

DURECT CORP  
Form 10-Q  
August 02, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2016**

**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 000-31615**

**DURECT CORPORATION**  
**(Exact name of registrant as specified in its charter)**

**Delaware**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**94-3297098**  
**(I.R.S. Employer**  
**Identification No.)**

**10260 Bubb Road**  
**Cupertino, California 95014**

**(Address of principal executive offices, including zip code)**

**(408) 777-1417**

**(Registrant's telephone number, including area code)**

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

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

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition 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  Smaller reporting company

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

As of July 25, 2016, there were 137,410,381 shares of the registrant's Common Stock outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****DURECT CORPORATION****CONDENSED BALANCE SHEETS**

(in thousands)

	<b>June 30, 2016 (unaudited)</b>	<b>December 31, 2015 (Note 1)</b>
<b><u>ASSETS</u></b>		
Current assets:		
Cash and cash equivalents	\$ 8,036	\$ 3,583
Short-term investments	24,523	25,457
Short-term restricted investments	100	
Accounts receivable (net of allowances of \$148 at June 30, 2016 and \$161 at December 31, 2015)	1,855	2,222
Inventories	4,157	3,917
Prepaid expenses and other current assets	2,602	3,142
<b>Total current assets</b>	<b>41,273</b>	<b>38,321</b>
Property and equipment (net of accumulated depreciation of \$21,170 and \$20,971 at June 30, 2016 and December 31, 2015, respectively)	1,382	1,566
Goodwill	6,399	6,399
Long-term investments	1,050	
Long-term restricted investments	150	250
Other long-term assets	236	236
<b>Total assets</b>	<b>\$ 50,490</b>	<b>\$ 46,772</b>
<b><u>LIABILITIES AND STOCKHOLDERS EQUITY</u></b>		
Current liabilities:		
Accounts payable	\$ 1,317	\$ 1,286
Accrued liabilities	4,770	4,970
Contract research liabilities	569	575
Deferred revenue, current portion	1,033	616
<b>Total current liabilities</b>	<b>7,689</b>	<b>7,447</b>
Deferred revenue, non-current portion	2,097	2,269
Long-term debt, net	19,752	19,684
Other long-term liabilities	1,790	2,489
Commitments and contingencies		

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Stockholders' equity:		
Common stock	14	12
Additional paid-in capital	441,572	420,453
Accumulated other comprehensive income (loss)	10	(14)
Accumulated deficit	(422,434)	(405,568)
Stockholders' equity	19,162	14,883
Total liabilities and stockholders' equity	\$ 50,490	\$ 46,772

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

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**DURECT CORPORATION**  
**CONDENSED STATEMENTS OF COMPREHENSIVE LOSS**

(in thousands, except per share amounts)

(unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Collaborative research and development and other revenue (see Note 2)	\$ 371	\$ 1,778	\$ 790	\$ 3,516
Product revenue, net	2,786	2,663	5,975	5,698
<b>Total revenues</b>	<b>3,157</b>	<b>4,441</b>	<b>6,765</b>	<b>9,214</b>
Operating expenses:				
Cost of product revenues	913	1,022	2,155	2,028
Research and development	7,852	5,638	14,477	11,005
Selling, general and administrative	2,888	2,724	5,950	5,544
<b>Total operating expenses</b>	<b>11,653</b>	<b>9,384</b>	<b>22,582</b>	<b>18,577</b>
<b>Loss from operations</b>	<b>(8,496)</b>	<b>(4,943)</b>	<b>(15,817)</b>	<b>(9,363)</b>
Other income (expense):				
Interest and other income	40	23	67	151
Interest expense	(558)	(558)	(1,116)	(1,119)
<b>Net other expense</b>	<b>(518)</b>	<b>(535)</b>	<b>(1,049)</b>	<b>(968)</b>
<b>Net loss</b>	<b>\$ (9,014)</b>	<b>\$ (5,478)</b>	<b>\$ (16,866)</b>	<b>\$ (10,331)</b>
Net change in unrealized gain (loss) on available-for-sale securities, net of reclassification adjustments and taxes	7	(4)	24	(89)
<b>Total comprehensive loss</b>	<b>\$ (9,007)</b>	<b>\$ (5,482)</b>	<b>\$ (16,842)</b>	<b>\$ (10,420)</b>
Net loss per share				
Basic	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.09)
Diluted	\$ (0.07)	\$ (0.05)	\$ (0.13)	\$ (0.09)
Weighted-average shares used in computing net loss per share				
Basic	132,812	118,804	127,480	116,313

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Diluted	132,812	118,804	127,480	116,313
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The accompanying notes are an integral part of these financial statements.

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**DURECT CORPORATION**  
**CONDENSED STATEMENTS OF CASH FLOWS**

(in thousands)

(unaudited)

	<b>Six months ended</b>	
	<b>June 30,</b>	
	<b>2016</b>	<b>2015</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (16,866)	\$ (10,331)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	206	260
Stock-based compensation	1,407	1,274
Amortization of debt issuance costs	68	37
Realized gain from sale of marketable equity security, net of tax		(117)
Net amortization/accretion on investment	(107)	(146)
Changes in assets and liabilities:		
Accounts receivable	367	221
Inventories	(241)	(288)
Prepaid expenses and other assets	540	(137)
Accounts payable	31	(367)
Accrued and other liabilities	257	(24)
Contract research liabilities	(6)	46
Deferred revenue	245	(31)
Total adjustments	2,767	728
Net cash used in operating activities	(14,099)	(9,603)
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(22)	(53)
Purchases of available-for-sale securities	(18,646)	(17,561)
Proceeds from maturities of available-for-sale securities	18,661	17,871
Proceeds from sale of marketable equity security		178
Net cash (used in) provided by investing activities	(7)	435
<b>Cash flows from financing activities</b>		
Payments on equipment financing obligations	(12)	(10)
Net proceeds from issuances of common stock	18,571	12,488
Net cash provided by financing activities	18,559	12,478



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Net increase in cash and cash equivalents	4,453	3,310
Cash and cash equivalents, beginning of the period	3,583	2,680
Cash and cash equivalents, end of the period	\$ 8,036	\$ 5,990

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

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**DURECT CORPORATION**

**NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS**

**Note 1. Summary of Significant Accounting Policies**

***Nature of Operations***

DURECT Corporation (the Company) was incorporated in the state of Delaware on February 6, 1998. The Company is a biopharmaceutical company with research and development programs broadly falling into two categories: (i) new chemical entities derived from our Epigenomics Regulator Program, in which we attempt to discover and develop molecules which have not previously been approved and marketed as therapeutics, and (ii) Drug Delivery Programs, in which we apply our formulation expertise and technologies largely to active pharmaceutical ingredients whose safety and efficacy have previously been established but which we aim to improve in some manner through a new formulation. The Company has several products under development by itself and with third party collaborators. The Company also manufactures and sells osmotic pumps used in laboratory research, and designs, develops and manufactures a wide range of standard and custom biodegradable polymers and excipients for pharmaceutical and medical device clients for use as raw materials in their products. In addition, the Company conducts research and development of pharmaceutical products in collaboration with third party pharmaceutical and biotechnology companies.

***Basis of Presentation***

The accompanying unaudited financial statements include the accounts of the Company. These financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (SEC), and therefore do not include all the information and footnotes necessary for a complete presentation of the Company's results of operations, financial position and cash flows in conformity with U.S. generally accepted accounting principles (U.S. GAAP). The unaudited financial statements reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position at June 30, 2016, the operating results and comprehensive loss for the three and six months ended June 30, 2016 and 2015, and cash flows for the six months ended June 30, 2016 and 2015. The balance sheet as of December 31, 2015 has been derived from audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. These financial statements and notes should be read in conjunction with the Company's audited financial statements and notes thereto, included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2015 filed with the SEC.

The results of operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

***Inventories***

Inventories are stated at the lower of cost or market, with cost determined on a first-in, first-out basis. Inventories, in part, include certain excipients that are sold to a customer and included in products awaiting regulatory approval. These inventories are capitalized based on management's judgment of probable sale prior to their expiration date which in turn is primarily based on non-binding forecasts from our customers as well as management's internal estimates. The valuation of inventory requires management to estimate the value of inventory that may become expired prior to use. The Company may be required to expense previously capitalized inventory costs upon a change in management's judgment, due to, among other potential factors, a denial or delay of approval of a customer's product

by the necessary regulatory bodies, or new information that suggests that the inventory will not be saleable. In addition, these circumstances may cause the Company to record a liability related to minimum purchase agreements that the Company has in place for raw materials. In 2014, the Company recorded charges to cost of goods sold of approximately \$1.6 million, of which approximately \$1.1 million related to the write-down of the cost basis of inventory and \$500,000 related to the accrual of a liability for the minimum purchase commitment for the excipients. As of June 30, 2016, the remaining carrying value of the excipients in the Company's inventory was \$1.2 million. In addition, the Company has remaining unrecorded future purchase commitments totaling \$1.5 million through 2018. In the event that management determines that the Company will not utilize all of these materials, there could be a potential write-off related to this inventory and a reserve for future purchase commitments.

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The Company's inventories consisted of the following (in thousands):

	<b>June 30, 2016 (unaudited)</b>	<b>December 31, 2015</b>
Raw materials	\$ 1,159	\$ 1,168
Work in process	1,589	1,412
Finished goods	1,409	1,337
Total inventories	\$ 4,157	\$ 3,917

**Revenue Recognition**

Revenue from the sale of products is recognized when there is persuasive evidence that an arrangement exists, the product is shipped and title transfers to customers, provided no continuing obligation on the Company's part exists, the price is fixed or determinable and the collectability of the amounts owed is reasonably assured. The Company enters into license and collaboration agreements under which it may receive upfront license fees, research funding and contingent milestone payments and royalties. The Company's deliverables under these arrangements typically consist of granting licenses to intellectual property rights and providing research and development services. The accounting standards contain a presumption that separate contracts entered into at or near the same time with the same entity or related parties were negotiated as a package and should be evaluated as a single agreement.

**Comprehensive Income (Loss)**

Components of other comprehensive income (loss) are comprised entirely of unrealized gains and losses on the Company's available-for-sale securities and marketable equity security for all periods presented. Total comprehensive loss has been disclosed in the Company's Condensed Statements of Comprehensive Loss.

**Net Loss Per Share**

Basic net loss per share is calculated by dividing the net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed using the weighted-average number of common shares outstanding and common stock equivalents (i.e., options to purchase common stock) outstanding during the period, if dilutive, using the treasury stock method for options.

Options to purchase approximately 20.8 million and 20.6 million shares of common stock were excluded from the denominator in the calculation of diluted net loss per share for the three and six months ended June 30, 2016, respectively, as the effect would be anti-dilutive. Options to purchase approximately 11.5 million and 17.1 million shares of common stock were excluded from the denominator in the calculation of diluted net loss per share for the three and six months ended June 30, 2015, respectively, as the effect would be anti-dilutive.

**Recent Accounting Pronouncements**

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as equity or liabilities, an option to recognize gross share compensation

expense with actual forfeitures recognized as they occur, as well as certain classifications on the statement of cash flows. Some of the areas of simplification apply only to nonpublic entities. For public business entities, the amendments in ASU 2016-09 are effective for annual periods beginning after 15 December 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after 15 December 2017, and interim periods within annual periods beginning after 15 December 2018. Early adoption is permitted for any entity in any interim or annual period for which financial statements haven't been issued or made available for issuance. If an entity early adopts the amendments in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period. The Company is currently evaluating the impact that ASU 2016-09 will have on its financial statements.

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases* (Topic 842), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. This ASU becomes effective for the Company in the first quarter of

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fiscal year 2019 and early adoption is permitted. This ASU is required to be applied with a modified retrospective approach and requires application of the new standard at the beginning of the earliest comparative period presented. The Company is currently evaluating the impact that ASU 2016-02 will have on its financial statements.

In May 2014, the FASB issued guidance codified in ASC 606, Revenue Recognition Revenue from Contracts with Customers, which amends the guidance in former ASC 605, Revenue Recognition. The core principle of the guidance is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The guidance provides companies with two implementation methods. Companies can choose to apply the standard retrospectively to each prior reporting period presented (full retrospective application) or retrospectively with the cumulative effect of initially applying the standard as an adjustment to the opening balance of retained earnings of the annual reporting period that includes the date of initial application (modified retrospective application). The standard was to have been effective for public entities for annual and interim periods beginning after December 15, 2016. In July 2015, the FASB voted to delay the effective date for this guidance. This guidance will be effective for the Company in the first quarter of 2018. The Company is currently evaluating the impact of the provisions of ASC 606.

In August 2014, the FASB issued Accounting Standards Update 2014-15, Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern (ASU 2014-15). This update is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. ASU 2014-15 requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments: (1) provide a definition of the term substantial doubt; (2) require an evaluation every reporting period including interim periods; (3) provide principles for considering the mitigating effect of management's plans; (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans; (5) require an express statement and other disclosures when substantial doubt is not alleviated; and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). ASU 2014-15 will be effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016, with early adoption permitted. ASU 2014-15 will be effective for the Company beginning with its annual report for fiscal 2016 and interim periods thereafter. The Company is currently evaluating the impact that ASU 2014-15 will have on its financial statements.

In November 2015, the FASB issued Accounting Standards Update 2015-17(ASU 2015-17), Balance Sheet Classification of Deferred Taxes to simplify the presentation of deferred income taxes. The amendments in this update require that deferred tax liabilities and assets be classified as noncurrent on the balance sheet instead of separating deferred taxes into current and noncurrent amounts. The new guidance will be effective for public business entities in fiscal years beginning after December 15, 2016, including interim periods within those years (i.e., in the first quarter of 2017 for calendar year-end companies). Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. The guidance may be applied either prospectively, for all deferred tax assets and liabilities, or retrospectively (i.e., by reclassifying the comparative balance sheet). The Company early adopted ASU 2015-17, on a prospective basis, for the year ended December 31, 2015.

**Note 2. Strategic Agreements**

The collaborative research and development and other revenues associated with the Company's major third-party collaborators are as follows (in thousands):

<b>Collaborator</b>	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Zogenix, Inc. (Zogenix) (1)	\$ 195	\$ 1,121	\$ 441	\$ 2,278
Santen Pharmaceutical Co. Ltd. (Santen) (2)	148	241	310	548
Pain Therapeutics, Inc. (Pain Therapeutics)	6	163	10	163
Others	22	253	29	527
Total collaborative research and development and other revenue	\$ 371	\$ 1,778	\$ 790	\$ 3,516

- (1) Amounts related to ratable recognition of upfront fees were \$52,000 and \$104,000 for the three and six months ended June 30, 2016 respectively, compared to \$64,000 and \$127,000 for the corresponding periods in 2015.
- (2) Amounts related to ratable recognition of upfront fees were \$57,000 and \$114,000 for the three and six months ended June 30, 2016 respectively, compared to \$71,000 and \$142,000 for the corresponding periods in 2015.

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**Table of Contents*****Agreement with Pain Therapeutics, Inc.***

In December 2002, the Company entered into an exclusive agreement with Pain Therapeutics, Inc. (Pain Therapeutics) to develop and commercialize on a worldwide basis REMOXY® ER and other oral sustained release, abuse deterrent opioid products incorporating four specified opioid drugs, using the ORADUR technology. Total collaborative research and development revenue recognized under the agreements with Pain Therapeutics was \$6,000 and \$10,000 for the three and six months ended June 30, 2016, respectively compared with \$163,000 for each of the corresponding periods in 2015. In May 2015, Pain Therapeutics sent a letter to the Company that provided the Company with formal written notice that Pain Therapeutics was deleting, effective as of January 12, 2015, the opioid drug hydrocodone (and only hydrocodone) as a licensed product under the agreement. The letter did not alter the terms of the agreement regarding the remaining three licensed products (REMOXY, hydromorphone or oxymorphone) or otherwise amend the agreement. Under the agreement with Pain Therapeutics, subject to and upon the achievement of predetermined development and regulatory milestones for the three drug candidates, the Company is entitled to receive milestone payments of up to \$7.2 million in the aggregate. The cumulative aggregate payments received by the Company from Pain Therapeutics as of June 30, 2016 were \$39.3 million under this agreement.

Under the terms of this agreement, Pain Therapeutics paid the Company an upfront license fee of \$1.0 million, with the potential for an additional \$7.2 million in performance milestone payments based on the successful development and approval of the three ORADUR-based opioids. Of these potential milestones, all \$7.2 million are development-based milestones. There are no sales-based milestones under the agreement. As of June 30, 2016, the Company had received \$1.7 million in cumulative milestone payments.

In March 2009, King Pharmaceuticals (King) assumed the responsibility for further development of REMOXY from Pain Therapeutics. As a result of this change, the Company continued to perform REMOXY-related activities in accordance with the terms and conditions set forth in the license agreement between the Company and Pain Therapeutics. King was substituted in lieu of Pain Therapeutics with respect to interactions with the Company in its performance of those activities including the obligation to pay the Company with respect to all REMOXY-related costs incurred by the Company. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to REMOXY; accordingly, amounts attributed to King were recorded as Pfizer figures. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY, and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics and that Pfizer would continue ongoing activities under the agreement until the scheduled termination date in April 2015. The cumulative aggregate payments received by the Company from Pfizer as of June 30, 2016 were \$7.1 million under this agreement. In July 2015, Pain Therapeutics stated that it had substantially completed the transition of REMOXY from Pfizer. In March 2016, Pain Therapeutics announced that it had resubmitted the NDA to the FDA, and in April 2016, Pain Therapeutics announced that the FDA had determined that the NDA was sufficiently complete to permit a substantive review. Pain Therapeutics further stated that September 25, 2016 is the target action date under the Prescription Drug User Fee Act (PDUFA). In May 2016, the FDA informed Pain Therapeutics that there was a tentative date of August 5, 2016 for an Advisory Committee meeting to review the REMOXY NDA. In July 2016, Pain Therapeutics announced that the FDA had determined that the Advisory Committee meeting is unnecessary and would not be held on August 5. Pain Therapeutics also stated that the FDA advised them that the regulatory review remains active and is on-going, and the PDUFA date of September 25, 2016 remains unchanged.

Total collaborative research and development revenue recognized for REMOXY-related work performed by the Company for Pain Therapeutics was \$6,000 and \$10,000 for the three and six months ended June 30, 2016, compared with \$51,000 for each of the corresponding periods in 2015. Prior to March 2009 and after November 2014, the Company recognized collaborative research and development revenue for REMOXY-related work for Pain Therapeutics. The cumulative aggregate payments received by the Company from Pain Therapeutics as of June 30,



2016 were \$39.3 million under this agreement.

***Long Term Supply Agreement with King (Pfizer)***

In August 2009, the Company signed an exclusive long term excipient supply agreement with respect to REMOXY with King. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to this long term supply agreement. This agreement stipulated the terms and conditions under which the Company would supply to King, based on the Company's manufacturing cost plus a specified percentage mark-up, two key excipients used in the manufacture of REMOXY. The term of the agreement commenced in August 2009 and continued in effect until April 2015, when the related development and license agreement between Pain Therapeutics and King terminated.

Total revenues recognized related to these excipients was zero and \$279,000 for the three and six months ended June 30, 2016 compared to zero and \$96,000 for the corresponding periods in 2015. The associated cost of goods sold was zero and \$124,000 for the three and six months ended June 30, 2016, compared with zero and \$51,000 for the corresponding periods in 2015. Recent orders for these excipients from Pain Therapeutics have been processed through mutually agreeable purchase orders, in the absence of an existing long-term contract. Pursuant to the Company's 2002 agreement with Pain Therapeutics, we are to be the exclusive supplier of certain defined excipients for products in our collaboration.

***Agreement with Zogenix, Inc.***

On July 11, 2011, the Company and Zogenix, Inc., (Zogenix), entered into a Development and License Agreement (the Zogenix Agreement). The Company and Zogenix had previously been working together under a feasibility agreement pursuant to which the Company's research and development costs were reimbursed by Zogenix. Under the Zogenix Agreement, Zogenix will be responsible

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for the clinical development and commercialization of a proprietary, long-acting injectable formulation of risperidone using the Company's SABER controlled-release formulation technology in combination with Zogenix's DosePro needle-free, subcutaneous drug delivery system. DURECT will be responsible for non-clinical, formulation and CMC development activities. The Company will be reimbursed by Zogenix for its research and development efforts on the product.

Zogenix paid a non-refundable upfront fee to the Company of \$2.25 million in July 2011. The Company's research and development services are considered integral to utilizing the licensed intellectual property and, accordingly, the deliverables are accounted for as a single unit of accounting. The \$2.25 million upfront fee is being recognized as collaborative research and development revenue ratably over the term of the Company's continuing research and development involvement with Zogenix with respect to this product candidate. Zogenix is obligated to pay the Company up to \$103 million in total future milestone payments with respect to the product subject to and upon the achievement of various developments, regulatory and sales milestones. Of these potential milestones, \$28 million are development-based milestones (none of which has been achieved as of June 30, 2016), and \$75 million are sales-based milestones (none of which had been achieved as of June 30, 2016). Zogenix is also required to pay a mid single-digit to low double-digit percentage patent royalty on annual net sales of the product determined on a jurisdiction-by-jurisdiction basis. The patent royalty term is equal to the later of the expiration of all DURECT technology patents or joint patent rights in a particular jurisdiction, the expiration of marketing exclusivity rights in such jurisdiction, or 15 years from first commercial sale in such jurisdiction. After the patent royalty term, Zogenix will continue to pay royalties on annual net sales of the product at a reduced rate for so long as Zogenix continues to sell the product in the jurisdiction. Zogenix is also required to pay to the Company a tiered percentage of fees received in connection with any sublicense of the licensed rights.

The Company granted to Zogenix an exclusive worldwide license, with sub-license rights, to the Company's intellectual property rights related to the Company's proprietary polymeric and non-polymeric controlled-release formulation technology to make and have made, use, offer for sale, sell and import risperidone products, where risperidone is the sole active agent, for administration by injection in the treatment of schizophrenia, bipolar disorder or other psychiatric related disorders in humans. The Company retains the right to supply Zogenix's Phase III clinical trial and commercial product requirements on the terms set forth in the Zogenix Agreement. Zogenix may terminate the Zogenix Agreement without cause at any time upon prior written notice, and either party may terminate the Zogenix Agreement upon certain circumstances including written notice of a material uncured breach.

The following table provides a summary of collaborative research and development revenue recognized under the agreements with Zogenix (in thousands). The cumulative aggregate payments received by the Company as of June 30, 2016 were \$20.1 million under these agreements.

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Ratable recognition of upfront payment	\$ 52	\$ 64	\$ 104	\$ 127
Research and development expenses reimbursable by Zogenix	143	1,057	337	2,151
<b>Total collaborative research and development revenue</b>	<b>\$ 195</b>	<b>\$ 1,121</b>	<b>\$ 441</b>	<b>\$ 2,278</b>

***Agreement with Santen Pharmaceutical Co., Ltd.***

On December 11, 2014, the Company and Santen Pharmaceutical Co., Ltd. (Santen) entered into a definitive agreement (the Santen Agreement). Pursuant to the Santen Agreement, the Company granted Santen an exclusive worldwide license to the Company's proprietary SABER formulation platform and other intellectual property to develop and commercialize a sustained release product utilizing the Company's SABER technology to deliver an ophthalmology drug. Santen will control and fund the development and commercialization program, and the parties have established a joint management committee to oversee, review and coordinate the development activities of the parties under the Santen Agreement.

In connection with the Santen agreement, Santen agreed to pay the Company an upfront fee of \$2.0 million in cash and to make contingent cash payments to the Company of up to \$76.0 million upon the achievement of certain milestones, of which \$13.0 million are development-based milestones and \$63.0 million are commercialization-based milestones including milestones requiring the achievement of certain product sales targets (none of which has been achieved as of June 30, 2016). Santen will also pay for certain Company costs incurred in the development of the licensed product. If the product is commercialized, the Company would also receive a tiered royalty on annual net product sales ranging from single-digit to the low double digits, determined on a country-by-country basis. Santen may terminate the Santen Agreement without cause at any time upon prior written notice, and either party may terminate the Santen Agreement upon certain circumstances including written notice of a material uncured breach. As of June 30, 2016, the cumulative aggregate payments received by the Company under this agreement were \$2.7 million.

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The following table provides a summary of collaborative research and development revenue recognized under the Santen Agreement (in thousands).

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Ratable recognition of upfront payment	\$ 57	\$ 71	\$ 114	\$ 142
Research and development expenses reimbursable by Santen	91	170	196	406
<b>Total collaborative research and development revenue</b>	<b>\$ 148</b>	<b>\$ 241</b>	<b>\$ 310</b>	<b>\$ 548</b>

**Note 3. Financial Instruments**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company's valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The Company follows a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value. These levels of inputs are the following:

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

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

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

The Company's financial instruments are valued using quoted prices in active markets or based upon other observable inputs. Money market funds are classified as Level 1 financial assets. Certificates of deposit, commercial paper, corporate debt securities, and U.S. Government agency securities are classified as Level 2 financial assets. The fair value of the Level 2 assets is estimated using pricing models using current observable market information for similar securities. The Company's Level 2 investments include U.S. government-backed securities and corporate securities that are valued based upon observable inputs that may include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications. The fair value of commercial paper is based upon the time to maturity and discounted using the three-month treasury bill rate. The average remaining maturity of the Company's Level 2 investments as of June 30, 2016 is less than twelve months and these investments are rated by S&P and Moody's at AAA or AA- for securities and A1 or P1 for commercial paper.



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The following is a summary of available-for-sale securities as of June 30, 2016 and December 31, 2015 (in thousands):

	<b>June 30, 2016</b>			<b>Estimated Fair Value</b>
	<b>Amortized Cost</b>	<b>Unrealized Gain</b>	<b>Unrealized Loss</b>	
Money market funds	\$ 502	\$	\$	\$ 502
Certificates of deposit	250			250
Commercial paper	7,393			7,393
Corporate debt	3,899		(1)	3,898
U.S. Government agencies	20,719	12	(1)	20,730
	\$ 32,763	\$ 12	\$ (2)	\$ 32,773
<b>Reported as:</b>				
Cash and cash equivalents	\$ 6,950	\$	\$	\$ 6,950
Short-term investments	24,514	11	(2)	24,523
Short-term restricted investments	100			100
Long-term investments	1,049	1		1,050
Long-term restricted investments	150			150
	\$ 32,763	\$ 12	\$ (2)	\$ 32,773

	<b>December 31, 2015</b>			<b>Estimated Fair Value</b>
	<b>Amortized Cost</b>	<b>Unrealized Gain</b>	<b>Unrealized Loss</b>	
Money market funds	\$ 81	\$	\$	\$ 81
Certificates of deposit	250			250
Commercial paper	898			898
Corporate debt	5,215	1	(5)	5,211
U.S. Government agencies	19,558	1	(11)	19,548
	\$ 26,002	\$ 2	\$ (16)	\$ 25,988
<b>Reported as:</b>				
Cash and cash equivalents	\$ 281	\$	\$	\$ 281
Short-term investments	25,471	2	(16)	25,457
Long-term restricted investments	250			250
	\$ 26,002	\$ 2	\$ (16)	\$ 25,988

The following is a summary of the cost and estimated fair value of available-for-sale securities at June 30, 2016, by contractual maturity (in thousands):

	<b>June 30, 2016</b>	
	<b>Amortized Cost</b>	<b>Estimated Fair Value</b>
Mature in one year or less	\$ 31,212	\$ 31,221
Mature after one year through five years	1,049	1,050
	<b>\$ 32,261</b>	<b>\$ 32,271</b>

There were no securities that have had an unrealized loss for more than 12 months as of June 30, 2016.

As of June 30, 2016, unrealized losses on available-for-sale investments are not attributed to credit risk and are considered to be temporary. The Company believes that it is more-likely-than-not that investments in an unrealized loss position will be held until maturity or the recovery of the cost basis of the investment. To date, the Company has not recorded any impairment charges on marketable securities related to other-than-temporary declines in market value.

**Table of Contents****Note 4. Stock-Based Compensation**

As of June 30, 2016, the Company has three stock-based compensation plans. The stock-based compensation cost that has been included in the statements of comprehensive loss is shown as below (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
Cost of product revenues	\$ 26	\$ 27	\$ 53	\$ 56
Research and development	357	332	710	683
Selling, general and administrative	314	265	644	535
Total stock-based compensation	\$ 697	\$ 624	\$ 1,407	\$ 1,274

As of June 30, 2016 and December 31, 2015, \$15,000 and \$13,000 of stock-based compensation cost was capitalized in inventory on the Company's balance sheets, respectively.

The Company uses the Black-Scholes option pricing model to value its stock options. The expected life computation is based on historical exercise patterns and post-vesting termination behavior. The Company considered its historical volatility in developing its estimate of expected volatility.

The Company used the following assumptions to estimate the fair value of stock options granted (including fully vested options issued in January 2016 and 2015) and shares purchased under its employee stock purchase plan for the three and six months ended June 30, 2016 and 2015:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
<b>Stock options</b>				
Risk-free rate	1.3-1.8%	1.0-2.4%	1.3-1.9%	1.0-2.4%
Expected dividend yield				
Expected life of option (in years)	7.0-10.0	7.0-10.0	6.5-10.0	6.5-10.0
Volatility	76-81%	78-84%	76-83%	78-85%

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
<b>Employee Stock Purchase Plan</b>				
Risk-free rate	0.4%	0.1%	0.3-0.4%	0.1%
Expected dividend yield				
Expected life of option (in years)	0.5	0.5	0.5	0.5
Volatility	66%	76%	66-68%	76-95%





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**Table of Contents****Note 5. Long-Term Debt**

On June 26, 2014, the Company entered into a Loan and Security Agreement (the "Loan Agreement") with Oxford Finance LLC ("Oxford Finance"), pursuant to which Oxford Finance provided a \$20 million secured single-draw term loan to the Company with a maturity date of July 1, 2018. The term loan was fully drawn at close and the proceeds were to be used for working capital and general business requirements. The term loan repayment schedule provided for interest only payments for the first 18 months, followed by consecutive equal monthly payments of principal and interest in arrears starting on February 1, 2016 and continuing through the maturity date. The Loan Agreement provided for a 7.95% interest rate on the term loan, a \$150,000 facility fee that was paid at closing and an additional payment equal to 8% of the principal amount of the term loan, which was due when the term loan becomes due or upon the prepayment of the facility. If the Company elected to prepay the loan, there was also a prepayment fee between 1% and 3% of the principal amount of the term loan depending on the timing and circumstances of prepayment.

In connection with the term loan, the Company received proceeds of \$19.8 million, net of debt offering/issuance costs. The debt offering/issuance costs were recorded as debt discount on the Company's balance sheet which together with the final \$1.6 million payment and fixed interest rate payments were amortized to interest expense throughout the life of the term loan using the effective interest rate method.

The term loan was secured by substantially all of the assets of the Company, except that the collateral did not include any intellectual property (including licensing, collaboration and similar agreements relating thereto), and certain other excluded assets. The Loan Agreement contained customary representations, warranties and covenants by the Company, which covenants limit the Company's ability to convey, sell, lease, transfer, assign or otherwise dispose of certain assets of the Company; engage in any business other than the businesses currently engaged in by the Company or reasonably related thereto; liquidate or dissolve; make certain management changes; undergo certain change of control events; create, incur, assume, or be liable with respect to certain indebtedness; grant certain liens; pay dividends and make certain other restricted payments; make certain investments; and make payments on any subordinated debt.

The Loan Agreement also contained customary indemnification obligations and customary events of default, including, among other things, our failure to fulfill certain obligations of the Company under the Loan Agreement and the occurrence of a material adverse change which was defined as a material adverse change in the Company's business, operations, or condition (financial or otherwise), a material impairment of the prospect of repayment of any portion of the loan, or a material impairment in the perfection or priority of lender's lien in the collateral or in the value of such collateral. In the event of default by the Company under the Loan Agreement, the lender would be entitled to exercise its remedies thereunder, including the right to accelerate the debt, upon which the Company may have been required to repay all amounts then outstanding under the Loan Agreement, which could harm the Company's financial condition. The conditionally exercisable call option related to the event of default was considered to be an embedded derivative which was required to be bifurcated and accounted for as a separate financial instrument. In the periods presented, the value of the embedded derivative was not material, but could have become material in future periods if an event of default became more probable than was estimated.

In July 2015, the Company and Oxford Finance entered into the First Amendment of the Loan Agreement and modified the terms of the Loan Agreement to change the maturity date from July 1, 2018 to July 1, 2019 and to change the first principal payment date from February 1, 2016 to February 1, 2017. The interest rate remained unchanged, the Company paid a loan modification fee of \$240,000 and the additional payment originally equal to 8% of the principal amount of the term loan, which was due when the term loan becomes due or upon the prepayment of the facility, was increased to 10%. Consistent with the accounting treatment noted above for the final payment, the

loan modification fee has been recorded on the balance sheet as a debt discount and was being amortized to interest expense over the remaining life of the term loan using the effective interest method.

As described in Note 7, Subsequent Event, the Company repaid the existing term loan in July 2016 and entered into a new loan agreement with Oxford Finance at that time.

As of June 30, 2016, the Company was in compliance with all material covenants under the Loan Agreement and there had been no material adverse change.

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As of June 30, 2016, the carrying value of the term loan approximated its fair value based on Level 3 unobservable inputs involving discounted cash flows and the estimated market rate of borrowing that could be obtained by companies with credit risk similar to the Company's credit risk. Future maturities and interest payments under the term loan as of June 30, 2016, were as follows (in thousands):

Six months ended December 31, 2016	\$ 795
2017	8,848
2018	8,848
2019	6,423
<b>Total minimum payments</b>	<b>24,914</b>
Less amount representing interest	(4,914)
<b>Gross balance of long-term debt</b>	<b>20,000</b>
Less unamortized debt discount	(248)
<b>Carrying value of long-term debt</b>	<b>19,752</b>
Less current portion of long-term debt	
<b>Long-term debt, less current portion and unamortized debt discount</b>	<b>\$ 19,752</b>

Interest expense, including amortization of the debt discount, related to the long-term debt was \$557,000 and \$1.1 million for the three and six months ended June 30, 2016, respectively, compared to \$557,000 and \$1.1 million for the corresponding periods in 2015. As a result of the debt refinancing described in Note 7, Subsequent Event, \$886,000 of accrued interest was included in accrued liabilities of the Company's balance sheet as of June 30, 2016.

**Note 6. Stockholders' Equity**

During the second quarter of 2016, the Company raised net proceeds (net of commission) of approximately \$948,000 from the sale of 730,048 shares of its common stock at a weighted average price of \$1.34 per share in the open market through its Controlled Equity Offering<sup>SM</sup> sales agreement with Cantor Fitzgerald, entered into in November 2015. The shares were issued pursuant to a registration statement on Form S-3 declared effective in November 2015. As of July 25, 2016, the Company had up to \$35.7 million of common stock available for sale under the Controlled Equity Offering program.

In April 2016, the Company completed an underwritten public offering in which the Company sold an aggregate of 13.8 million shares of its common stock pursuant to an effective registration statement at a price to the public of \$1.25. The Company received net proceeds of approximately \$16.1 million after deducting underwriting discounts and commissions and offering expenses. As of July 25, 2016, the Company had up to \$67.8 million of common stock available for sale under an effective registration statement in addition to what is available under the Controlled Equity Offering program.

**Note 7. Subsequent Event**

In July 2016, the Company repaid to Oxford Finance the entire outstanding principal balance under its existing Loan Agreement of \$20.0 million, together with accrued unpaid interest due under the existing Loan Agreement. In connection therewith, the Company also paid Oxford Finance \$886,000, which represented Oxford Finance's accrued amount of a final payment equal to 10% of the principal amount of the term loan.

In July 2016, concurrent with the repayment noted above, the Company entered into a new Loan and Security Agreement (the "2016 Loan Agreement") with Oxford Finance, pursuant to which Oxford Finance provided a \$20.0 million secured single-draw term loan to the Company with a maturity date of August 1, 2020. The term loan was fully drawn at close. The term loan repayment schedule provides for interest only payments for the first 18 months, followed by consecutive monthly payments of principal and interest in arrears starting on March 1, 2018 and continuing through the maturity date of August 1, 2020. The Loan Agreement provides for a floating interest rate (7.95% initially) based on an index rate plus a spread, a \$150,000 facility fee that was paid at closing and an additional payment equal to 9.25% of the principal amount of the term loan, which is due when the term loan becomes due or upon the prepayment of the facility. If the Company elects to prepay the loan, there is also a prepayment fee between 1% and 3% of the principal amount of the term loan depending on the timing of prepayment.

In connection with the term loan, the Company received proceeds of \$19.8 million, net of debt offering/issuance costs. The debt offering/issuance costs have been recorded as debt discount on the Company's balance sheet which together with the final \$1.9 million payment and interest rate payments will be amortized to interest expense throughout the life of the term loan using the effective interest rate method.

The term loan is secured by substantially all of the assets of the Company, except that the collateral does not include any intellectual property (including licensing, collaboration and similar agreements relating thereto), and certain other excluded assets. The

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2016 Loan Agreement contains customary representations, warranties and covenants by the Company, which covenants limit the Company's ability to convey, sell, lease, transfer, assign or otherwise dispose of certain assets of the Company; engage in any business other than the businesses currently engaged in by the Company or reasonably related thereto; liquidate or dissolve; make certain management changes; undergo certain change of control events; create, incur, assume, or be liable with respect to certain indebtedness; grant certain liens; pay dividends and make certain other restricted payments; make certain investments; and make payments on any subordinated debt.

The 2016 Loan Agreement also contains customary indemnification obligations and customary events of default, including, among other things, the Company's failure to fulfill certain obligations of the Company under the 2016 Loan Agreement and the occurrence of a material adverse change which is defined as a material adverse change in the Company's business, operations, or condition (financial or otherwise), a material impairment of the prospect of repayment of any portion of the loan, or a material impairment in the perfection or priority of lender's lien in the collateral or in the value of such collateral. In the event of default by the Company under the 2016 Loan Agreement, the lender would be entitled to exercise its remedies thereunder, including the right to accelerate the debt, upon which the Company may be required to repay all amounts then outstanding under the 2016 Loan Agreement, which could harm the Company's financial condition.

As of July 28, 2016, future maturities and interest payments under the refinanced term loan (with an assumed interest rate of 7.95%) are as follows (in thousands):

Period from July 28, 2016 to December 31, 2016	\$ 693
2017	1,612
2018	8,698
2019	8,724
2020	6,642
Total minimum payments	26,369
Less amount representing interest	(6,369)
Gross balance of long-term debt	\$ 20,000

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations for the three and six months ended June 30, 2016 and 2015 should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission and Risk Factors section included elsewhere in this Form 10-Q. This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended.

When used in this report, the words believe, anticipate, intend, plan, estimate, expect, may, will, could, and similar expressions are forward-looking statements. Such forward-looking statements are based on current expectations and beliefs. Any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors.

*Forward-looking statements made in this report include, for example, statements about:*

potential regulatory filings for or approval of REMOXY, POSIMIR, DUR-928 or any of our other product candidates;

the progress of our third-party collaborations, including estimated milestones;

our intention to seek, and ability to enter into and maintain strategic alliances and collaborations;

the potential benefits and uses of our products;

responsibilities of our third-party collaborators, including the responsibility to make cost reimbursement, milestone, royalty and other payments to us, and our expectations regarding our collaborators' plans with respect to our products and continued development of our products;

our responsibilities to our third-party collaborators, including our responsibilities to conduct research and development, clinical trials and manufacture products;

our ability to protect intellectual property, including intellectual property licensed to our collaborators;

market opportunities for products in our product pipeline;

the progress and results of our research and development programs;

requirements for us to purchase supplies and raw materials from third parties, and the ability of third parties to provide us with required supplies and raw materials;

the results, progress and timing of clinical trials, including for POSIMIR, DUR-928, Relday, ELADUR, or ORADUR-ADHD or other ORADUR-based product candidates, and the possible commencement of future clinical trials;

conditions for obtaining regulatory approval of our product candidates;

submission and timing of applications for regulatory approval;

the impact of FDA, DEA, EMEA and other government regulation on our business;

the impact of potential Risk Evaluation and Mitigation Strategies (REMS) on our business;

uncertainties associated with obtaining and protecting patents and other intellectual property rights, as well as avoiding the intellectual property rights of others;

products and companies that will compete with the products we are developing and may license to third-party collaborators or commercialize ourself;

the possibility we may commercialize our own products and build up our commercial, sales and marketing capabilities and other required infrastructure;

the possibility that we may develop additional manufacturing capabilities;

our employees, including the number of employees and the continued services of key management, technical and scientific personnel;

our future performance, including our anticipation that we will not derive meaningful revenues from our products in development for at least the next twelve months, potential for future inventory write-offs and our expectations regarding our ability to achieve profitability;



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sufficiency of our cash resources, anticipated capital requirements and capital expenditures, our ability to comply with covenants of our term loan, and our need for additional financing, including potential sales under our shelf registration statement;

our expectations regarding marketing expenses, research and development expenses, and selling, general and administrative expenses;

the composition of future revenues; and

accounting policies and estimates, including revenue recognition policies.

*Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors. For a more detailed discussion of such forward looking statements and the potential risks and uncertainties that may impact upon their accuracy, see the Risk Factors section and Overview section of this Management's Discussion and Analysis of Financial Condition and Results of Operations. These forward-looking statements reflect our view only as of the date of this report. We undertake no obligations to update any forward-looking statements. You should also carefully consider the factors set forth in other reports or documents that we file from time to time with the Securities and Exchange Commission.*

## **Overview**

We are a biopharmaceutical company with research and development programs broadly falling into two categories: (i) new chemical entities derived from our Epigenomic Regulator Program, in which we attempt to discover and develop molecules which have not previously been approved and marketed as therapeutics, and (ii) Drug Delivery Programs, in which we apply our formulation expertise and technologies largely to active pharmaceutical ingredients whose safety and efficacy have previously been established but which we aim to improve in some manner through a new formulation. We also manufacture and sell osmotic pumps used in laboratory research and design, develop and manufacture a wide range of standard and custom biodegradable polymers and excipients for pharmaceutical and medical device clients for use as raw materials in their products. In addition, we conduct research and development of pharmaceutical products in collaboration with third party pharmaceutical and biotechnology companies.

A central aspect of our business strategy involves advancing multiple product candidates at one time, which is enabled by leveraging our resources with those of corporate collaborators. Thus, certain of our programs are currently licensed to corporate collaborators on terms which typically call for our collaborator to fund all or a substantial portion of future development costs and then pay us milestone payments based on specific development or commercial achievements plus a royalty on product sales. At the same time, we have retained the rights to other programs, which are the basis of future collaborations and which over time may provide a pathway for us to develop our own commercial, sales and marketing organization.

Additional details of these programs and related strategic agreements are contained in our annual report on Form 10-K for the year ended December 31, 2015 and in Note 2 above.

## ***Epigenomic Regulator Program and New Chemical Entities***

DURECT's Epigenomic Regulator Program involves a multi-year collaborative effort with the Department of Internal Medicine at Virginia Commonwealth University (VCU), the VCU Medical Center and the McGuire VA Medical Center. The discoveries from this program are a result of more than 20 years of lipid research by Shunlin Ren, M.D., Ph.D., Professor of Internal Medicine at the VCU Medical Center and a recipient of multiple grants from the National Institutes of Health (NIH) for metabolic disease research. Epigenetics is the study of how reversible modifications of a cell's DNA or histones (proteins associated with DNA) affect gene expression without altering the DNA sequence. Epigenomics is the study of large scale effects on cellular function and interrelated collections of epigenetic modifications. Epigenetic and epigenomic modifications play an important role in regulation of key cellular processes. DUR-928 is our program's lead product candidate. We hold the exclusive worldwide right to develop and commercialize DUR-928 and related molecules discovered in the program.

During the course of this program, a number of compounds have been identified that may have therapeutic utility for various diseases and syndromes for orphan indications as well as for broader patient populations. The lead compound from this program (DUR-928) is an endogenous, orally bioavailable small molecule that modulates the activity of various nuclear receptors that play an important regulatory role in lipid homeostasis, inflammation and cell survival.

*NOTE: POSIMIR®, SABER®, CLOUD , TRANSDUR®, ORADUR®, ALZET® and LACTEL® are trademarks of DURECT Corporation. Other trademarks referred to belong to their respective owners.*

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The biological activity of DUR-928 has been demonstrated in 8 different animal disease models that we have disclosed involving three animal species. Four of these models represent chronic disorders of hepatic lipid accumulation and dysfunction (e.g., nonalcoholic fatty liver disease (NAFLD) and nonalcoholic steatohepatitis (NASH) associated with diabetes) and four represent acute organ injuries (endotoxin shock, kidney, liver and brain). We have conducted multiple additional animal studies to de-risk and guide the design of future human trials, and to support various patent applications or for future publication.

We are pursuing the development of DUR-928 through two broad programs for: (i) chronic metabolic diseases using an oral formulation, and (ii) acute organ injury using an injectable formulation. We are also evaluating additional indications beyond these broad programs.

In pharmacokinetic and toxicity studies conducted in mice, hamsters, rats, dogs and monkeys, DUR-928 has been found to be orally bioavailable and safe at all doses tested to date. These non-clinical results supported the initiation of DUR-928 into human safety trials with an oral formulation. Pharmacokinetic and toxicity studies with an injectable formulation were also conducted in rats and dogs; these non-clinical results supported the initiation into human safety trials with an injectable formulation of DUR-928.

*Chronic Metabolic Disease Program with DUR-928*

The initial Phase 1 trial of DUR-928 was a single-site, randomized, double-blinded, placebo-controlled, single-ascending-dose study that evaluated the safety, tolerability and pharmacokinetics of DUR-928 when orally administered. The 30-subject study evaluated DUR-928 in five cohorts of healthy volunteers receiving DUR-928 (n=20 on drug, 10 on placebo) at escalating doses that resulted in peak plasma concentrations greater than 100-fold higher than endogenous levels. DUR-928 was well-tolerated at all dose levels, with no serious treatment-related adverse events reported. We subsequently conducted a Phase 1 multiple-ascending-dose, oral administration trial in 20 healthy subjects (n=16 on drug, 4 on placebo). Following multiple daily dosing for 5 consecutive days, DUR-928 was well-tolerated at all doses, with no clinically significant changes in vital signs, laboratory values or ECG parameters, no serious drug-related adverse events reported and no subjects withdrawing from the study. Peak plasma concentrations achieved were greater than 100-fold higher than endogenous levels, no accumulation in plasma concentrations were observed with repeat dosing, and dose related increases in plasma concentrations were observed with peak plasma concentration at approximately 2-6 hours after dosing. We also conducted a food effect study with 8 healthy volunteers and observed no food effect on absorption.

We are currently conducting a single-ascending-dose Phase 1b clinical trial with DUR-928 in patients with nonalcoholic steatohepatitis (NASH). This open-label Phase 1b trial is a safety and pharmacokinetic study of DUR-928 in subjects with NASH and matched control subjects. We currently anticipate conducting this study in two successive cohorts evaluating two single-dose levels of oral DUR-928. After a PK/safety review at the low dose, the study can proceed to a higher dose. Assuming both cohorts are dosed, the study will comprise approximately 32 subjects, of which approximately 20 will have received DUR-928. The study is being conducted in Australia, and we anticipate that we will obtain results from this trial starting in the third quarter of 2016. We anticipate that the single-ascending-dose Phase 1b clinical trial described above will enable and inform a multiple-dose study in NASH patients and/or patients with other liver function impairment. We are also preparing to request in the near future a pre-IND meeting with the FDA as precursor to submitting an IND later this year which is required to enable future clinical trials in liver diseases in the United States.

*Acute Organ Injury Program with DUR-928*

In addition to the oral administration clinical studies described above, we have conducted a Phase 1 single-site, randomized, double-blinded, placebo-controlled, single-ascending-dose study that evaluated the safety, tolerability and pharmacokinetics of four doses of DUR-928 when administered by injection. The 24-subject study evaluated DUR-928 in four cohorts of healthy volunteers receiving DUR-928 (n=16 on drug, 8 on placebo) at escalating doses that resulted in dose proportionality of systemic exposure. DUR-928 was well-tolerated at all dose levels, with no serious treatment-related adverse events reported. We also conducted a multiple-dose study involving 10 healthy volunteers, in which participants received DUR-928 for 5 consecutive days (n=8 on drug, 2 on placebo) with the next to highest dose in the single dose study. No serious treatment related adverse events were reported, no subjects withdrew from the study, no accumulation in plasma concentrations were observed with repeat dosing, and the pain scores and injection site reactions were minimal. We have started dosing patients for a Phase 1b single-ascending-dose, injectable administration trial in renal function impaired patients and matched control subjects. We currently anticipate conducting this open-label, safety and pharmacokinetic study in up to three successive cohorts evaluating two or three single-dose levels of injectable DUR-928. After a PK/safety review at each dose, the study can proceed to the next higher dose. Assuming three cohorts are dosed, the study will comprise approximately 45 subjects, of which approximately 30 will have received DUR-928. This study is being conducted in Australia and we anticipate that we will obtain results from this trial in 2016. We anticipate that this trial will enable and inform subsequent patient studies in acute kidney injury and/or other kidney function impairment. Our request for a pre-IND meeting has been granted by the FDA; we anticipate that feedback from that meeting will enable the filing of an IND later in the year which is required to enable future clinical trials in kidney diseases in the United States.

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**Table of Contents*****REMOXY® ER and other ORADUR®-based opioid products licensed to Pain Therapeutics***

In December 2002, we entered into an agreement with Pain Therapeutics, amended in December 2005, under which we granted Pain Therapeutics the exclusive, worldwide right to develop and commercialize selected long-acting oral opioid products using our ORADUR technology incorporating four specified opioid drugs. The first product being developed under the collaboration is REMOXY, a novel long-acting oral formulation of the opioid oxycodone targeted to decrease the potential for oxycodone abuse. REMOXY is intended for patients with chronic pain. In November 2005, Pain Therapeutics and King entered into collaboration and license agreements for the development and commercialization of REMOXY by King. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to REMOXY and to the other ORADUR-based opioids.

Pain Therapeutics submitted an NDA for REMOXY to the FDA in June 2008, and in August 2008 the FDA accepted the NDA and granted priority review. In December 2008, Pain Therapeutics received a Complete Response Letter for its NDA for REMOXY in which the FDA determined that the NDA was not approved. According to Pain Therapeutics, the FDA indicated that additional non-clinical data would be required to support the approval of REMOXY, but the FDA had not requested or recommended additional clinical efficacy studies prior to approval. King assumed responsibility for further development of REMOXY from Pain Therapeutics in March 2009. In July 2009, King met with the FDA to discuss the Complete Response Letter. King took over the NDA from Pain Therapeutics and resubmitted the NDA in December of 2010. In February 2011, King was acquired by Pfizer. On June 23, 2011, a Complete Response Letter from the FDA was received by Pfizer on the resubmission to the NDA for REMOXY. The FDA's June 2011 Complete Response Letter raised concerns related to, among other matters, the Chemistry, Manufacturing, and Controls section of the NDA for REMOXY. Pfizer undertook efforts to resolve these issues. In October 2013, Pfizer stated that, having achieved technical milestones related to manufacturing, they would continue the development program for REMOXY. Following guidance received from the FDA earlier in 2013, Pfizer announced that they were proceeding with the additional clinical studies and other actions required to address the Complete Response Letter. Pfizer stated that these new clinical studies would include, in part, a pivotal bioequivalence study with the modified REMOXY formulation to bridge to the clinical data related to the original REMOXY formulation, and an abuse-potential study with the modified formulation. It is possible that the results of such studies will not be satisfactory to the FDA. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY, and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics and that Pfizer would continue ongoing activities under the agreement until the scheduled termination date in April 2015. In April 2015, Pain Therapeutics stated that it had resumed responsibility for REMOXY under the terms of a letter agreement with Pfizer. In March 2016, Pain Therapeutics stated that it had resubmitted the NDA for REMOXY to the FDA. In April 2016, Pain Therapeutics announced that the FDA had determined that the NDA was sufficiently complete to permit a substantive review. Pain Therapeutics further stated that September 25, 2016 is the target action date under the Prescription Drug User Fee Act (PDUFA). In May 2016, the FDA informed Pain Therapeutics that there was a tentative date of August 5, 2016 for an Advisory Committee meeting to review the REMOXY NDA. In July 2016, Pain Therapeutics announced that the FDA had determined that the Advisory Committee meeting is unnecessary and would not be held on August 5. Pain Therapeutics also stated that the FDA advised them that the regulatory review remains active and is on-going, and the PDUFA date of September 25, 2016 remains unchanged.

Phase I clinical trials have been conducted for two of the other ORADUR-based opioid product candidates (hydrocodone and hydromorphone), and an Investigational New Drug (IND) application has been accepted by the FDA for the fourth ORADUR-based opioid (oxymorphone). In October 2013, Pain Therapeutics stated that it had regained all rights from Pfizer with respect to the three other ORADUR-based opioid drug candidates (hydrocodone, hydromorphone and oxymorphone). In 2015, Pain Therapeutics returned to us all of Pain Therapeutics' rights and obligations under our license agreement to develop and commercialize ORADUR-based formulations of hydrocodone

but without impacting the rights and obligations of the two parties with respect to REMOXY (oxycodone), hydromorphone and oxymorphone.

***POSIMIR® (SABER®-Bupivacaine)***

Our post-operative pain relief depot, POSIMIR, is a sustained release injectable using our SABER delivery system to deliver bupivacaine, an off-patent pharmaceutical agent. SABER is a controlled drug delivery technology that is administered via the parenteral (i.e., injectable) route to deliver drugs that act systemically or locally. POSIMIR is designed to be administered to a surgical site at the end of surgery for post-operative pain relief and is intended to provide local analgesia for up to 3 days, which we believe coincides with the time period of the greatest need for post-surgical pain control in most patients. We are in discussions with potential partners regarding licensing development and commercialization rights to POSIMIR, for which we hold worldwide rights. We are also continuing to evaluate the requirements for commercializing POSIMIR on our own in the U.S., in the event that we determine that to be the preferred route of commercialization.

In April 2013, we submitted an NDA as a 505(b)(2) application, which relies in part on the FDA's findings of safety and effectiveness of a reference drug. In February 2014 we received a Complete Response Letter from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial (the PERSIST trial) consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. We began recruiting patients for this trial in November 2015 comparing POSIMIR to

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placebo. Based on advice from the FDA received subsequent to the start of the trial, in April 2016 we decided to amend the PERSIST trial. Starting in August 2016, we are implementing Part 2 of the PERSIST trial to evaluate POSIMIR against standard bupivacaine HCl rather than placebo as we have been doing in Part 1. Additionally, we are switching in Part 2 the primary efficacy endpoint (pain reduction on movement) from 0-72 hours after surgery to 0-48 hours after surgery. Assessing pain reduction on movement from 0-72 hours is now the key secondary efficacy endpoint and other efficacy endpoints, including 72-hour opioid use, remain the same. We expect to enroll approximately 264 patients in Part 2 of PERSIST, and we expect this part of the trial to take approximately one year to enroll. We believe that a positive outcome from this new trial design would result in a stronger NDA resubmission and potential commercial advantages. In a previous clinical trial of 50 patients undergoing laparoscopic cholecystectomy, POSIMIR was compared with the active control bupivacaine HCl, against which POSIMIR demonstrated in a post hoc analysis an approximately 25% reduction in pain intensity on movement for the first 3 days after surgery ( $p=0.024$ ) and for the first 2 days after surgery ( $p=0.0198$ ), using the same statistical methodology specified for the current trial.

***ELADUR<sup>®</sup> (TRANSDUR<sup>®</sup>-Bupivacaine)***

Our transdermal bupivacaine patch (ELADUR) uses our proprietary TRANSDUR transdermal technology and is intended to provide continuous delivery of bupivacaine for up to three days from a single application, as compared to a wearing time limited to 12 hours with currently available lidocaine patches. In December 2007, we announced positive results from a 60 patient Phase IIa study for post-herpetic neuralgia (PHN or post-shingles pain).

Effective in October 2008, we entered into a development and license agreement with Alharma granting Alharma the exclusive worldwide rights to develop and commercialize ELADUR. Alharma paid us an upfront license fee of \$20 million in October 2008. Alharma was acquired by King in December 2008 and, as a result, the rights and obligations of the agreement were assumed by King. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to ELADUR.

We reported top line data from a Phase II clinical trial conducted by King for ELADUR in April 2011. In this study of 263 patients suffering from chronic low back pain, the primary efficacy endpoint of demonstrating a positive treatment difference for the mean change in pain intensity scores from baseline to the mean of weeks 11 and 12 between ELADUR as compared to placebo was not met.

In February 2012, Pfizer gave notice that its rights with respect to ELADUR were being returned to us. In January 2014, we and Impax Laboratories, Inc. (Impax) entered into a definitive agreement (the Impax Agreement) pursuant to which we have granted Impax an exclusive worldwide license to our proprietary TRANSDUR transdermal delivery technology and other intellectual property to develop and commercialize ELADUR, in addition to selling certain assets and rights in and related to the product. Impax will control and fund the development and commercialization programs, and the parties have established a joint management committee to oversee, review and coordinate the development and commercialization activities of the parties under the Impax Agreement.

***ORADUR-ADHD Program***

We are developing drug candidates (ORADUR-ADHD) based on DURECT's ORADUR Technology for the treatment of ADHD. These drug candidates are intended to provide once-a-day dosing, or immediate release dosing, in each case with added tamper-resistant characteristics to address common methods of abuse and misuse of these types of drugs.

In August 2009, we entered into a development and license agreement with Orient Pharma Co., Ltd., a diversified multinational pharmaceutical, healthcare and consumer products company with headquarters in Taiwan, under which we granted to Orient Pharma development and commercialization rights in certain defined Asian and South Pacific countries to ORADUR-Methylphenidate. DURECT retains rights to North America, Europe, Japan and all other countries not specifically licensed to Orient Pharma. Since 2010, we and Orient Pharma have conducted several Phase I clinical trials in this program with multiple formulations. In 2013, we and Orient Pharma selected a lead formulation based on its potential for rapid onset of action, long duration for once-a-day dosing and target pharmacokinetic profile as demonstrated in a Phase 1 trial. In addition, this product candidate is expected to utilize a small capsule size relative to the leading existing long-acting products on the market. Orient Pharma has initiated a Phase 3 study in Taiwan and anticipates completing it in 2016. We retain rights to all other territories in the world and are engaged in licensing discussions with other companies.

***Relday (risperidone) Program***

On July 11, 2011, we and Zogenix, Inc. (Zogenix) entered into a development and license agreement for the purpose of developing and commercializing Relday, a proprietary, long-acting injectable formulation of risperidone using our SABER-controlled release formulation technology in combination with Zogenix's DosePro® needle-free, subcutaneous drug delivery system. Risperidone is one of the most widely prescribed medications used to treat the symptoms of schizophrenia and bipolar I disorder in adults and teenagers 13 years of age and older. Under the agreement, we granted Zogenix worldwide development and commercialization rights to Relday.



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On January 3, 2013, Zogenix reported positive single-dose pharmacokinetic (PK) results from the Phase 1 clinical trial of Relday. According to Zogenix, adverse events in the Phase 1 trial in patients diagnosed with schizophrenia were generally mild to moderate and consistent with other risperidone products. The Phase 1 clinical trial for Relday was conducted as a single-center, open-label, safety and PK trial of 30 patients with chronic, stable schizophrenia or schizoaffective disorder. Per Zogenix, based on the favorable safety and PK profile demonstrated with the 25 mg and 50 mg once-monthly doses tested in the Phase 1 trial, Zogenix extended the study to include a 100 mg dose of the same formulation. In May 2013, Zogenix announced positive results with the 100 mg arm, demonstrating dose proportionality across the full dose range that would be anticipated to be used in clinical practice. In March 2015, Zogenix commenced a Phase 1b multi-dose parallel clinical trial, enrolling 60 subjects, for which Zogenix announced positive top line results in September 2015. According to Zogenix, the results for Relday demonstrated that risperidone plasma concentrations in the therapeutic range were achieved on the first day of dosing, reached steady state levels following the second dose and consistently maintained therapeutic levels throughout the four-month period. Also according to Zogenix, Relday was generally safe and well-tolerated, with results consistent with the profile of risperidone and the previous Phase 1 single-dose clinical trial. Zogenix further stated that it has initiated efforts to secure a development and commercialization partner for Relday, and that Relday is well-positioned to begin a Phase 3 program once a partner is secured.

***Other Programs******Depot Injectable Programs***

In addition to biologic drugs, many traditional small molecule drugs have to be given by frequent injections, which is costly, inconvenient and may result in either unwanted side effects or suboptimal efficacy. We have active programs underway to improve our depot injectable systems and to apply those systems to various drugs and drug candidates, and have entered into a number of feasibility studies with biotechnology and pharmaceutical companies to test their products in our systems. The Relday program with Zogenix and the ophthalmic program with Santen are two projects which started as depot injectable feasibility projects and then matured into development and license agreements.

***Research and Development Programs in Other Therapeutic Categories***

We have underway a number of research programs covering medical diseases and conditions other than pain. Such programs include various diseases and disorders of the central nervous system, cardiovascular disease, ophthalmic conditions and metabolic disorders. In conducting our research programs and determining which particular efforts to prioritize for formal development, we employ a rigorous opportunity assessment process that takes into account the unmet medical need, commercial opportunity, technical feasibility, clinical viability, intellectual property considerations, and the development path including costs to achieve various critical milestones.

***Product Revenues***

We also currently generate product revenue from the sale of three product lines:

ALZET<sup>®</sup> osmotic pumps for animal research use;

LACTEL<sup>®</sup> biodegradable polymers which are used by our customers as raw materials in their pharmaceutical and medical products; and

certain key excipients that are included in REMOXY and one excipient that is included in a currently marketed animal health product.

Because we consider our core business to be developing and commercializing pharmaceuticals, we do not intend to significantly increase our investments in or efforts to sell or market any of our existing product lines. However, we expect that we will continue to make efforts to increase our revenue related to collaborative research and development by entering into additional research and development agreements with third-party collaborators to develop product candidates based on our drug delivery technologies.

### ***Operating Results***

Since our inception in 1998, we have had a history of operating losses. At June 30, 2016, we had an accumulated deficit of \$422.4 million. Our net loss was \$16.9 million for the six months ended June 30, 2016. Our net losses were \$22.7 million and \$22.1 million for the years ended December 31, 2015 and 2014, respectively. These losses have resulted primarily from costs incurred to research and develop our product candidates and to a lesser extent, from selling, general and administrative costs associated with our operations and product sales. We expect our research and development expenses to increase in the near future compared to the second quarter of 2016. We expect selling, general and administrative expenses in the near future to be comparable to the second quarter of 2016. We do not anticipate meaningful revenues from our pharmaceutical product candidates, should they be approved, for at least the next twelve months. Therefore, we expect to incur continuing losses and negative cash flow from operations for the foreseeable future.

**Table of Contents****Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, the recoverability of our long-lived assets, including goodwill and other intangible assets, accrued liabilities, contract research liabilities, inventories and stock-based compensation. Actual amounts could differ significantly from these estimates. There have been no material changes to our critical accounting policies and estimates as compared to the disclosures in our annual report on Form 10-K for the year ended December 31, 2015.

**Results of Operations**

*Three and Six months ended June 30, 2016 and 2015*

*Collaborative research and development and other revenue*

We recognize revenues from collaborative research and development activities and service contracts. Collaborative research and development revenue primarily represents reimbursement of qualified expenses related to collaborative agreements with various third parties to research, develop and commercialize potential products using our drug delivery technologies, and revenue recognized from ratable recognition of upfront fees and milestone payments in connection with our collaborative agreements.

We expect our collaborative research and development revenue in the next few quarters to remain comparable to the second quarter of 2016, pending establishment of new collaborations or an increase in activities undertaken by us under existing collaborations. In general, we expect our collaborative research and development revenue to fluctuate in future periods pending our efforts to enter into potential new collaborations and our existing third party collaborators' commitment to and progress in the research and development programs as well as our role in the workplans for those programs at any point in time. The collaborative research and development and other revenues associated with our major collaborators are as follows (in thousands):

<b>Collaborator</b>	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30, 2016</b>	<b>2015</b>	<b>June 30, 2016</b>	<b>2015</b>
Zogenix, Inc. (Zogenix) (1)	\$ 195	\$ 1,121	\$ 441	\$ 2,278
Santen Pharmaceutical Co. Ltd. (Santen) (2)	148	241	310	548
Pain Therapeutics, Inc. (Pain Therapeutics)	6	163	10	163
Others	22	253	29	527
Total collaborative research and development and other revenue	\$ 371	\$ 1,778	\$ 790	\$ 3,516

(1)

- Amounts related to ratable recognition of upfront fees were \$52,000 and \$104,000 for the three and six months ended June 30, 2016 respectively, compared to \$64,000 and \$127,000 for the corresponding periods in 2015.
- (2) Amounts related to ratable recognition of upfront fees were \$57,000 and \$114,000 for the three and six months ended June 30, 2016 respectively, compared to \$71,000 and \$142,000 for the corresponding periods in 2015.

***Product revenue***

A portion of our revenues is derived from product sales, which include our ALZET mini pump product line, our LACTEL biodegradable polymer product line and certain excipients that are included in REMOXY and another product. Net product revenues were \$2.8 million and \$6.0 million in the three and six months ended June 30, 2016, respectively, compared to \$2.7 million and \$5.7 million for the corresponding periods in 2015. The increase in the three months ended June 30, 2016 was primarily attributable to higher revenue from our ALZET mini pump product line as a result of higher average selling prices and higher units sold, partially offset by lower product revenue from the sale of certain excipients included in REMOXY and another product compared to the corresponding period in 2015. The increase in the six months ended June 30, 2016 was primarily attributable to higher product revenue from our ALZET mini pump product line as a result of higher average selling prices and higher units sold as well as higher revenue from the sale of certain excipients included in REMOXY and another product compared to the corresponding period in 2015. Revenue from our LACTEL product line in the three and six months ended June 30, 2016 was comparable to the corresponding periods in 2015.

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**Table of Contents*****Cost of product revenues***

Cost of product revenues were \$913,000 and \$2.2 million for the three and six months ended June 30, 2016, respectively, compared to \$1.0 million and \$2.0 million for the corresponding periods in 2015. The decrease in the cost of product revenue in the three months ended June 30, 2016 was primarily the result of lower cost of goods sold related to our LACTEL product line arising from lower manufacturing costs for units sold and lower cost of goods sold related to the sale of certain excipients included in REMOXY and another product, partially offset by higher cost of goods sold related to our ALZET mini pump product line arising from higher units sold compared to the corresponding period in 2015. The increase in the cost of product revenue in the six months ended June 30, 2016 was primarily the result of higher cost of goods sold related to our ALZET mini pump product line arising from higher units sold and from higher cost of goods sold related to the sale of certain excipients included in REMOXY and another product, partially offset by lower cost of goods sold related to our LACTEL product line arising from lower units sold in the six months ended June 30, 2016 compared to the corresponding periods in 2015. Cost of product revenues and gross profit margin will fluctuate from period to period depending upon the product mix in a particular period and unit volumes sold. Stock-based compensation expense recognized related to cost of product revenues was \$26,000 and \$53,000 for the three and six months ended June 30, 2016, respectively, compared to \$27,000 and \$56,000 for the corresponding periods in 2015.

As of June 30, 2016, we had 20 manufacturing employees compared with 22 as of June 30, 2015. We expect the number of employees involved in manufacturing will remain comparable in the near future.

***Research and development.***

Research and development expenses are primarily comprised of salaries, benefits, stock-based compensation and other compensation cost associated with research and development personnel, overhead and facility costs, preclinical and non-clinical development costs, clinical trial and related clinical manufacturing costs, contract services, and other outside costs. Research and development expenses were \$7.9 million and \$14.5 million for the three and six months ended June 30, 2016, respectively, compared to \$5.6 million and \$11.0 million for the corresponding periods in 2015. The increase in the three months ended June 30, 2016 was primarily attributable to higher research and development costs associated with DUR-928, POSIMIR and other research programs, partially offset by lower research and development costs associated with Relday, depot injectable programs, the Santen ophthalmic program, ORADUR-ADHD, other ORADUR-based opioid products licensed to Pain Therapeutics and REMOXY compared to the corresponding period in 2015, as more fully discussed below. The increase in the six months ended June 30, 2016 was primarily attributable to higher research and development costs associated with POSIMIR, DUR-928, REMOXY and other research programs, partially offset by lower research and development costs associated with Relday, depot injectable programs, the Santen ophthalmic program, other ORADUR-based opioid products licensed to Pain Therapeutics, ELADUR and ORADUR-ADHD compared to the corresponding period in 2015 as more fully discussed below. Stock-based compensation expense recognized related to research and development personnel was \$357,000 and \$710,000 for the three and six months ended June 30, 2016, respectively, compared to \$332,000 and \$683,000 for the corresponding periods in 2015. As of June 30, 2016, we had 53 research and development employees compared with 55 as of June 30, 2015. We expect research and development expenses to increase in the near future compared to recent quarters as we increase development activities for POSIMIR and DUR-928.

Research and development expenses associated with our major development programs approximate the following (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2016	2015	2016	2015
DUR-928	\$ 3,705	\$ 2,022	\$ 6,165	\$ 4,195
POSIMIR (1)	3,135	1,468	5,861	2,414
Depot Injectable Programs	291	508	786	1,002
Relday (1)	202	1,030	439	2,040
Santen ophthalmic program (1)	143	207	259	456
REMOXY (1)	74	87	300	152
ORADUR-ADHD	46	77	142	156
ELADUR (1)	7	1	28	60
Other ORADUR-based opioid products licensed to Pain Therapeutics (1)	4	31	39	115
Others	245	207	458	415
<b>Total research and development expenses</b>	<b>\$ 7,852</b>	<b>\$ 5,638</b>	<b>\$ 14,477</b>	<b>\$ 11,005</b>

- (1) See Note 2 Strategic Agreements in the condensed financial statements for more details about our agreements with Pfizer, Pain Therapeutics, Zogenix and Santen.

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*DUR-928*

Our research and development expenses for DUR-928 were \$3.7 million and \$6.2 million in the three and six months ended June 30, 2016, respectively, compared to \$2.0 million and \$4.2 million for the corresponding periods in 2015. The increases in the three and six months ended June 30, 2016 were primarily due to increased development activities, including higher employee-related costs, non-clinical related expenses, contract manufacturing and contract research expenses incurred for this drug candidate compared with the corresponding periods in 2015.

*POSIMIR*

Our research and development expenses for POSIMIR were \$3.1 million and \$5.9 million in the three and six months ended June 30, 2016, respectively, compared to \$1.5 million and \$2.4 million for the corresponding periods in 2015. The increases in the three and six months ended June 30, 2016 were primarily due to higher employee-related costs, clinical trial expenses, contract manufacturing expenses and chemical and drug supplies expenses for POSIMIR compared with the corresponding periods in 2015.

*Depot Injectable Programs*

Our research and development expenses for depot injectable programs were \$291,000 and \$786,000 in the three and six months ended June 30, 2016, respectively, compared to \$508,000 and \$1.0 million for the corresponding periods in 2015. The decreases in the three and six months ended June 30, 2016 were primarily due to lower employee-related costs and lower costs related to research supplies for these programs compared with the corresponding periods in 2015.

*Relday*

Our research and development expenses for Relday were \$202,000 and \$439,000 in the three and six months ended June 30, 2016, respectively, compared to \$1.0 million and \$2.0 million for the corresponding periods in 2015. The decreases in the three and six months ended June 30, 2016 were primarily due to decreased development activities and lower employee-related costs incurred for this drug candidate compared with the corresponding periods in 2015.

*Santen ophthalmic program*

Our research and development expenses for the Santen ophthalmic program were \$143,000 and \$259,000 in the three and six months ended June 30, 2016, respectively, compared to \$207,000 and \$456,000 for the corresponding periods in 2015. The decreases in the three and six months ended June 30, 2016 were primarily due to decreased formulation development activities and lower employee-related costs associated with this drug candidate compared with the corresponding periods in 2015.

*REMOXY*

Our research and development expenses for REMOXY were \$74,000 and \$300,000 in the three and six months ended June 30, 2016, respectively, compared to \$87,000 and \$152,000 for the corresponding periods in 2015. The decrease in the three months ended June 30, 2016 was primarily due to lower employee-related costs for REMOXY compared with the corresponding period in 2015. The increase in the six months ended June 30, 2016 was primarily due to higher employee-related costs for REMOXY compared with the corresponding period in 2015.

*ORADUR-ADHD*

Our research and development expenses for ORADUR-ADHD were \$46,000 and \$142,000 in the three and six months ended June 30, 2016, respectively, compared to \$77,000 and \$156,000 for the corresponding periods in 2015. The decreases in the three and six months ended June 30, 2016 were primarily due to lower employee-related costs for these drug candidates compared with the corresponding periods in 2015.

*Other ORADUR-based opioid products licensed to Pain Therapeutics*

Our research and development expenses for other ORADUR-based opioid products licensed to Pain Therapeutics were \$4,000 and \$39,000 in the three and six months ended June 30, 2016, respectively, compared to \$31,000 and \$115,000 for the corresponding periods in 2015. The decreases in the three and six months ended June 30, 2016 were primarily due to lower employee-related costs as well as lower outside expenses associated with these product candidates compared with the corresponding periods in 2015.

*ELADUR*

Our research and development expenses for ELADUR were \$7,000 and \$28,000 in the three and six months ended June 30, 2016, respectively, compared to \$1,000 and \$60,000 for the corresponding periods in 2015. The increase in the three months ended June 30, 2016 was primarily due to higher employee-related costs associated with this product candidate compared with the corresponding period in 2015. The decrease in the six months ended June 30, 2016 was primarily due to lower employee-related costs associated with this product candidate compared with the corresponding period in 2015.



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**Table of Contents***Other DURECT research programs*

Our research and development expenses for all other programs were \$245,000 and \$458,000 in the three and six months ended June 30, 2016, respectively, compared to \$207,000 and \$415,000 for the corresponding periods in 2015, respectively. The increases in the three and six months ended June 30, 2016 were primarily due to higher employee-related costs incurred for these programs compared with the corresponding periods in 2015.

We cannot reasonably estimate the timing and costs of our research and development programs due to the risks and uncertainties associated with developing pharmaceuticals, as outlined in the Risk Factors section of this report. The duration of development of our research and development programs may span as many as ten years or more, and estimation of completion dates or costs to complete would be highly speculative and subjective due to the numerous risks and uncertainties associated with developing pharmaceutical products, including significant and changing government regulation, the uncertainties of future preclinical and clinical study results, the uncertainties with our collaborators' commitment and progress to the programs and the uncertainties associated with process development and manufacturing as well as sales and marketing. In addition, with respect to our development programs subject to third-party collaborations, the timing and expenditures to complete the programs are subject to the control of our collaborators. Therefore, we cannot reasonably estimate the timing and estimated costs of the efforts necessary to complete the research and development programs. For additional information regarding these risks and uncertainties, see Risk Factors below.

***Selling, general and administrative.*** Selling, general and administrative expenses are primarily comprised of salaries, benefits, stock-based compensation and other compensation cost associated with finance, legal, business development, sales and marketing and other administrative personnel, overhead and facility costs, and other general and administrative costs. Selling, general and administrative expenses were \$2.9 million and \$6.0 million for the three and six months ended June 30, 2016, respectively, compared to \$2.7 million and \$5.5 million for the corresponding periods in 2015. The increases in selling, general and administrative expenses in the three and six months ended June 30, 2016 were primarily due to higher employee related expenses and market research expenses compared to the corresponding periods in 2015. Stock-based compensation expense recognized related to selling, general and administrative personnel was \$314,000 and \$644,000 for the three and six months ended June 30, 2016, respectively, compared to \$265,000 and \$535,000 for the corresponding periods in 2015.

As of June 30, 2016, we had 25 selling, general and administrative employees compared with 26 as of June 30, 2015. We expect selling, general and administrative expenses in the near future to be comparable to the second quarter of 2016.

***Other income (expense).*** Interest and other income was \$40,000 and \$67,000 for the three and six months ended June 30, 2016, respectively, compared to \$23,000 and \$151,000 for the corresponding periods in 2015. The increase in interest and other income in the three months ended June 30, 2016 was primarily the result of higher cash and investments balance in the second quarter of 2016 compared with the same period in 2015. The decrease in interest and other income in the six months ended June 30, 2016 was primarily the result of a realized gain from the sale of a marketable equity security in the first quarter of 2015.

Interest expense was \$558,000 and \$1.1 million for the three and six months ended June 30, 2016, respectively, compared to \$558,000 and \$1.1 million for the corresponding periods in 2015. The interest expense was primarily related to interest expense and amortization of debt discount related to a long-term debt arrangement entered into in June 2015.

***Liquidity and Capital Resources***

We had cash, cash equivalents and investments totaling \$33.9 million at June 30, 2016 compared to \$29.3 million at December 31, 2015. These balances include \$250,000 of interest-bearing marketable securities classified as restricted investments on our balance sheets as of June 30, 2016 and December 31, 2015, respectively. The increase in cash, cash equivalents and investments during the six months ended June 30, 2016 was primarily the result of the sale of common stock in the second quarter of 2016 and payments received from collaboration partners and customers, partially offset by ongoing operating expenses.

We used \$14.1 million of cash in operating activities for the six months ended June 30, 2016 compared to \$9.6 million for the corresponding period in 2015. The cash used for operations was primarily to fund operations as well as our working capital requirements and reflected an increase in net loss of \$6.5 million, partially offset by the changes in accounts receivable, prepaid expenses and other assets, and accrued and other liabilities.

We used \$7,000 of cash in investing activities for the six months ended June 30, 2016 compared to \$435,000 provided by investing activities for the corresponding period in 2015. The decrease in cash received in investing activities was primarily due to a decrease in net proceeds from maturities of available-for-sale securities for the six months ended June 30, 2016 compared to the

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corresponding period in 2015. We anticipate incurring capital expenditures of approximately \$100,000 in 2016 to purchase research and development and other capital equipment. The amount and timing of these capital expenditures will depend on, among other things, the timing of clinical trials for our products and our collaborative research and development activities.

We received \$18.6 million of cash from financing activities for the six months ended June 30, 2016 compared to \$12.5 million for the corresponding period in 2015. During the six months of 2016, we raised net proceeds (net of commission) of approximately \$2.3 million from the sale of approximately 1.6 million shares of common stock at a weighted average price of \$1.48 per share in the open market through our Controlled Equity Offering sales agreement with Cantor Fitzgerald, entered into in November 2015. We also completed an underwritten public offering in which we sold an aggregate of 13.8 million shares of our common stock pursuant to an effective registration statement at a price to the public of \$1.25. We received net proceeds of approximately \$16.1 million after deducting underwriting discounts and commissions and offering expenses from this public offering.

We anticipate that cash used in operating activities will increase in the near future compared to recent quarters.

During the six months ended June 30, 2016, there have been no significant changes in our commercial commitments and contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015. However, in July 2016 we refinanced the term loan with Oxford Finance as described in Note 7.

We believe that our existing cash, cash equivalents and investments will be sufficient to fund our planned operations, contractual commitments, planned capital expenditures and service our debt through at least the next 12 months. We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding. Additionally, we do not expect to generate meaningful revenues from our pharmaceutical product candidates currently under development for at least the next twelve months, if at all. Depending on whether we enter into additional collaborative agreements in the near term, we may be required to raise additional capital through a variety of sources, including:

the public equity markets;

private equity financings;

collaborative arrangements; and/or

public or private debt.

There can be no assurance that we will enter into additional collaborative agreements in the near term or additional capital will be available on favorable terms, if at all. If adequate funds are not available, we may be required to significantly reduce or refocus our operations or to obtain funds through arrangements that may require us to relinquish rights to certain of our products, technologies or potential markets, any of which could have a material adverse effect on our business, financial condition and results of operations. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities would result in ownership dilution to our existing stockholders.

Our cash and investments policy emphasizes liquidity and preservation of principal over other portfolio considerations. We select investments that maximize interest income to the extent possible given these two constraints. We satisfy liquidity requirements by investing excess cash in securities with different maturities to match projected cash needs and limit concentration of credit risk by diversifying our investments among a variety of high credit-quality issuers.

#### ***Off-Balance Sheet Arrangements***

As of June 30, 2016, we did not have any off-balance sheet arrangements, as defined under SEC Regulation S-K Item 303(a)(4)(ii).

#### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

During the six months ended June 30, 2016, there have been no significant changes in market risks as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

#### **Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures:* The Company's principal executive and financial officers reviewed and evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Form 10-Q. Based on that evaluation, the Company's principal executive and financial officers concluded that the Company's disclosure controls and procedures are effective at ensuring that information required to be disclosed by the Company in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including the Company's principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

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*Changes in Internal Control Over Financial Reporting:* There were no significant changes in the Company's internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the Company's most recently completed 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 1. Legal Proceedings**

We are not a party to any material legal proceedings.

**Item 1A. Risk Factors.**

In addition to the other information in this Form 10-Q, a number of factors may affect our business and prospects. These factors include but are not limited to the following, which you should consider carefully in evaluating our business and prospects.

**Risks Related To Our Business**

*Regulatory approval of POSIMIR has been delayed and may be denied, and regulatory approval of our other product candidates is subject to delay or may be denied, which could harm our business*

In February 2014, we received a Complete Response Letter to our NDA for POSIMIR from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. We began recruiting patients for this trial in November 2015 comparing POSIMIR to placebo. Based on advice received from the FDA subsequent to the start of the trial, in April 2016 we decided to amend the PERSIST trial including by incorporating standard bupivacaine HCl as an active control. Starting in August 2016, we are implementing changes to the PERSIST trial to evaluate POSIMIR against standard bupivacaine HCl rather than placebo. At the same time, we are switching the primary efficacy endpoint (pain reduction on movement) from 0-72 hours after surgery to 0-48 hours after surgery. Assessing pain reduction on movement from 0-72 hours is now the key secondary efficacy endpoint and other efficacy endpoints, including 72-hour opioid use, remain the same. We expect to enroll approximately 264 patients in Part 2 of PERSIST, and we expect this part of the trial to take approximately one year to enroll. These changes will add to the time and cost to complete the PERSIST trial, and there can be no assurance that this clinical trial will be completed in a timely manner or generate data necessary to support a successful NDA resubmission. There can also be no assurance that the results of this trial will be sufficient to support FDA approval. The failure to adequately demonstrate the safety and effectiveness of a pharmaceutical product candidate under development to the satisfaction of FDA and other regulatory agencies has, with respect to POSIMIR and could, with respect to other product candidates, delay or prevent regulatory clearance of the potential product candidate, resulting in delays to the commercialization of our product candidate, and could materially harm our business. Clinical trials may not demonstrate the sufficient levels of safety and efficacy necessary to obtain the requisite regulatory approvals for our product candidates, or may require such significant numbers of patients or additional costs to make it impractical to satisfy the FDA's requirements, and thus our product candidates may not be approved for marketing. During the review process, the FDA may request more information regarding the safety of our product candidates, as they have in their Complete Response Letter for POSIMIR, and answering such questions could require significant additional work and expense, and take a significant amount of time, resulting in a material delay of approval or the failure to obtain approval. During the review process, the FDA may also request more information regarding the chemistry, manufacturing or controls related to our product candidates, as they have in their Complete Response Letter for REMOXY, and answering such questions could require significant additional work and expense, and take a significant amount of time, resulting in a material delay of approval or the failure to obtain approval.

*We do not control development of REMOXY*

We have relied on Pfizer and its subsidiaries to devote time and resources to the development, manufacturing and commercialization of REMOXY. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics. There can also be no assurance that Pain Therapeutics will continue development of REMOXY, or if Pain Therapeutics continues development of REMOXY, there can be no assurance that their resubmission of the NDA will satisfy the FDA's requirements. Pain Therapeutics and its subsidiaries and affiliates may commercialize, develop or acquire drugs or drug candidates that may compete indirectly or compete for resources with REMOXY. Any further delay or discontinuation in the development of REMOXY will significantly harm our prospects and would be likely to have a negative effect on the price of our common stock.

*Development of our pharmaceutical product candidates is not complete, and we cannot be certain that our product candidates will be able to be commercialized*

To be profitable, we or our third-party collaborators must successfully research, develop, obtain regulatory approval for, manufacture, introduce, market and distribute our pharmaceutical product candidates under development. For each product candidate that we or our third-party collaborators intend to commercialize, we must successfully meet a number of critical developmental milestones for each disease or medical condition targeted, including:

with respect to each new chemical entity, determining appropriate indications;

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with respect to our Drug Delivery Program product candidates, selecting and developing a drug delivery technology to deliver the proper dose of drug over the desired period of time;

determining the appropriate drug dosage for use in the pharmaceutical product candidate;

developing drug compound formulations that will be tolerated, safe and effective and that will be compatible with the active pharmaceutical agent;

demonstrating the drug formulation will be stable for commercially reasonable time periods;

demonstrating through clinical trials that the drug formulation is safe and effective in patients for the intended indication at an achievable dose; and

completing the manufacturing development and scale-up to permit manufacture of the pharmaceutical product candidate in commercial quantities and at acceptable cost.

The time frame necessary to achieve these developmental milestones for any individual product is long and uncertain, and we may not successfully complete these milestones for any of our products in development. We have not yet completed development of any of our product candidates, including DUR-928, ORADUR-ADHD and other ORADUR-based opioid products, Relday, or ELADUR, and we have limited experience in developing such products. We may not be able to finalize the design or formulation of any of these product candidates. Further, although we believe our design and formulation of REMOXY and POSIMIR to be substantially complete, there can be no assurance that additional developments will not be required prior to any regulatory approval of these products. In addition, we may select components, solvents, excipients or other ingredients to include in our product candidates that have not been previously approved for use in pharmaceutical products, which may require us or our collaborators to perform additional studies and may delay clinical testing and regulatory approval of our product candidates. Even after we complete the design of a product candidate, the product candidate must still complete required clinical trials and additional safety testing in animals before approval for commercialization. We are continuing testing and development of our product candidates and may explore possible design or formulation changes to address issues of safety, manufacturing efficiency and performance. We or our collaborators may not be able to complete development of any product candidates that will be safe and effective and that will have a commercially reasonable treatment and storage period. If we or our third-party collaborators are unable to complete development of DUR-928, ORADUR-ADHD and other ORADUR-based opioid products, Relday, or ELADUR, or other product candidates, we will not be able to earn revenue from them, which would materially harm our business.

*We or our third-party collaborators must show the safety and efficacy of our drug candidates in animal studies and human clinical trials to the satisfaction of regulatory authorities before they can be sold; failure to obtain approvals for REMOXY, POSIMIR, DUR-928 or our other product candidates would significantly harm our business, prospects and financial condition*

Before we or our third-party collaborators can obtain government approval to sell any of our pharmaceutical product candidates, we or they, as applicable, must demonstrate through laboratory performance studies and safety testing, nonclinical (animal) studies and clinical (human) trials that each system is safe and effective for human use for each targeted indication. The clinical development status of our major development programs is as follows:



**DUR-928** In 2015, we completed initial Phase 1 human safety trials of DUR-928 when orally administered and when administered through injection to a total of over 75 healthy volunteers. These trials evaluated the safety, tolerability and pharmacokinetics of DUR-928 when administered with a single dose and then with multiple doses. The high doses in these studies resulted in plasma levels greater than 100-fold higher than endogenous levels of DUR-928, and DUR-928 was observed to be well tolerated at all doses, with no severe or serious drug-related adverse events reported. In these studies, there was no accumulation in plasma concentrations observed with repeated dosing, and there were dose related increases in plasma concentrations. In 2016, we initiated a single-ascending-dose Phase 1b clinical trial with DUR-928 in patients with nonalcoholic steatohepatitis (NASH), and we expect to obtain results from this study in 2016. We also are conducting a Phase 1b single-ascending-dose, injectable administration trial in renal function impaired patients, with data expected to be available from the study in 2016. There can be no assurance that biological activity demonstrated in previous animal disease models will also be seen in human trials, or that any clinically relevant biological activity will be seen in humans. There can also be no assurance that current and future planned trials will be completed on the timetable anticipated, that further human trials will not identify safety issues, or that we will be able to successfully develop DUR-928 to obtain marketing approval by the FDA or other regulatory agencies.

**POSIMIR** In April 2013, we submitted a new drug application as a 505(b)(2) application, which relies in part on the FDA's findings of safety and effectiveness of a reference drug. In February 2014, we received a Complete Response Letter from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. We began recruiting patients for this trial in November 2015 comparing POSIMIR to placebo. Based on advice from the FDA received subsequent to the start of the trial, in April 2016, we decided to amend the PERSIST trial including by incorporating standard bupivacaine HCl as an active control. Starting in August 2016, we are implementing Part 2 of the PERSIST trial to evaluate POSIMIR against standard bupivacaine HCl rather than placebo as we have been doing in Part 1. Additionally, we are switching in Part 2 the primary efficacy endpoint (pain reduction on movement) from 0-72 hours after surgery to 0-48 hours after surgery. Assessing pain reduction on movement from 0-72 hours is now the key secondary efficacy endpoint and other

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efficacy endpoints, including 72-hour opioid use, remain the same. We expect to enroll approximately 264 patients in Part 2 of PERSIST, and we expect this part of the trial to take approximately one year to enroll. This amendment to the trial will add to the time and cost to complete PERSIST, and could add to the risk of the trial. There can be no assurance that the trial will enroll on the timetable we anticipate, that we will be able to adequately or timely address all of FDA's concerns and suggestions regarding POSIMIR, that the FDA will grant regulatory approval of POSIMIR, that adverse effects will not arise from additional testing or use of POSIMIR, or that the data we have generated or may generate will be deemed sufficient by FDA or other regulatory agencies to support regulatory approval of POSIMIR.

**REMOXY** In December 2010, King (now Pfizer) resubmitted the NDA in response to a Complete Response Letter received in December 2008 by Pain Therapeutics. On June 23, 2011, a Complete Response Letter from the FDA was received by Pfizer on the resubmission to the NDA for REMOXY. The issues raised in the Complete Response Letter relate primarily to manufacturing. In October 2013, Pfizer stated that, having achieved technical milestones related to manufacturing, it would continue developing REMOXY. Pfizer had also announced that it was proceeding with additional clinical studies in support of resubmission of the NDA. It is possible that the results of such studies will not be satisfactory to the FDA. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY, and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics and that Pfizer would continue ongoing activities under the agreement until the scheduled termination date in April 2015. In April 2015, Pain Therapeutics stated that it had resumed responsibility for REMOXY under the terms of a letter agreement with Pfizer. In July 2015, Pain Therapeutics stated that it had substantially completed the transition of REMOXY from Pfizer. In March 2016, Pain Therapeutics announced that it had resubmitted the NDA to the FDA, and in April 2016, Pain Therapeutics announced that the FDA had determined that the NDA was sufficiently complete to permit a substantive review. Pain Therapeutics further stated that September 25, 2016 is the target action date under the Prescription Drug User Fee Act (PDUFA). In May 2016, the FDA informed Pain Therapeutics that there was a tentative date of August 5, 2016 for an Advisory Committee meeting to review the REMOXY NDA. In July 2016, Pain Therapeutics announced that the FDA had determined that the Advisory Committee meeting is unnecessary and would not be held on August 5. Pain Therapeutics also stated that the FDA advised them that the regulatory review remains active and is on-going, and the PDUFA date of September 25, 2016 remains unchanged. There can be no assurance that Pain Therapeutics will successfully obtain marketing approval by the FDA on a timely basis or at all, or that Pain Therapeutics will obtain a new commercialization partner.

**ORADUR-ADHD** Since 2010, we and Orient Pharma conducted several Phase 1 studies to evaluate multiple formulations of ORADUR-Methylphenidate. We and Orient Pharma have selected a lead formulation based on its potential for rapid onset of action, long duration for once-a-day dosing and target pharmacokinetic profile as demonstrated in the latest Phase 1 trial. In addition, this product candidate will utilize a small capsule size relative to the leading existing long-acting products on the market. Orient Pharma, our licensee in defined Asian and South Pacific countries, has initiated a Phase 3 trial in Taiwan and anticipates completing it in 2016. We retain rights to all other territories in the world and are engaged in licensing discussions with other companies. There can be no assurance that Orient Pharma will complete the Phase 3 trial on the anticipated timetable or that we will be able to successfully develop ORADUR-Methylphenidate to obtain marketing approval by the Taiwan FDA or the U.S. FDA or other regulatory agencies, nor is there any assurance that we will be able to find a collaborator with respect to the development and commercialization of this drug candidate for the territories not currently licensed to Orient Pharma.

**Relday** In January 2013, Zogenix announced positive single-dose pharmacokinetic (PK) results from a Phase 1 clinical trial of Relday. Per Zogenix, based on the favorable safety and PK profile demonstrated with the 25 mg and 50 mg once-monthly doses tested in the Phase 1 trial, Zogenix extended the study to include a 100 mg dose of the same formulation. In May 2013, Zogenix announced positive results with the 100 mg arm, demonstrating dose proportionality across the full dose range that would be anticipated to be used in clinical practice. According to Zogenix, the positive results from this study extension positioned Zogenix to begin a multi-dose clinical trial, which would provide the required steady-state pharmacokinetic and safety data prior to initiating Phase 3 development studies. In September 2015, Zogenix announced positive top line results from this multi-dose clinical trial. According to Zogenix, the results for Relday demonstrated that risperidone plasma concentrations in the therapeutic range were achieved on the first day of dosing, reached steady state levels following the second dose and consistently maintained therapeutic levels throughout the four-month period. Also according to Zogenix, Relday was generally safe and well-tolerated, with results consistent with the profile of risperidone and the previous Phase 1 single-dose clinical trial. Zogenix further stated that it has now initiated efforts to secure a development and commercialization partner for Relday, and that Relday is well-positioned to begin a Phase 3 program once a partner is secured. There can be no assurance that Zogenix will secure a development and commercialization partner for Relday or that Relday will begin the Phase 3 program or that if such a program is begun it will generate data sufficient to support a successful NDA.

**ELADUR** A Phase 2a clinical trial in post-herpetic neuralgia (PHN or post-shingles pain) was completed and positive efficacy trends were reported in the fourth quarter of 2007. King, which assumed worldwide development and commercialization rights for ELADUR through its acquisition of Alpharma, conducted a Phase 2 clinical trial to evaluate ELADUR for the treatment of chronic low back pain and reported in April 2011 that the primary efficacy endpoint for the

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trial was not met. In February 2012, Pfizer, which assumed worldwide development and commercialization rights to ELADUR through its acquisition of King, notified us that they were returning their worldwide development and commercialization rights to ELADUR. In January 2014, we and Impax entered into an agreement, pursuant to which we have granted Impax an exclusive worldwide license to our proprietary TRANSDUR transdermal delivery technology and other intellectual property to develop and commercialize ELADUR. There can be no assurance that Impax will continue to develop ELADUR or will be able to successfully develop ELADUR to obtain marketing approval by the FDA or other regulatory agencies.

**ORADUR-based opioids** In addition to REMOXY, Phase 1 clinical trials have been conducted for two other ORADUR-based product candidates (hydrocodone and hydromorphone), and an IND has been accepted by the FDA for another ORADUR-based opioid (oxymorphone). In October 2013, Pain Therapeutics stated that it had regained all rights from Pfizer with respect to the three ORADUR-based opioid drug candidates (hydrocodone, hydromorphone and oxymorphone). In May 2015, Pain Therapeutics returned to us all of Pain Therapeutics' rights and obligations under our license agreement to develop and commercialize ORADUR-based formulations of hydrocodone but without impacting the rights and obligations of the two parties with respect to REMOXY (oxycodone), hydromorphone or oxymorphone. There can be no assurance that we or our collaborator will be able to successfully develop ORADUR-based formulations of oxycodone, hydromorphone or oxymorphone to obtain marketing approval by the FDA or other regulatory agencies.

We are currently in the clinical, preclinical or research stages with respect to all of our product candidates under development. We plan to continue extensive and costly tests, clinical trials and safety studies in animals to assess the safety and effectiveness of our product candidates. These studies include laboratory performance studies and safety testing, clinical trials and animal toxicological studies necessary to support regulatory approval of development products in the United States and other countries of the world. These studies are costly, complex and last for long durations, and may not yield data supportive of the safety or efficacy of our drug candidates or required for regulatory approval.

*New chemical entities derived from our Epigenomic Regulator Program, which is in the early stages of development, may require more time and resources for development, testing and regulatory approval than our Drug Delivery Program product candidates, and may not result in viable commercial products*

Our Epigenomic Regulator Program is in the early stages of development, involves unproven technology, requires significant further research and development and regulatory approvals and is subject to the risks of failure inherent in the development of products based on innovative technologies. New chemical entities derived from our Epigenomic Regulator Program are molecules that have not previously been approved and marketed as therapeutics, unlike product candidates in our Drug Delivery Programs, in which we apply our formulation expertise and technologies largely to active pharmaceutical ingredients whose safety and efficacy have previously been established but which we aim to improve in some manner through a new formulation. As a result, the product candidates from our Epigenomic Regulator Program may face greater risk of unanticipated safety issues or other side-effects, or may not demonstrate efficacy. Further, the regulatory pathway for our new chemical entities will be more demanding than that for product candidates under our Drug Delivery Programs, for which we may be able to leverage existing data under Section 505(b)(2) of the Act to reduce development risk, time and cost.

Also, because our Epigenomic Regulator Program is in early stages, we have not defined with precision those indications we wish to pursue initially, each of which may have unique challenges. If the first indications pursued do not show positive results, the credibility of any product candidate from this program may be tarnished, even if the molecule might be effective for other indications. Our decisions regarding which indications to pursue may cause us to fail to capitalize on indications that could have given rise to viable commercial products and profitable market

opportunities.

*Early clinical trial results may not predict the results of later trials, and our clinical trials or those of our collaborators for POSIMIR or REMOXY may not satisfy regulatory agencies*

While some clinical trials of our product candidates have shown indications of safety and efficacy of our product candidates, there can be no assurance that these results will be confirmed in subsequent clinical trials or provide a sufficient basis for regulatory approval. In addition, side effects observed in clinical trials, or other side effects that appear in later clinical trials, may adversely affect our or our collaborators' ability to obtain regulatory approval or market our product candidates. For example, the finding that DUR-928 appears safe in the initial Phase 1 trials may not be confirmed in subsequent Phase 1 or other clinical trials. Likewise, the reduction in pain intensity on movement of POSIMIR compared to bupivacaine HCl in previous trials may not be repeated in the ongoing POSIMIR trial. In the Phase 2b hysterectomy trial and the BESST Phase 3 abdominal surgery trial of POSIMIR, transient local hematoma-like discolorations were observed near the surgical site. Side effects such as these, toxicity or other safety issues associated with the use of our drug candidates could require us to perform additional studies or halt development of our drug candidates. We or our collaborators may be required by regulatory agencies to conduct additional animal or human studies regarding the safety and efficacy of our pharmaceutical product candidates which we have not planned or anticipated. For example, the FDA's Complete Response Letter raised concerns related to, among other matters, the Chemistry, Manufacturing, and Controls section of the NDA for REMOXY. There can be no assurance that Pain Therapeutics will resolve these issues to the satisfaction of the FDA in a

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timely manner or ever, which could harm our business, prospects and financial condition. Further, the FDA's Complete Response Letter for POSIMIR raised concerns that insufficient safety data had been provided and FDA has indicated that an additional clinical trial for POSIMIR needs to be conducted. There can be no assurance that the additional clinical trial we are conducting for POSIMIR will be sufficient to obtain FDA approval, and any additional trials would entail added expense and further delay or may preclude product approval, harming our business, prospects and financial condition.

*Regulatory action or failure to obtain product approvals could delay or limit development and commercialization of our product candidates and result in failure to achieve anticipated revenues*

The manufacture and marketing of our pharmaceutical product candidates and our research and development activities are subject to extensive regulation for safety, efficacy and quality by numerous government authorities in the United States and abroad. We or our third-party collaborators must obtain clearance or approval from applicable regulatory authorities before we or they, as applicable, can perform clinical trials, market or sell our products in development in the United States or abroad. Clinical trials, manufacturing and marketing of products are subject to the rigorous testing and approval process of the FDA and equivalent foreign regulatory authorities. In particular, the FDA rigorously focuses on the safety of drug products at every stage of drug development and commercialization from initial clinical trials to regulatory approval and beyond, and the interpretation of data that may pertain to safety can be subject to the interpretation of individual reviewers within the FDA. These rigorous and potentially evolving standards, that often differ by therapeutic area, may delay and increase the expenses of our development efforts. The FDA or other foreign regulatory agency may, at any time, halt our and our collaborators' development and commercialization activities due to safety concerns, in which case our business will be harmed. In addition, the FDA or other foreign regulatory agency may refuse or delay approval of our or our collaborators' drug candidates for failure to collect sufficient clinical or animal safety data, and require us or our collaborators to conduct additional clinical or animal safety studies which may cause lengthy delays and increased costs to our programs.

The Federal Food, Drug and Cosmetic Act and other federal, state and foreign statutes and regulations govern and influence the testing, manufacture, labeling, advertising, distribution and promotion of drugs and medical devices. These laws and regulations are complex and subject to change. Furthermore, these laws and regulations may be subject to varying interpretations, and we may not be able to predict how an applicable regulatory body or agency may choose to interpret or apply any law or regulation to our pharmaceutical product candidates. As a result, clinical trials and regulatory approval can take a number of years to accomplish and require the expenditure of substantial resources. We or our third-party collaborators, as applicable, may encounter delays or rejections based upon administrative action or interpretations of current rules and regulations. We or our third-party collaborators, as applicable, may not be able to timely reach agreement with the FDA on our clinical trials or on the required clinical or animal data we or they must collect to continue with our clinical trials or eventually commercialize our product candidates.

We or our third-party collaborators, as applicable, may also encounter delays or rejections based upon additional government regulation from future legislation, administrative action or changes in FDA policy during the period of product development, clinical trials and FDA regulatory review. We or our third-party collaborators, as applicable, may encounter similar delays in foreign countries. Sales of our pharmaceutical product candidates outside the United States are subject to foreign regulatory standards that vary from country to country.

The time required to obtain approvals from foreign countries may be shorter or longer than that required for FDA approval, and requirements for foreign licensing may differ from FDA requirements. We or our third-party collaborators, as applicable, may be unable to obtain requisite approvals from the FDA and foreign regulatory authorities, and even if obtained, such approvals may not be on a timely basis, or they may not cover the clinical uses that we specify. If we or our third-party collaborators, as applicable, fail to obtain timely clearance or approval for our

development products, we or they will not be able to market and sell our pharmaceutical product candidates, which will limit our ability to generate revenue.

*Many of our drug candidates under development, including REMOXY and our other ORADUR-based opioids are subject to mandatory Risk Evaluation and Mitigation Strategy (REMS) programs, which could delay the approval of these drug candidates, reduce demand for them, and increase the cost, burden and liability associated with their commercialization*

On February 6, 2009, the FDA sent letters to manufacturers of certain opioid drug products, indicating that these drugs will be required to have a Risk Evaluation and Mitigation Strategy (REMS) to ensure that the benefits of the drugs continue to outweigh the risks. The affected opioid drugs include brand name and generic products and are formulated with the active ingredients fentanyl, hydromorphone, methadone, morphine, oxycodone, and oxymorphone.

On April 19, 2011, the Office of National Drug Control Policy (ONDCP) released the Obama Administration's Epidemic: Responding to America's Prescription Drug Abuse Crisis—a comprehensive action plan to address the national prescription drug abuse epidemic. This plan includes action in four major areas to reduce prescription drug abuse: education, monitoring, proper disposal, and enforcement. In support of the action plan, the FDA announced the elements of a Risk Evaluation and Mitigation Strategy (REMS) that will require all manufacturers of long-acting and extended-release opioids to ensure that training is provided to prescribers of these medications and to develop information that prescribers can use when counseling patients about the risks and benefits of opioid use. The FDA wants drug makers to work together to develop a single system for implementing the REMS strategies.

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On July 9, 2012 the FDA approved a REMS for extended-release (ER) and long-acting (LA) opioids. The REMS is part of a federal initiative to address the prescription drug abuse, misuse, and overdose epidemic. The REMS introduces new safety measures designed to reduce risks and improve the safe use of ER/LA opioids, while ensuring access to needed medications for patients in pain.

The new ER/LA opioid REMS will affect more than 20 companies that manufacture these opioid analgesics. Under the new REMS, companies will be required to make education programs available to prescribers based on an FDA Blueprint. It is expected that companies will meet this obligation by providing educational grants to continuing education (CE) providers, who will develop and deliver the training. The REMS also will require companies to make available FDA-approved patient education materials on the safe use of these drugs. The companies will be required to perform periodic assessments of the implementation of the REMS and the success of the program in meeting its goals. The FDA will review these assessments and may require additional elements to achieve the goals of the program.

On September 10, 2013, the FDA announced safety labeling changes and post-market study requirements for extended-release and long-acting opioid analgesics (ER/LA opioids). The updated class-wide labeling changes state that ER/LA opioids are indicated for the management of pain severe enough to require daily, around-the-clock, long-term opioid treatment and for which alternative treatment options are inadequate. The updated indication further clarifies that, because of the risks of addiction, abuse, and misuse, even at recommended doses, and because of the greater risks of overdose and death, these drugs should be reserved for use in patients for whom alternative treatment options (e.g., non-opioid analgesics or immediate-release opioids) are ineffective, not tolerated, or would be otherwise inadequate to provide sufficient management of pain; ER/LA opioid analgesics are not indicated for as-needed pain relief. Recognizing that more information is needed to assess the serious risks associated with long-term use of ER/LA opioids, the FDA is requiring the drug companies that make these products to conduct further post-market studies and clinical trials. These changes may result in a decrease in prescriptions for this class of drugs and will increase the costs borne by manufacturers of ER/LA opioids.

More recently, in February 2016, the FDA announced a comprehensive action plan to take concrete steps towards reducing the impact of opioid abuse on American families and communities. As part of this plan, the agency will review product and labelling decisions and re-examine the risk-benefit paradigm for opioids.

Many of our drug candidates including REMOXY and other ORADUR-based opioid drug candidates are subject to the REMS requirement. The FDA's REMS requirements have been evolving, and until the contours of required REMS programs are established by the FDA and understood by drug developers and marketers such as ourselves and our collaborators, and until the results of the FDA's recently announced initiatives are known, there may be delays in marketing approvals for these drug candidates. In addition, there may be increased cost, administrative burden and potential liability associated with the marketing and sale of these types of drug candidates subject to the REMS requirement, as well as decreased demand resulting from new labeling requirements, which could negatively impact the commercial benefits to us and our collaborators from the sale of these drug candidates.

*We depend to a large extent on third-party collaborators, and we have limited or no control over the development, sales, distribution and disclosure for our pharmaceutical product candidates which are the subject of third-party collaborative or license agreements*

Our performance depends to a large extent on the ability of our third-party collaborators to successfully develop and obtain approvals for our pharmaceutical product candidates. We have entered into agreements with Pain Therapeutics, Zogenix, Impax, Santen, Orient Pharma and others under which we granted such third parties the right to develop, apply for regulatory approval for, market, promote or distribute REMOXY and certain other ORADUR-based products, Relday, ELADUR and other product candidates, subject to payments to us in the form of product royalties



and other payments. We have limited or no control over the expertise or resources that any collaborator may devote to the development, clinical trial strategy, regulatory approval, marketing or sale of these product candidates, or the timing of their activities. Any of our present or future collaborators may not perform their obligations as expected. These collaborators may breach or terminate their agreement with us or otherwise fail to conduct their collaborative activities successfully and in a timely manner. Enforcing any of these agreements in the event of a breach by the other party could require the expenditure of significant resources and consume a significant amount of management time and attention. Our collaborators may also conduct their activities in a manner that is different from the manner we would have chosen, had we been developing such product candidates ourselves. Further, our collaborators may elect not to develop or commercialize product candidates arising out of our collaborative arrangements or not devote sufficient resources to the development, clinical trials, regulatory approval, manufacture, marketing or sale of these product candidates. If any of these events occur, we may not recognize revenue from the commercialization of our product candidates based on such collaborations. In addition, these third parties may have similar or competitive products to the ones which are the subject of their collaborations with us, or relationships with our competitors, which may reduce their interest in developing or selling our product candidates. We may not be able to control public disclosures made by some of our third-party collaborators, which could negatively impact our stock price.

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*Cancellation of collaborations regarding our product candidates may impact our near-term revenues and adversely affect potential economic benefits*

Third-party collaboration agreements typically allow the third party to terminate the agreement (or a specific program within an agreement) by providing notice. For example, in January 2012, we were notified that Nycomed was terminating the Development and License Agreement between Nycomed and us relating to the development and commercialization of POSIMIR in Europe and their other licensed territories. In February 2012, we were notified that Pfizer was terminating the worldwide Development and License Agreement between Alpharma (acquired by King which subsequently was acquired by Pfizer) and us relating to the development and commercialization of ELADUR. In March 2012, we were notified that Hospira was terminating the Development and License Agreement between Hospira and us relating to the development and commercialization of POSIMIR in the United States and Canada. In October 2014, we were notified that Pfizer had decided to discontinue development of REMOXY, and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics. If there have been payments under such agreements that are being recognized over time, termination of such agreements (or programs) can lead to a near-term increase in our reported revenues resulting from the immediate recognition of the balance of such payments. Termination deprives us of potential future economic benefits under such agreements, and may make it more difficult to enter into agreements with other third parties for use of the assets that were subject to the terminated agreement. Termination of our agreements with Pain Therapeutics, Zogenix, Impax, Santen or Orient Pharma could have similar effects.

*Our revenues depend on collaboration agreements with other companies. These agreements subject us to obligations which must be fulfilled and also make our revenues dependent on the performance of such third parties. If we are unable to meet our obligations or manage our relationships with our collaborators under these agreements or enter into additional collaboration agreements or if our existing collaborations are terminated, our revenues may decrease. Acquisitions of our collaborators can be disruptive*

Our revenues are based to a significant extent on collaborative arrangements with third parties, pursuant to which we receive payments based on our performance of research and development activities set forth in these agreements. We may not be able to fulfill our obligations or attain milestones set forth in any specific agreement, which could cause our revenues to fluctuate or be less than anticipated and may expose us to liability for contractual breach. In addition, these agreements may require us to devote significant time and resources to communicating with and managing our relationships with such collaborators and resolving possible issues of contractual interpretation which may detract from time our management would otherwise devote to managing our operations. Such agreements are generally complex and contain provisions that could give rise to legal disputes, including potential disputes concerning ownership of intellectual property under collaborations. Such disputes can delay or prevent the development of potential new product candidates, or can lead to lengthy, expensive litigation or arbitration. In general, our collaboration agreements, including our agreements with Pain Therapeutics with respect to REMOXY and certain other ORADUR-based opioids, Orient Pharma with respect to ORADUR-Methylphenidate, Zogenix with respect to Relday, Impax with respect to ELADUR, and Santen with respect to an ophthalmic product may be terminated by the other party at will or upon specified conditions including, for example, if we fail to satisfy specified performance milestones or if we breach the terms of the agreement. From time to time, our licensees may be the subject of an acquisition by another company. For example, Alpharma was acquired by King in December 2008, King was acquired by Pfizer in February 2011 and Nycomed was acquired by Takeda in October 2011. Such transactions can lead to turnover of program staff, a review of development programs and strategies by the acquirer, and other events that can disrupt a program, resulting in program delays or discontinuations.

If any of our collaborative agreements are terminated or delayed, our anticipated revenues may be reduced or not materialize, and our products in development related to those agreements may not be commercialized.

*Our cash flows are likely to differ from our reported revenues*

Our revenues will likely differ from our cash flows from revenue-generating activities. Upfront payments received upon execution of collaborative agreements are recorded as deferred revenue and generally recognized on a straight-line basis over the period of our continuing involvement with the third-party collaborator pursuant to the applicable agreement. The period of continuing involvement may also be revised on a prospective basis. As of June 30, 2016, we had \$3.1 million of deferred revenue which will be recognized in future periods and may cause our reported revenues to be greater than cash flows from our ongoing revenue-generating activities.

*Our revenues also depend on milestone payments based on achievements by our third-party collaborators. Failure of such collaborators to attain such milestones would result in our not receiving additional revenues*

In addition to payments based on our performance of research and development activities, our revenues also depend on the attainment of milestones set forth in our collaboration agreements. Such milestones are typically related to development activities or sales accomplishments. While our involvement is necessary to the achievement of development-based milestones, the performance of our third-party collaborators is also required to achieve those milestones. Under our third-party collaborative agreements, our third party collaborators will take the lead in commercialization activities and we are typically not involved in the achievement of sales-based

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milestones. Therefore, we are even more dependent upon the performance of our third-party collaborators in achieving sales-based milestones. To the extent we and our third-party collaborators do not achieve such development-based milestones or our third-party collaborators do not achieve sales-based milestones, we will not receive the associated revenues, which could harm our financial condition and may cause us to defer or cut-back development activities or forego the exploitation of opportunities in certain geographic territories, any of which could have a material adverse effect on our business.

*Our business strategy includes the entry into additional collaborative agreements. We may not be able to enter into additional collaborative agreements or may not be able to negotiate commercially acceptable terms for these agreements*

Our current business strategy includes the entry into additional collaborative agreements for the development and commercialization of our pharmaceutical product candidates. The negotiation and consummation of these types of agreements typically involve simultaneous discussions with multiple potential collaborators and require significant time and resources from our officers, business development, legal, and research and development staff. In addition, in attracting the attention of pharmaceutical and biotechnology company collaborators, we compete with numerous other third parties with product opportunities as well the collaborators' own internal product opportunities. We may not be able to consummate additional collaborative agreements, or we may not be able to negotiate commercially acceptable terms for these agreements. If we do not consummate additional collaborative agreements, we may have to consume money more rapidly on our product development efforts, defer development activities or forego the exploitation of certain geographic territories, any of which could have a material adverse effect on our business.

*We will require and may have difficulty raising needed capital in the future*

Our business currently does not generate sufficient revenues to meet our capital requirements and we do not expect that it will do so in the near future. We have expended and will continue to expend substantial funds to complete the research, development and clinical testing of our pharmaceutical product candidates. We will require additional funds for these purposes, to establish additional clinical- and commercial-scale manufacturing arrangements and facilities, and to provide for the marketing and distribution of our product candidates. Additional funds may not be available on acceptable terms, if at all. If adequate funds are unavailable from operations or additional sources of financing, we may have to delay, reduce the scope of or eliminate one or more of our research or development programs which would materially harm our business, financial condition and results of operations.

We believe that our cash, cash equivalents and investments, will be adequate to satisfy our capital needs for at least the next 12 months. However, our actual capital requirements will depend on many factors, including:

regulatory actions with respect to our product candidates;

continued progress and cost of our research and development programs;

the continuation of our collaborative agreements that provide financial funding for our activities;

success in entering into collaboration agreements and meeting milestones under such agreements;

progress with preclinical studies and clinical trials;

the time and costs involved in obtaining regulatory clearance;

costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims;

costs of developing sales, marketing and distribution channels and our ability and that of our collaborators to sell our pharmaceutical product candidates;

costs involved in establishing manufacturing capabilities for clinical and commercial quantities of our product candidates;

competing technological and market developments;

market acceptance of our product candidates;

costs for recruiting and retaining employees and consultants; and

unexpected legal, accounting and other costs and liabilities related to our business.

We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding. We may seek to raise any necessary additional funds through equity or debt financings, convertible debt financings, collaborative arrangements with corporate collaborators or other sources, which may be dilutive to existing stockholders and may cause the price of our common stock to decline. In addition, in the event that additional funds are obtained through arrangements with collaborators or other sources, we may have to relinquish rights to some of our technologies or pharmaceutical product candidates that we would otherwise seek to develop or commercialize ourselves. If adequate funds are not available, we may be required to significantly reduce or refocus our product development efforts, resulting in delays in generating future product revenue.

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*We and our third-party collaborators may not be able to manufacture sufficient quantities of our pharmaceutical product candidates and components to support the clinical and commercial requirements of our collaborators and ourselves at an acceptable cost or in compliance with applicable government regulations, and we have limited manufacturing experience*

We or our third-party collaborators to whom we have assigned such responsibility must manufacture our pharmaceutical product candidates and components in clinical and commercial quantities, either directly or through third parties, in compliance with regulatory requirements and at an acceptable cost. The manufacturing processes associated with our product candidates are complex. We and our third-party collaborators, where relevant, have not yet completed development of the manufacturing process for any product candidates or components, including POSIMIR, REMOXY and our other ORADUR-based drug candidates, ELADUR, Relday and DUR-928. If we and our third-party collaborators, where relevant, fail to timely complete the development of the manufacturing process for our product candidates, we and our third-party collaborators, where relevant, will not be able to timely produce product for clinical trials and commercialization of our product candidates. We have also committed to manufacture and supply product candidates or components under a number of our collaborative agreements with third-party companies. We have limited experience manufacturing pharmaceutical products, and we may not be able to timely accomplish these tasks. If we and our third-party collaborators, where relevant, fail to develop manufacturing processes to permit us to manufacture a product candidate or component at an acceptable cost, then we and our third-party collaborators may not be able to commercialize that product candidate or we may be in breach of our supply obligations to our third-party collaborators.

Our manufacturing facility in Cupertino is a multi-disciplinary site that we have used to manufacture only research and clinical supplies of several of our pharmaceutical product candidates, including POSIMIR, REMOXY and our other ORADUR-based drug candidates, Relday and ELADUR. If we experience delays or technical difficulties in scaling up the manufacturing of our product candidates, it could result in delays or added cost in our development programs. We have not manufactured commercial quantities of any of our product candidates. In the future, we intend to develop additional manufacturing capabilities for our product candidates and components to meet our demands and those of our third-party collaborators by contracting with third-party manufacturers and by potentially constructing additional manufacturing space at our facilities in California and Alabama. We have limited experience building and validating manufacturing facilities, and we may not be able to accomplish these tasks in a timely or cost effective manner.

If we and our third-party collaborators, where relevant, are unable to manufacture our pharmaceutical product candidates or components in a timely manner or at an acceptable cost, quality or performance level, and are unable to attain and maintain compliance with applicable regulations, the clinical trials and the commercial sale of our product candidates and those of our third-party collaborators could be delayed. Additionally, we may need to alter our facility design or manufacturing processes, install additional equipment or do additional construction or testing in order to meet regulatory requirements, optimize the production process, increase efficiencies or production capacity or for other reasons, which may result in additional cost to us or delay production of product needed for the clinical trials and commercial launch of our product candidates and those of our third-party collaborators.

We had entered into a supply agreement with Hospira Worldwide, Inc. for clinical and commercial supplies of POSIMIR. This third party was our sole source for drug product required for development and commercialization of this drug candidate. Our agreement with Hospira terminated at the end of 2015 and we have entered into a manufacturing development agreement with a different contract manufacturing organization for future supply of POSIMIR. There may be technical risks associated with establishing an alternative commercial manufacturer that could entail delays in supply, quality issues or delays in the possible regulatory approval of POSIMIR. Furthermore, we and our contract manufacturer may also need or choose to subcontract with additional third-party contractors to

perform manufacturing steps of POSIMIR or supply required components for POSIMIR. Where third party contractors perform manufacturing services for us, we will be subject to the schedule, expertise and performance of third parties as well as incur significant additional costs. Failure of third parties to perform their obligations could adversely affect our operations, development timeline and financial results. We expect to put in place in the future second source supply arrangements, which may be costly and time consuming.

We have entered into contract manufacturing agreements with multiple vendors for DUR-928. There can be no assurance that we will receive sufficient quantities of DUR-928 to commence and conduct the clinical trials we are planning, and delays in supply could delay development of DUR-928.

If we or our third-party collaborators cannot manufacture our pharmaceutical product candidates or components in time to meet the clinical or commercial requirements of our collaborators or ourselves or at an acceptable cost, our operating results will be harmed.

*Failure to comply with ongoing governmental regulations for our pharmaceutical product candidates could materially harm our business in the future*

Marketing or promoting a drug is subject to very strict controls. Furthermore, clearance or approval may entail ongoing requirements for post-marketing studies. The manufacture and marketing of drugs are subject to continuing FDA and foreign regulatory review and requirements that we update our regulatory filings. Later discovery of previously unknown problems with a product, manufacturer or facility, or our failure to update regulatory files, may result in restrictions, including withdrawal of the

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product from the market. Any of the following or other similar events, if they were to occur, could delay or preclude us from further developing, marketing or realizing full commercial use of our product candidates, which in turn would materially harm our business, financial condition and results of operations:

failure to obtain or maintain requisite governmental approvals;

failure to obtain approvals for clinically intended uses of our pharmaceutical product candidates under development; or

FDA required product withdrawals or warnings arising from identification of serious and unanticipated adverse side effects in our product candidates.

Manufacturers of drugs must comply with the applicable FDA good manufacturing practice regulations, which include production design controls, testing, quality control and quality assurance requirements as well as the corresponding maintenance of records and documentation. Compliance with current good manufacturing practices regulations is difficult and costly. Manufacturing facilities are subject to ongoing periodic inspection by the FDA and corresponding state agencies, including unannounced inspections, and must be licensed before they can be used for the commercial manufacture of our development products. We and/or our present or future suppliers and distributors may be unable to comply with the applicable good manufacturing practice regulations and other FDA regulatory requirements. We have not been subject to a good manufacturing regulation inspection by the FDA relating to our product candidates. If we, our third-party collaborators or our respective suppliers do not achieve compliance for our product candidates we or they manufacture, the FDA may refuse or withdraw marketing clearance or require product recall, which may cause interruptions or delays in the manufacture and sale of our product candidates.

*We have a history of operating losses, expect to continue to have losses in the future and may never achieve or maintain profitability*

We have incurred significant operating losses since our inception in 1998 and, as of June 30, 2016, had an accumulated deficit of approximately \$422.4 million. We expect to continue to incur significant operating losses over the next several years as we continue to incur significant costs for research and development, clinical trials, manufacturing, sales, and general and administrative functions. Our ability to achieve profitability depends upon our ability, alone or with others, to successfully complete the development of our proposed product candidates, obtain the required regulatory clearances, and manufacture and market our proposed product candidates. Development of pharmaceutical product candidates is costly and requires significant investment. In addition, we may choose to license from third parties either additional drug delivery platform technology or rights to particular drugs or other appropriate technology for use in our product candidates. The license fees for these technologies or rights would increase the costs of our product candidates.

To date, we have not generated significant revenue from the commercial sale of our pharmaceutical product candidates and do not expect to do so in the near future. Our current revenues are from the sale of the ALZET product line, the sale of LACTEL biodegradable polymers and certain excipient sales, and from payments under collaborative research and development agreements with third parties. We do not expect our product revenues to increase significantly in the near future, and we do not expect that collaborative research and development revenues will exceed our actual operating expenses. We do not anticipate meaningful revenues to derive from the commercialization and marketing of our product candidates in development in the near future, and therefore do not expect to generate



sufficient revenues to cover expenses or achieve profitability in the near future.

*We may develop our own sales force and commercial group to market future products but we have limited sales and marketing experience with respect to pharmaceuticals and may not be able to do so effectively*

We have a small sales and marketing group focused on our ALZET and LACTEL product lines. We may choose to develop our own sales force and commercial group to market products that we may develop in the future, or to market POSIMIR if we do not enter into an agreement with a third party to commercialize POSIMIR. Developing a sales force and commercial group will require substantial expenditures and the hiring of qualified personnel. We have limited sales and marketing experience, and may not be able to effectively recruit, train or retain sales personnel. If we are not able to put in place an appropriate sales force and commercial group for POSIMIR, we may not be able to effectively launch the product. We may not be able to effectively sell our product candidates, if approved, and our failure to do so could limit or materially harm our business.

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*We and our third-party collaborators may not sell our product candidates effectively*

We and our third-party collaborators compete with many other companies that currently have extensive and well-funded marketing and sales operations. Our marketing and sales efforts and those of our third-party collaborators may be unable to compete successfully against these other companies. We and our third-party collaborators, if relevant, may be unable to establish a sufficient sales and marketing organization on a timely basis, if at all. We and our third-party collaborators, if relevant, may be unable to engage qualified distributors. Even if engaged, these distributors may:

fail to satisfy financial or contractual obligations to us;

fail to adequately market our product candidates;

cease operations with little or no notice to us;

offer, design, manufacture or promote competing product lines;

fail to maintain adequate inventory and thereby restrict use of our product candidates; or

build up inventory in excess of demand thereby limiting future purchases of our product candidates resulting in significant quarter-to-quarter variability in our sales.

The failure of us or our third-party collaborators to effectively develop, gain regulatory approval for, sell, manufacture and market our product candidates will hurt our business, prospects and financial results.

*We rely heavily on third parties to support development, clinical testing and manufacturing of our product candidates*

We rely on third-party contract research organizations, consultants, service providers and suppliers to provide critical services to support development, clinical testing, and manufacturing of our product candidates. For example, we currently depend on third-party vendors to manage and monitor our clinical trials and to perform critical manufacturing steps for our product candidates. These third parties may not execute their responsibilities and tasks competently in compliance with applicable laws and regulations or in a timely fashion. We rely on third-parties to manufacture or perform manufacturing steps relating to our product candidates or components. We anticipate that we will continue to rely on these and other third-party contractors to support development, clinical testing, and manufacturing of our product candidates. Failure of these contractors to provide the required services in a competent or timely manner or on reasonable commercial terms could materially delay the development and approval of our development products, increase our expenses and materially harm our business, financial condition and results of operations.

*Key components of our product candidates are provided by limited numbers of suppliers, and supply shortages or loss of these suppliers could result in interruptions in supply or increased costs*

Certain components and drug substances used in our product candidates (including POSIMIR, REMOXY, our other ORADUR-based drug candidates, Relday and ELADUR, are currently purchased from a single or a limited number of outside sources. In particular, Eastman Chemical is the sole supplier, pursuant to a supply agreement entered into in December 2005, of our requirements of sucrose acetate isobutyrate, a necessary component of POSIMIR, REMOXY, our other ORADUR-based drug candidates, Relday, ELADUR and certain other pharmaceutical product candidates we have under development, and Hospira was our sole supplier for clinical and commercial supplies of POSIMIR. The reliance on a sole or limited number of suppliers could result in:

delays associated with redesigning a pharmaceutical product candidate due to a failure to obtain a single source component;

an inability to obtain an adequate supply of required components; and

reduced control over pricing, quality and delivery time.

We have supply agreements in place for certain components of our pharmaceutical product candidates, but do not have in place long term supply agreements with respect to all of the components of any of our product candidates. Therefore the supply of a particular component could be terminated at any time without penalty to the supplier. In addition, we may not be able to procure required components or drugs from third-party suppliers at a quantity, quality and cost acceptable to us. Any interruption in the supply of single source components could cause us to seek alternative sources of supply or manufacture these components internally. Furthermore, in some cases, we are relying on our third-party collaborators to procure supply of necessary components. If the supply of any components for our product candidates is interrupted, components from alternative suppliers may not be available in sufficient volumes or at acceptable quality levels within required timeframes, if at all, to meet our needs or those of our third-party collaborators. This could delay our ability to complete clinical trials and obtain approval for commercialization and marketing of our product candidates, causing us to lose sales, incur additional costs, delay new product introductions and could harm our reputation.

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*If we are unable to adequately protect, maintain or enforce our intellectual property rights or secure rights to third-party patents, we may lose valuable assets, experience reduced market share or incur costly litigation to protect our rights or our third-party collaborators may choose to terminate their agreements with us*

Our ability to commercially exploit our products will depend significantly on our ability to obtain and maintain patents, maintain trade secret protection and operate without infringing the proprietary rights of others.

As of July 25, 2016, we held over 55 unexpired issued U.S. patents and over 355 unexpired issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have over 35 pending U.S. patent applications and over 95 foreign applications pending in Europe, Australia, Japan, Canada and other countries.

The patent status of our most advanced drug candidates, POSIMIR and REMOXY, are as follows:

In the U.S., POSIMIR is covered by two patent families. One patent family includes granted patents expiring in at least 2025. Another patent family includes a pending patent application, which if granted, could result in a patent expiring in 2026, plus any eligible patent term adjustments and extensions. In Europe, POSIMIR is covered by four granted patents with two expiring in each of 2025 and 2026, respectively, plus any eligible patent term extensions.

In the U.S., REMOXY is covered by five patent families. Two patent families include granted patents expiring in at least 2025 and 2031, respectively. The patent family providing protection until at least 2025 includes ten granted patents. The other three patent families include pending patent applications, which if granted, could result in patents expiring in 2026, 2034, and 2034, respectively, plus any eligible patent term adjustments and extensions. We currently have pending U.S. applications for each of these five patent families. There can be no assurance that the pending patent applications will be granted. In Europe, REMOXY is covered by four granted patents with two expiring in each of 2023 and 2026, respectively, plus any eligible patent term extensions.

Our Epigenomic Regulator Program includes six in-licensed patent families. Two patent families each include at least one granted patent expiring in at least 2026 and 2032, respectively. The other patent families include pending patent applications, which if granted, could result in patents expiring in 2033, 2034, 2035, and 2035, respectively, plus any eligible patent term adjustments and extensions. Of the six patent families covering DUR-928 and/or other molecules in the Epigenomic Regulator Program, two were only filed in the U.S., and the other four have been filed or likely will be filed both in the U.S. and internationally. Since DUR-928 is an endogenous small molecule, patent claims directed to DUR-928 composition of matter may be more difficult to maintain or enforce in the U.S. under *Myriad Genetics* and other recent court decisions. One of the U.S. patents issued before *Myriad Genetics*, and two of the DUR-928 U.S. patents issued after *Myriad Genetics*. The granted claims in the U.S. include both composition of matter and method of treatment claims. There can be no assurance that the pending patent applications will be granted. Further, there can be no assurance that VCU will not attempt to terminate their license to us, which termination would result in the loss of our rights to these patent families.

The patent positions of pharmaceutical companies, including ours, are uncertain and involve complex legal and factual questions. In addition, the coverage claimed in a patent application can be significantly reduced before the patent is issued. Consequently, our patent applications or those that are licensed to us may not issue into patents, and any issued patents may not provide protection against competitive technologies or may be held invalid if challenged. Our competitors may also independently develop products similar to ours or design around or otherwise circumvent patents issued to us or licensed by us. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as U.S. law.

The patent laws of the U.S. have recently undergone changes through court decisions which may have significant impact on us and our industry. Decisions of the U.S. Supreme Court and other courts with respect to the standards of patentability, enforceability, availability of injunctive relief and damages may make it more difficult for us to procure, maintain and enforce patents. In addition, the America Invents Act was signed into law in September 2011, which among other changes to the U.S. patent laws, changes patent priority from first to invent to first to file, implements a post-grant opposition system for patents and provides a prior user defense to infringement. These judicial and legislative changes have introduced significant uncertainty in the patent law landscape and may potentially negatively impact our ability to procure, maintain and enforce patents to provide exclusivity for our products.

We also rely upon trade secrets, technical know-how and continuing technological innovation to develop and maintain our competitive position. We require our employees, consultants, advisors and collaborators to execute appropriate confidentiality and assignment-of-inventions agreements with us. These agreements typically provide that all materials and confidential information developed or made known to the individual during the course of the individual's relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances, and that all inventions arising out of the individual's relationship with us will be our exclusive property. These agreements may be breached, and in some instances, we may not have an appropriate remedy available for breach of the agreements. Furthermore, our competitors may independently develop substantially equivalent proprietary information and techniques, reverse engineer our information and techniques, or otherwise gain access to our proprietary technology.

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We may be unable to meaningfully protect our rights in trade secrets, technical know-how and other non-patented technology. We may have to resort to litigation to protect our intellectual property rights, or to determine their scope, validity or enforceability. In addition, interference, derivation, post-grant oppositions, and similar proceedings may be necessary to determine rights to inventions in our patents and patent applications. Enforcing or defending our proprietary rights is expensive, could cause diversion of our resources and may be unsuccessful. Any failure to enforce or protect our rights could cause us to lose the ability to exclude others from using our technology to develop or sell competing products.

*Our collaboration agreements may depend on our intellectual property*

We are party to collaborative agreements with Pain Therapeutics, Zogenix, Orient Pharma, Impax and Santen among others. Our third-party collaborators have entered into these agreements based on the exclusivity that our intellectual property rights confer on the products being developed. The loss or diminution of our intellectual property rights could result in a decision by our third-party collaborators to terminate their agreements with us. In addition, these agreements are generally complex and contain provisions that could give rise to legal disputes, including potential disputes concerning ownership of intellectual property and data under collaborations. Such disputes can lead to lengthy, expensive litigation or arbitration requiring us to devote management time and resources to such dispute which we would otherwise spend on our business. To the extent that our agreements call for future royalties to be paid conditional on our having patents covering the royalty-bearing subject matter, the decision by the Supreme Court in the case of *MedImmune v. Genentech* could encourage our licensees to challenge the validity of our patents and thereby seek to avoid future royalty obligations without losing the benefit of their license. Should they be successful in such a challenge, our ability to collect future royalties could be substantially diminished.

*We may be sued by third parties claiming that our product candidates infringe on their intellectual property rights, particularly because there is substantial uncertainty about the validity and breadth of medical patents*

We or our collaborators may be exposed to future litigation by third parties based on claims that our product candidates or activities infringe the intellectual property rights of others or that we or our collaborators have misappropriated the trade secrets of others. This risk is exacerbated by the fact that the validity and breadth of claims covered in medical technology patents and the breadth and scope of trade secret protection involve complex legal and factual questions for which important legal principles are unresolved. Any litigation or claims against us or our collaborators, whether or not valid, could result in substantial costs, could place a significant strain on our financial resources and could harm our reputation. We also may not have sufficient funds to litigate against parties with substantially greater resources. In addition, pursuant to our collaborative agreements, we have provided our collaborators with the right, under specified circumstances, to defend against any claims of infringement of the third party intellectual property rights, and such collaborators may not defend against such claims adequately or in the manner that we would do ourselves. Intellectual property litigation or claims could force us or our collaborators to do one or more of the following, any of which could harm our business or financial results:

cease selling, incorporating or using any of our pharmaceutical product candidates that incorporate the challenged intellectual property, which would adversely affect our revenue;

obtain a license from the holder of the infringed intellectual property right, which license may be costly or may not be available on reasonable terms, if at all; or

redesign our product candidates, which would be costly and time-consuming.

*Technologies and businesses which we acquire or license may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention*

We may acquire technologies, products or businesses to broaden the scope of our existing and planned product lines and technologies. Future acquisitions expose us to:

increased costs associated with the acquisition and operation of the new businesses or technologies and the management of geographically dispersed operations;

the risks associated with the assimilation of new technologies, operations, sites and personnel;

the diversion of resources from our existing business and technologies;

the inability to generate revenues to offset associated acquisition costs;

the requirement to maintain uniform standards, controls, and procedures; and

the impairment of relationships with employees and customers or third party collaborators as a result of any integration of new management personnel.

Acquisitions may also result in the issuance of dilutive equity securities, the incurrence or assumption of debt or additional expenses associated with the amortization of acquired intangible assets or potential businesses. Acquisitions may not generate any additional revenue or provide any benefit to our business.

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*Some of our pharmaceutical product candidates contain controlled substances, the making, use, sale, importation and distribution of which are subject to regulation by state, federal and foreign law enforcement and other regulatory agencies*

Some of our product candidates currently under development contain, and our products in the future may contain, controlled substances which are subject to state, federal and foreign laws and regulations regarding their manufacture, use, sale, importation and distribution. REMOXY and our other ORADUR-based drug candidates, and certain other product candidates we have under development contain active ingredients which are classified as controlled substances under the regulations of the U.S. Drug Enforcement Agency. For our product candidates containing controlled substances, we and our suppliers, manufacturers, contractors, customers and distributors are required to obtain and maintain applicable registrations from state, federal and foreign law enforcement and regulatory agencies and comply with state, federal and foreign laws and regulations regarding the manufacture, use, sale, importation and distribution of controlled substances. These regulations are extensive and include regulations governing manufacturing, labeling, packaging, testing, dispensing, production and procurement quotas, record keeping, reporting, handling, shipment and disposal. These regulations increase the personnel needs and the expense associated with development and commercialization of drug candidates including controlled substances. Failure to obtain and maintain required registrations or comply with any applicable regulations could delay or preclude us from developing and commercializing our product candidates containing controlled substances and subject us to enforcement action. In addition, because of their restrictive nature, these regulations could limit our commercialization of our product candidates containing controlled substances. In particular, among other things, there is a risk that these regulations may interfere with the supply of the drugs used in our clinical trials, and in the future, our ability to produce and distribute our products in the volume needed to meet commercial demand.

*Write-offs related to the impairment of long-lived assets, inventories and other non-cash charges, as well as stock-based compensation expenses may adversely impact or delay our profitability*

We may incur significant non-cash charges related to impairment write-downs of our long-lived assets, including goodwill and other intangible assets. We will continue to incur non-cash charges related to amortization of other intangible assets. We are required to perform periodic impairment reviews of our goodwill at least annually. The carrying value of goodwill on our balance sheet was \$6.4 million at June 30, 2016. To the extent these reviews conclude that the expected future cash flows generated from our business activities are not sufficient to recover the cost of our long-lived assets, we will be required to measure and record an impairment charge to write-down these assets to their realizable values. We completed our last review during the fourth quarter of 2015 and determined that goodwill was not impaired as of December 31, 2015. However, there can be no assurance that upon completion of subsequent reviews a material impairment charge will not be recorded. If future periodic reviews determine that our assets are impaired and a write-down is required, it will adversely impact or delay our profitability.

Inventories, in part, include certain excipients that are sold to customers and included in products in development. These inventories are capitalized based on management's judgment of probable sale prior to their expiration date which in turn is primarily based on management's internal estimates. The valuation of inventory requires us to estimate the value of inventory that may become expired prior to use. We may be required to expense previously capitalized inventory costs upon a change in our judgment, due to, among other potential factors, a denial or delay of approval of a product by the necessary regulatory bodies, changes in product development timelines, or other information that suggests that the inventory will not be saleable. In addition, these circumstances may cause us to record a liability related to minimum purchase agreements that we have in place for raw materials. For example, we recorded charges to cost of goods sold of approximately \$1.6 million, of which approximately \$1.1 million related to the write-down of the cost basis of inventory and approximately \$500,000 related to the accrual of a liability for the minimum purchase commitment for excipients in the year ended December 31, 2014 as a result of a change in the forecasted demand for



the excipients after Pfizer announced that it had decided to discontinue the development and commercialization of REMOXY and return its rights to Pain Therapeutics.

*Global credit and financial market conditions could negatively impact the value of our current portfolio of cash equivalents, short-term investments or long-term investments and our ability to meet our financing objectives*

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. Our short-term investments consist primarily of readily marketable debt securities with original maturities of greater than 90 days from the date of purchase but remaining maturities of less than one year from the balance sheet date. Our long-term investments consist primarily of readily marketable debt securities with maturities in one year or beyond from the balance sheet date. While, as of the date of this filing, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents, short-term investments or long-term investments since June 30, 2016, no assurance can be given that deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents, short-term investments or long-term investments or our ability to meet our financing objectives.

*We depend upon key personnel who may terminate their employment with us at any time, and we may need to hire additional qualified personnel*

Our success will depend to a significant degree upon the continued services of key management, technical and scientific personnel. In addition, our success will depend on our ability to attract and retain other highly skilled personnel, particularly as we

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develop and expand our Epigenomic Regulator Program. Competition for qualified personnel is intense, and the process of hiring and integrating such qualified personnel is often lengthy. We may be unable to recruit such personnel on a timely basis, if at all. Our management and other employees may voluntarily terminate their employment with us at any time. The loss of the services of key personnel, or the inability to attract and retain additional qualified personnel, could result in delays to product development or approval, loss of sales and diversion of management resources.

*We may not successfully manage our company through varying business cycles*

Our success will depend on properly sizing our company through growth and contraction cycles caused in part by changing business conditions, which places a significant strain on our management and on our administrative, operational and financial resources. To manage through such cycles, we must expand or contract our facilities, our operational, financial and management systems and our personnel. If we were unable to manage growth and contractions effectively our business would be harmed.

*Our business involves environmental risks and risks related to handling regulated substances*

In connection with our research and development activities and our manufacture of materials and pharmaceutical product candidates, we are subject to federal, state and local laws, rules, regulations and policies governing the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials, biological specimens and wastes. Although we believe that we have complied with the applicable laws, regulations and policies in all material respects and have not been required to correct any material noncompliance, we may be required to incur significant costs to comply with environmental and health and safety regulations in the future. Our research and development involves the use, generation and disposal of hazardous materials, including but not limited to certain hazardous chemicals, solvents, agents and biohazardous materials. The extent of our use, generation and disposal of such substances has increased substantially since we started manufacturing and selling biodegradable polymers. Although we believe that our safety procedures for storing, handling and disposing of such materials comply with the standards prescribed by state and federal regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. We currently contract with third parties to dispose of these substances generated by us, and we rely on these third parties to properly dispose of these substances in compliance with applicable laws and regulations. If these third parties do not properly dispose of these substances in compliance with applicable laws and regulations, we may be subject to legal action by governmental agencies or private parties for improper disposal of these substances. The costs of defending such actions and the potential liability resulting from such actions are often very large. In the event we are subject to such legal action or we otherwise fail to comply with applicable laws and regulations governing the use, generation and disposal of hazardous materials and chemicals, we could be held liable for any damages that result, and any such liability could exceed our resources.

*Our corporate headquarters, manufacturing facilities and personnel are located in a geographical area that is seismically active*

Our corporate headquarters, primary manufacturing facilities and personnel are located in a geographical area that is known to be seismically active and prone to earthquakes. Should such a natural disaster occur, our ability to conduct our business could be severely restricted, and our business and assets, including the results of our research, development and manufacturing efforts, could be destroyed.

*We currently have significant debt. Compliance with repayment obligations and other covenants may be difficult, and failure by us to fulfill our obligations under the applicable loan agreements may cause the repayment obligations to accelerate.*

In July 2016, we entered into a Loan and Security Agreement (the "2016 Loan Agreement") with Oxford Finance LLC ("Oxford Finance"), pursuant to which Oxford Finance provided a \$20 million secured single-draw term loan to us with a maturity date of August 1, 2020. The 2016 Loan Agreement replaces a prior term loan agreement with Oxford Finance originally entered into in June 2014. The term loan was fully drawn at close and the proceeds may be used for working capital and general business requirements. The term loan repayment schedule provides for interest only payments for the first 18 months, followed by consecutive monthly payments of principal and interest in arrears starting on March 1, 2018 and continuing through the maturity date of August 1, 2020. The 2016 Loan Agreement provides for a floating interest rate (7.95% initially) based on an index rate plus a spread, a \$150,000 facility fee that was paid at closing and an additional payment equal to 9.25% of the principal amount of the term loan, which is due when the term loan becomes due or upon the prepayment of the facility. If we elect to prepay the loan, there is also a prepayment fee between 1% and 3% of the principal amount of the term loan depending on the timing of prepayment. Our debt repayment obligations under the Loan Agreement may prove a burden to the Company as they become due, particularly following the expiration of the interest-only period.

In addition, the term loan is secured by substantially all of our assets, except that the collateral does not include any equity interests in the Company, any intellectual property (including all licensing, collaboration and similar agreements relating thereto), and certain other excluded assets. The 2016 Loan Agreement contains customary representations, warranties and covenants by us, which covenants limit our ability to convey, sell, lease, transfer, assign or otherwise dispose of certain of our assets; engage in any business other than the businesses currently engaged in by us or reasonably related thereto; liquidate or dissolve; make certain management changes; undergo certain change of control events; create, incur, assume, or be liable with respect to certain indebtedness; grant certain liens; pay dividends and make certain other restricted payments; make certain investments; make payments on any subordinated debt; and enter into transactions with any of our affiliates outside of the ordinary course of business or permit our subsidiaries to do the same. Complying with these covenants may make it more difficult for us to successfully execute our business strategy.

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The 2016 Loan Agreement also contains customary events of default, including, among other things, our failure to fulfill certain of our obligations under the 2016 Loan Agreement and the occurrence of a material adverse change in our business, operations or condition (financial or otherwise), a material impairment of the prospect of repayment of any portion of the loan, or a material impairment in the perfection or priority of lender's lien in the collateral or in the value of such collateral. In the event of default by us under the 2016 Loan Agreement, the lender would be entitled to exercise its remedies thereunder, including the right to accelerate the debt, upon which we may be required to repay all amounts then outstanding under the 2016 Loan Agreement, which could harm our business, operations and financial condition.

**Risks Related To Our Industry**

*The market for our pharmaceutical product candidates is rapidly changing and competitive, and new products or technologies developed by others could impair our ability to grow our business and remain competitive*

The pharmaceutical industry is subject to rapid and substantial technological change. Developments by others may render our product candidates under development or technologies noncompetitive or obsolete, or we may be unable to keep pace with technological developments or other market factors. Technological competition in the industry from pharmaceutical and biotechnology companies, universities, governmental entities and others diversifying into the field is intense and is expected to increase.

We may face competition from other companies in numerous industries including pharmaceuticals, medical devices and drug delivery. POSIMIR, ELADUR, Relday, REMOXY and other ORADUR-based drug candidates, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, anti-psychotics, stimulants, implantable and external infusion pumps which can be used for infusion of opioids and local anesthetics. Products of these types are marketed by Purdue Pharma, AbbVie, Janssen, Actavis, Medtronic, Endo, AstraZeneca, Pernix Therapeutics, Tricumed, Halyard Health, Cumberland Pharmaceuticals, Pacira, Acorda Therapeutics, Mallinckrodt, Inspirin Delivery Technologies, Mylan, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis, Teva Pharmaceuticals, and others. Purdue Pharma, Sandoz, Actavis, Collegium Pharmaceutical, Pfizer, Elite Pharmaceuticals, Intellipharma, Egalet, Teva Pharmaceuticals and others have also announced regulatory approval or development plans for abuse deterrent opioid products. Our ORADUR-ADHD product candidates, if approved, will compete with currently marketed or approved products by Shire, Johnson & Johnson, UCB, Novartis, Noven, Eli Lilly, Pfizer and others. Relday, if approved, will compete with currently marketed products by Johnson & Johnson, Eli Lilly, Astra Zeneca, Pfizer, Bristol-Myers Squibb, Otsuka, Sunovion Pharmaceuticals, Teva and others. Competition for DUR-928, if approved, will depend on the specific indications for which DUR-928 is approved. Intercept, Gilead, Shire, Conatus Pharmaceuticals, Galectin Therapeutics, Genfit, Pfizer, Roche, Galmed Pharmaceuticals, Tobira Therapeutics, Enanta Pharmaceuticals, Novo Nordisk, Takeda, Vital Therapies, Akarna Therapeutics and others have development plans for products to treat NAFLD/NASH. Ischemix, Thrasos Therapeutics, AM-Pharma, Complexa, AbbVie, AlloCure, Quark Pharmaceuticals and others have development plans for products to treat acute kidney injury. Numerous companies are applying significant resources and expertise to the problems of drug delivery and several of these are focusing or may focus on delivery of drugs to the intended site of action, including Alkermes, Pacira, Immune Pharmaceuticals, Innocoll, Nektar, Kimberly-Clark, Acorda Therapeutics, Flamel, Alexza, Mallinckrodt, Hospira, Pfizer, Cumberland Pharmaceuticals, Egalet, Acura, Elite Pharmaceuticals, Phosphagenics, Intellipharma, Collegium Pharmaceutical, Heron Therapeutics and others. Some of these competitors may be addressing the same therapeutic areas or indications as we are. Our current and potential competitors may succeed in obtaining patent protection or commercializing products before us. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. Acquisitions of, or investments in, competing pharmaceutical or biotechnology companies by large

corporations could increase such competitors' financial, marketing, manufacturing and other resources.

We are engaged in the development of novel therapeutic technologies. Our resources are limited and we may experience technical challenges inherent in such novel technologies. Competitors have developed or are in the process of developing technologies that are, or in the future may be, the basis for competitive products. Some of these products may have an entirely different approach or means of accomplishing similar therapeutic effects than our product candidates. Our competitors may develop products that are safer, more effective or less costly than our product candidates and, therefore, present a serious competitive threat to our product offerings.

The widespread acceptance of therapies that are alternatives to ours may limit market acceptance of our product candidates even if commercialized. Chronic and post-operative pain are currently being treated by oral medication, transdermal drug delivery systems, such as drug patches, injectable products and implantable drug delivery devices which will be competitive with our product candidates. These treatments are widely accepted in the medical community and have a long history of use. The established use of these competitive products may limit the potential for our product candidates to receive widespread acceptance if commercialized.

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*Our relationships with customers and third-party payers will be subject to applicable anti-kickback, fraud and abuse and other healthcare laws and regulations, which could expose us to criminal sanctions, civil penalties, contractual damages, reputational harm and diminished profits and future earnings*

Healthcare providers, physicians and third-party payers will play a primary role in the recommendation and prescription of any product candidates for which we obtain marketing approval. Our future arrangements with third-party payers and customers may expose us to broadly applicable fraud and abuse and other healthcare laws and regulations that may constrain the business or financial arrangements and relationships through which we would market, sell and distribute our products. As a pharmaceutical company, even though we do not and may not control referrals of healthcare services or bill directly to Medicare, Medicaid or other third-party payers, federal and state healthcare laws and regulations pertaining to fraud and abuse and patients' rights are and will be applicable to our business. These regulations include:

the Federal Healthcare Anti-Kickback Statute, which prohibits, among other things, persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce or reward, or in return for, either the referral of an individual for, or the purchase, order or recommendation of, any good or service, for which payment may be made under a federal healthcare program such as Medicare and Medicaid, and which will constrain our marketing practices and the marketing practices of our licensees, educational programs, pricing policies, and relationships with healthcare providers or other entities;

the federal physician self-referral prohibition, commonly known as the Stark Law, which prohibits physicians from referring Medicare or Medicaid patients to providers of designated health services with whom the physician or a member of the physician's immediate family has an ownership interest or compensation arrangement, unless a statutory or regulatory exception applies;

federal false claims laws that prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other government reimbursement programs that are false or fraudulent, and which may expose entities that provide coding and billing advice to customers to potential criminal and civil penalties, including through civil whistleblower or qui tam actions, and including as a result of claims presented in violation of the Federal Healthcare Anti-Kickback Statute, the Stark Law or other healthcare-related laws, including laws enforced by the FDA;

the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which imposes criminal and civil liability for executing a scheme to defraud any healthcare benefit program and also created federal criminal laws that prohibit knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false statements in connection with the delivery of or payment for healthcare benefits, items or services, and which as amended by the Health Information Technology for Economic and Clinical Health Act, or HITECH, also imposes obligations, including mandatory contractual terms, with respect to safeguarding the privacy, security and transmission of individually identifiable health information;

federal physician sunshine requirements under the Affordable Care Act, which requires manufacturers of drugs, devices, biologics and medical supplies to report annually to HHS information related to payments and other transfers of value to physicians, other healthcare providers, and teaching hospitals, and ownership and investment interests held by physicians and other healthcare providers and their immediate family members and applicable group purchasing organizations;

the Federal Food, Drug, and Cosmetic Act, which, among other things, strictly regulates drug product marketing, prohibits manufacturers from marketing drug products for off-label use and regulates the distribution of drug samples; and

state and foreign law equivalents of each of the above federal laws, such as anti-kickback and false claims laws, which may apply to sales or marketing arrangements and claims involving healthcare items or services reimbursed by non- governmental third-party payers, including private insurers, state laws requiring pharmaceutical companies to comply with the pharmaceutical industry's voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government and which may require drug manufacturers to report information related to payments and other transfers of value to physicians and other healthcare providers or marketing expenditures, and state and foreign laws governing the privacy and security of health information in specified circumstances, many of which differ from each other in significant ways and often are not preempted by federal laws such as HIPAA, thus complicating compliance efforts.

Efforts to ensure that our business arrangements with third parties will comply with applicable healthcare laws and regulations will involve substantial costs. It is possible that governmental authorities will conclude that our business practices may not comply with current or future statutes, regulations or case law involving applicable fraud and abuse or other healthcare laws and regulations. If our operations are found to be in violation of any of these laws or any other governmental regulations that may apply to us, we may be subject to significant civil, criminal and administrative penalties, damages, fines, imprisonment, exclusion from government funded healthcare programs, such as Medicare and Medicaid, and the curtailment or restructuring of our operations. If any physicians or other healthcare providers or entities with whom we expect to do business are found to not be in compliance with applicable laws, they may be subject to criminal, civil or administrative sanctions, including exclusions from government funded healthcare programs.



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*Healthcare reform measures could hinder or prevent our product candidates' commercial success.*

In the United States, there have been, and we expect there will continue to be, a number of legislative and regulatory changes to the healthcare system that could affect our future revenue and profitability and the future revenue and profitability of our collaborators or potential collaborators. Federal and state lawmakers regularly propose and, at times, enact legislation that results in significant changes to the healthcare system, some of which is intended to contain or reduce the costs of medical products and services. For example, in March 2010, the President signed one of the most significant healthcare reform measures in decades, the Affordable Care Act. It contains a number of provisions, including those governing enrollment in federal healthcare programs, reimbursement changes and fraud and abuse measures, all of which impact existing government healthcare programs and will result in the development of new programs. The Affordable Care Act, among other things:

imposes a non-deductible annual fee on pharmaceutical manufacturers or importers who sell branded prescription drugs ;

increases the minimum level of Medicaid rebates payable by manufacturers of brand-name drugs from 15.1% to 23.1%;

requires collection of rebates for drugs paid by Medicaid managed care organizations;

addresses new methodologies by which rebates owed by manufacturers under the Medicaid Drug Rebate Program are calculated for drugs that are inhaled, infused, instilled, implanted or injected, and for drugs that are line extension products;

requires manufacturers to participate in a coverage gap discount program, under which they must agree to offer 50% point-of-sale discounts off negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer's outpatient drugs to be covered under Medicare Part D; and

mandates a further shift in the burden of Medicaid payments to the states.

Other legislative changes have been proposed and adopted since the Affordable Care Act was enacted. For example, automatic reductions to several government programs were enacted during sequestration. These reductions included aggregate reductions to Medicare payments to providers of up to 2% per fiscal year, which went into effect on April 1, 2013. On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012, or the ATRA, which, among other things, further reduced Medicare payments to several providers, including hospitals, imaging centers and cancer treatment centers, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years. Additional state and federal healthcare reform measures may be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand for our product candidates once approved or additional pricing pressures.

*We could be exposed to significant product liability claims which could be time consuming and costly to defend, divert management attention and adversely impact our ability to obtain and maintain insurance coverage*

The testing, manufacture, marketing and sale of our product candidates involve an inherent risk that product liability claims will be asserted against us. Although we are insured against such risks up to an annual aggregate limit in connection with clinical trials and commercial sales of our product candidates, our present product liability insurance may be inadequate and may not fully cover the costs of any claim or any ultimate damages we might be required to pay. Product liability claims or other claims related to our product candidates, regardless of their outcome, could require us to spend significant time and money in litigation or to pay significant damages. Any successful product liability claim may prevent us from obtaining adequate product liability insurance in the future on commercially desirable or reasonable terms. In addition, product liability coverage may cease to be available in sufficient amounts or at an acceptable cost. An inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or inhibit the commercialization of our product candidates. A product liability claim could also significantly harm our reputation and delay market acceptance of our product candidates.

*Acceptance of our pharmaceutical product candidates in the marketplace is uncertain, and failure to achieve market acceptance will delay our ability to generate or grow revenues*

Our future financial performance will depend upon the successful introduction and customer acceptance of our products in research and development, including POSIMIR, REMOXY and other ORADUR-based drug candidates, DUR-928, Relday and ELADUR. Even if approved for marketing, our product candidates may not achieve market acceptance. The degree of market acceptance will depend upon a number of factors, including:

the receipt of regulatory clearance of marketing claims for the uses that we are developing;

the establishment and demonstration in the medical community of the safety and clinical efficacy of our products and their potential advantages over existing therapeutic products, including oral medication, transdermal drug delivery products such as drug patches, injectable therapeutics, or external or implantable drug delivery products; and

pricing and reimbursement policies of government and third-party payors such as insurance companies, health maintenance organizations, hospital formularies and other health plan administrators.

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Physicians, patients, payers or the medical community in general may be unwilling to accept, utilize or recommend any of our products. If we are unable to obtain regulatory approval, commercialize and market our future products when planned and achieve market acceptance, we will not achieve anticipated revenues.

*If users of our products are unable to obtain adequate reimbursement from third-party payers, or if new restrictive legislation is adopted, market acceptance of our products may be limited and we may not achieve anticipated revenues*

The continuing efforts of government and insurance companies, health maintenance organizations and other payers of healthcare costs to contain or reduce costs of health care may affect our future revenues and profitability, and the future revenues and profitability of our potential customers, suppliers and third-party collaborators and the availability of capital. For example, in certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. In the United States, recent federal and state government initiatives have been directed at lowering the total cost of health care, and the U.S. Congress and state legislatures will likely continue to focus on health care reform, the cost of prescription pharmaceuticals and on the reform of the Medicare and Medicaid systems. While we cannot predict whether any such legislative or regulatory proposals will be adopted, the announcement or adoption of such proposals could materially harm our business, financial condition and results of operations.

The successful commercialization of our product candidates will depend in part on the extent to which appropriate reimbursement levels for the cost of our product candidates and related treatment are obtained by governmental authorities, private health insurers and other organizations, such as HMOs. Third-party payers often limit payments or reimbursement for medical products and services. Also, the trend toward managed health care in the United States and the concurrent growth of organizations such as HMOs, which could control or significantly influence the purchase of health care services and products, as well as legislative proposals to reform health care or reduce government insurance programs, may limit reimbursement or payment for our products. The cost containment measures that health care payers and providers are instituting and the effect of any health care reform could materially harm our ability to operate profitably.

*If we or our third-party collaborators are unable to train physicians to use our pharmaceutical product candidates to treat patients' diseases or medical conditions, we may incur delays in market acceptance of our products*

Broad use of our product candidates will require extensive training of numerous physicians on the proper and safe use of our product candidates. The time required to begin and complete training of physicians could delay introduction of our products and adversely affect market acceptance of our products. We or third parties selling our product candidates may be unable to rapidly train physicians in numbers sufficient to generate adequate demand for our product candidates. Any delay in training would materially delay the demand for our product candidates and harm our business and financial results. In addition, we may expend significant funds towards such training before any orders are placed for our products, which would increase our expenses and harm our financial results.

*Potential new accounting pronouncements and legislative actions are likely to impact our future financial position or results of operations*

Future changes in financial accounting standards may cause adverse, unexpected fluctuations in the timing of the recognition of revenues or expenses and may affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred with frequency and may occur in the future and we may make changes in our accounting policies in the future. Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses. Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC

regulations, PCAOB pronouncements and NASDAQ rules, are creating uncertainty for companies such as ours and insurance, accounting and auditing costs are high as a result of this uncertainty and other factors. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest all reasonably necessary resources to comply with evolving standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

### **Risks Related To Our Common Stock**

*Our stock price has in the past and may in the future not meet the minimum bid price for continued listing on Nasdaq. Our ability to continue operations or to publicly or privately sell equity securities and the liquidity of our common stock could be adversely affected if we are delisted from Nasdaq*

On each of January 16, 2013 and December 9, 2014, we received written notification from Nasdaq informing us that because the closing bid price of our common stock was below \$1.00 for 30 consecutive trading days, our shares no longer complied with the minimum closing bid price requirement for continued listing on the Nasdaq Global Market under Nasdaq Marketplace Rule 5450(a)(1). Each time, we were given a period of 180 days from the date of the notification to regain compliance with Nasdaq's listing requirements by having the closing bid price of our common stock listed on Nasdaq be at least \$1.00 for at least 10 consecutive trading days.

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While we regained compliance within the applicable time periods as of February 1, 2013 and March 6, 2015, respectively, if our shares again no longer comply with the minimum closing bid price requirement for continued listing on the Nasdaq Global Market under Nasdaq Marketplace Rule 5450(a)(1) and we do not regain compliance within the applicable 180-day time period, we may transfer our common stock listing to The Nasdaq Capital Market, provided that the Company (i) meets the applicable market value of publicly held shares requirement for continued listing and all other applicable requirements for initial listing on The Nasdaq Capital Market (except for the closing bid price requirement) based on the Company's most recent public filings and market information and (ii) notifies Nasdaq of its intent to cure this deficiency. Following a transfer to The Nasdaq Capital Market, the Company would be afforded the remainder of an additional 180 calendar day grace period in order to regain compliance with the minimum closing bid price requirement of \$1.00 per share under The Nasdaq Capital Market, unless it does not appear to NASDAQ that it would be possible for the Company to cure the deficiency.

If compliance is not demonstrated within the applicable compliance period, Nasdaq will notify the Company that its securities will be subject to delisting. The Company may appeal Nasdaq's determination to delist its securities to a Hearings Panel. During any appeal process, shares of the Company's common stock would continue to trade on the Nasdaq Global Market or Nasdaq Capital Market, as applicable.

There can be no assurance that we will maintain compliance with the requirements for listing our common stock on the Nasdaq Global Market or if we were not in compliance, that our common stock would be eligible for transfer to the Nasdaq Capital Market and remain in compliance with the requirements for listing on that market. Delisting from Nasdaq would constitute an event of default under our loan facility with Oxford, entitling Oxford to accelerate our obligations under such facility, among other actions. Under such circumstances, we could be required to renegotiate the repayment terms of our loan facility, on terms which would not be favorable to the Company as our current terms, or we could be required to take other actions, such as discontinuing some or all of our operations, selling assets, or other action. Delisting could also adversely affect our ability to raise additional financing through the public or private sale of equity securities, would significantly affect the ability of investors to trade our securities and would negatively affect the value and liquidity of our common stock. Delisting could also have other negative results, including the potential loss of confidence by employees, the loss of institutional investor interest and fewer business development opportunities.

*Our operating history makes evaluating our stock difficult*

Our quarterly and annual results of operations have historically fluctuated and we expect will continue to fluctuate for the foreseeable future. We believe that period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies with no approved pharmaceutical products, particularly companies in new and rapidly evolving markets such as pharmaceuticals, drug delivery and biotechnology. To address these risks, we must, among other things, obtain regulatory approval for and commercialize our product candidates, which may not occur. We may not be successful in addressing these risks and difficulties. We may require additional funds to complete the development of our product candidates and to fund operating losses to be incurred in the next several years.

*Investors may experience substantial dilution of their investment*

Investors may experience dilution of their investment if we raise capital through the sale of additional equity securities or convertible debt securities or grant additional stock options to employees and consultants. In November 2015, we filed a shelf registration statement on Form S-3 with the SEC that allows us to offer up to \$125 million of securities from time to time in one or more public offerings of our common stock. In addition, in November 2015, we entered into a Controlled Equity Offering sales agreement with Cantor Fitzgerald, under which we may sell, subject to certain

limitations, up to \$40 million of common stock through Cantor Fitzgerald, acting as agent, and in April 2016, we completed an underwritten public offering in which we sold an aggregate of 13.8 million shares of our common stock pursuant to an effective registration statement at a price to the public of \$1.25. As of July 25, 2016, we had up to \$35.7 million of common stock available for sale under the Controlled Equity Offering program and \$67.8 million of common stock available for sale under the shelf registration statement. Any additional sales in the public market of our common stock, under the agreements with Cantor Fitzgerald or otherwise under the shelf registration statement, could adversely affect prevailing market prices for our common stock.

*The price of our common stock may be volatile*

The stock markets in general, and the markets for pharmaceutical stocks in particular, have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

Price declines in our common stock could result from general market and economic conditions and a variety of other factors, including:

failure of third-party collaborators to continue development of the respective product candidates they are developing;

adverse results (including adverse events or failure to demonstrate safety or efficacy) or delays in our clinical and non-clinical trials of POSIMIR, REMOXY or our other ORADUR-based drug candidates, DUR-928, Relday, ELADUR or other product candidates;

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announcements of FDA non-approval of our product candidates, or delays in the FDA or other foreign regulatory agency review process;

adverse actions taken by regulatory agencies or law enforcement agencies with respect to our product candidates, clinical trials, manufacturing processes or sales and marketing activities, or those of our third party collaborators;

announcements of technological innovations, patents, product approvals or new products by our competitors;

regulatory, judicial and patent developments in the United States and foreign countries;

any lawsuit involving us or our product candidates including intellectual property infringement or product liability suits;

announcements concerning our competitors, or the biotechnology or pharmaceutical industries in general;

developments concerning our strategic alliances or acquisitions;

actual or anticipated variations in our operating results;

changes in recommendations by securities analysts or lack of analyst coverage;

deviations in our operating results from the estimates of analysts;

sales of our common stock by our executive officers or directors or sales of substantial amounts of common stock by us or others;

potential failure to meet continuing listing standards from The NASDAQ Global Market;

loss or disruption of facilities due to natural disasters;

changes in accounting principles; or

loss of any of our key scientific or management personnel.

The market price of our common stock may fluctuate significantly in response to factors which are beyond our control. The stock market in general has recently experienced extreme price and volume fluctuations. In addition, the market prices of securities of technology and pharmaceutical companies have also been extremely volatile, and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could result in extreme fluctuations in the price of our common stock, which could cause a decline in the value of our common stock.

In the past, following periods of volatility in the market price of a particular company's securities, litigation has often been brought against that company. If litigation of this type is brought against us, it could be extremely expensive and divert management's attention and our company's resources.

*We have broad discretion over the use of our cash and investments, and their investment may not always yield a favorable return*

Our management has broad discretion over how our cash and investments are used and may from time to time invest in ways with which our stockholders may not agree and that do not yield favorable returns.

*Executive officers, directors and principal stockholders have substantial control over us, which could delay or prevent a change in our corporate control favored by our other stockholders*

Our directors, executive officers and principal stockholders, together with their affiliates, have substantial control over us. The interests of these stockholders may differ from the interests of other stockholders. As a result, these stockholders, if acting together, could have the ability to exercise control over all corporate actions requiring stockholder approval irrespective of how our other stockholders may vote, including:

the election of directors;

the amendment of charter documents;

the approval of certain mergers and other significant corporate transactions, including a sale of substantially all of our assets; or

the defeat of any non-negotiated takeover attempt that might otherwise benefit the public stockholders.



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*Our certificate of incorporation, our bylaws and Delaware law contain provisions that could discourage another company from acquiring us*

Provisions of Delaware law, our certificate of incorporation and bylaws may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions include:

authorizing the issuance of blank check preferred stock without any need for action by stockholders;

providing for a classified board of directors with staggered terms;

requiring supermajority stockholder voting to effect certain amendments to our certificate of incorporation and bylaws;

eliminating the ability of stockholders to call special meetings of stockholders;

prohibiting stockholder action by written consent; and

establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

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**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Mine Safety Disclosures**

None

**Item 5. Other Information**

None

**Item 6. Exhibits**

- 10.1\* DURECT Corporation 2000 Stock Plan, as amended (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K ((File No. 000-31615) filed on June 23, 2016).
- 31.1 Rule 13a-14(a) Section 302 Certification of James E. Brown.
- 31.2 Rule 13a-14(a) Section 302 Certification of Matthew J. Hogan.
- 32.1 Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of James E. Brown.
- 32.2 Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Matthew J. Hogan.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Management contract or compensatory plan or arrangement.

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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.

DURECT CORPORATION

By: */S/ JAMES E. BROWN*  
**James E. Brown**

**Chief Executive Officer**

Date: August 2, 2016

By: */S/ MATTHEW J. HOGAN*  
**Matthew J. Hogan**

**Chief Financial Officer and Principal**

**Accounting Officer**

Date: August 2, 2016

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