are being purchased for investment and not for distribution or resale.

9. Notices. Any notice to be given by the Optionee hereunder shall be sent to the Company at its principal executive offices, and any notice from the Company to the Optionee shall be sent to the Optionee at Optionee's address set forth in the Grant Notice; all such notices shall be in writing and shall be delivered in person or by registered or certified mail. Either party may change the address to which notices are to be sent by notice in writing given to the other in accordance with the terms hereof.

10. Governing Law. The parties hereto hereby acknowledge and agree that the Option granted hereby is granted in the State of North Carolina and any shares issued upon exercise of the Option will be issued in the State of North Carolina. This Agreement, as well as the grant of such Option and issuance of such shares, is and shall be governed by and construed in accordance with the laws of the State of North Carolina applicable to the agreements made and to be performed entirely within such State.

11. Signatures. The signatures of the Optionee and the Company on the Grant Notice indicate both parties' acceptance to abide by the terms of this Option Agreement and the Plan.

PURCHASE FORM

(To be signed and delivered to
Aeolus Pharmaceuticals, Inc.
upon exercise of the Option)

The undersigned, the holder of the foregoing Option, hereby irrevocably elects to exercise the Stock Option for the purchase of _____ shares of Common Stock of Aeolus Pharmaceuticals, Inc. ("Shares") and herewith makes payment of $_____ ($_____ per share) therefor, plus $_____ ($ per share) for withholding tax, if any, required in connection with the exercise of the Stock Option, and requests that the Certificates for the Shares be issued in the name(s) of, and delivered to the address(es) set forth below.

_____

Signature

_____

Print Name

Dated: _____ __, 20__

Issue Certificates in
Following Name:

_____

_____

_____

Address

_____

Social Security #

EXHIBIT 31.1

CERTIFICATION

I, Richard P. Burgoon, Jr., certify that:

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

Date: February 8, 2005

By: /s/ RICHARD P. BURGOON, JR.

Richard P. Burgoon, Jr.
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

CERTIFICATION

I, Richard W. Reichow, certify that:

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

Date: February 8, 2005

By: /S/ RICHARD W. REICHOW

Richard W. Reichow
Executive Vice President, Chief Financial Officer and Treasurer

EXHIBIT 32.1

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Aeolus Pharmaceuticals, Inc. (the "Company") for the period ended December 31, 2004 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Richard P. Burgoon, Jr., Chief Executive Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ RICHARD P. BURGOON, JR.

Richard P. Burgoon, Jr.
Chief Executive Officer
(Principal Executive Officer)
February 8, 2005

EXHIBIT 32.2

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Aeolus Pharmaceuticals, Inc. (the "Company") for the period ended December 31, 2004 as filed with the Securities and Exchange Commission on or about the date hereof (the "Report"), I, Richard W. Reichow, Executive Vice President and Chief Financial Officer, hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ RICHARD W. REICHOW

Richard W. Reichow
Executive Vice President, Chief Financial Officer and Treasurer
February 8, 2005