DURECT CORP
Form 10-Q
August 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

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	94-3297098
(State or other jurisdiction of incorporation or organization)	(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
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 30, 2018, there were 162,001,652 shares of the registrant's Common Stock outstanding.

INDEX

		Page
	PART I. FINANCIAL INFORMATION	
Item 1.	Financial Statements	3
	Condensed Balance Sheets as of June 30, 2018 and December 31, 2017	3
	Condensed Statements of Comprehensive Loss for the three and six months ended June 30, 2018 and 2017	4
	Condensed Statements of Cash Flows for the six months ended June 30, 2018 and 2017	5
	Notes to Condensed Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	29
Item 4.	Controls and Procedures	29
	PART II. OTHER INFORMATION	
Item 1.	Legal Proceedings	30
Item 1A.	Risk Factors	30
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	54
Item 3.	Defaults Upon Senior Securities	54
Item 4.	Mine Safety Disclosures	54
Item 5.	Other Information	54
Item 6.	Exhibits	54
Signatures		55

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DURECT CORPORATION

CONDENSED BALANCE SHEETS

(in thousands)

	June 30, 2018 (unaudited)	December 31, 2017 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$37,338	$29,375
Short-term investments	5,061	7,384
Accounts receivable (net of allowances of $57 at June 30, 2018 and $155 at December 31, 2017)	1,465	2,376
Inventories, net	3,263	3,163
Prepaid expenses and other current assets	2,691	3,060
Total current assets	49,818	45,358
Property and equipment, net	749	929
Goodwill	6,399	6,399
Long-term restricted investments	150	150
Other long-term assets	282	277
Total assets	$57,398	$53,113
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$895	$1,520
Accrued liabilities	4,520	5,511
Contract research liabilities	710	834
Deferred revenue, current portion	203	682
Term loan, current portion, net	7,520	7,281
Total current liabilities	13,848	15,828
Deferred revenue, non-current portion	623	1,093
Term loan, non-current portion, net	12,341	12,634
Other long-term liabilities	2,317	2,070
Commitments and contingencies		
Stockholders' equity:		
Common stock	16	15
Additional paid-in capital	486,863	465,246
Accumulated other comprehensive loss	—	(1)
Accumulated deficit	(458,610)	(443,772)
Stockholders' equity	28,269	21,488
Total liabilities and stockholders' equity	$57,398	$53,113

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

DURECT CORPORATION

CONDENSED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands, except per share amounts)

(unaudited)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Collaborative research and development and other revenue	$645	$1,268	$1,741	$1,702
Product revenue, net	2,768	3,051	5,160	7,184
Total revenues	3,413	4,319	6,901	8,886
Operating expenses:				
Cost of product revenues	1,084	924	2,258	2,467
Research and development	6,120	9,079	13,072	16,627
Selling, general and administrative	2,816	3,681	6,010	6,724
Total operating expenses	10,020	13,684	21,340	25,818
Loss from operations	(6,607)	(9,365)	(14,439)	(16,932)
Other income (expense):				
Interest and other income	240	39	398	75
Interest expense	(644)	(601)	(1,267)	(1,184)
Net other expense	(404)	(562)	(869)	(1,109)
Net loss	$(7,011)	$(9,927)	$(15,308)	$(18,041)
Net change in unrealized loss on available-for-sale securities, net of reclassification adjustments and taxes	1	2	1	-
Total comprehensive loss	$(7,010)	$(9,925)	$(15,307)	$(18,041)
Net loss per share				
Basic	$(0.04)	$(0.07)	$(0.10)	$(0.13)
Diluted	$(0.04)	$(0.07)	$(0.10)	$(0.13)
Weighted-average shares used in computing net loss per share				
Basic	161,621	142,532	157,612	142,176
Diluted	161,621	142,532	157,612	142,176

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

DURECT CORPORATION

CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Six months ended June 30,	
	2018	2017
Cash flows from operating activities		
Net loss	$(15,308)	$(18,041)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	221	224
Stock-based compensation	1,300	1,228
Amortization of debt issuance cost	51	31
Net amortization (accretion) on investments	41	(65)
Changes in assets and liabilities:		
Accounts receivable	911	(231)
Inventories	(98)	68
Prepaid expenses and other assets	364	(1,013)
Accounts payable	(625)	(303)
Accrued and other liabilities	1,122	1,154
Contract research liabilities	(124)	1,348
Deferred revenue	(479)	18,977
Total adjustments	2,684	21,418
Net cash (used in) provided by operating activities	(12,624)	3,377
Cash flows from investing activities		
Purchases of property and equipment	(41)	(17)
Purchases of available-for-sale securities	(6,835)	-
Proceeds from maturities of available-for-sale securities	9,118	16,610
Net cash provided by investing activities	2,242	16,593
Cash flows from financing activities		
Payments on equipment financing obligations	(6)	(6)
Payment of additional issuance cost for term loan	(105)	-
Net proceeds from issuances of common stock	18,456	5,037
Net cash provided by financing activities	18,345	5,031
Net increase in Cash, cash equivalents, and restricted cash	7,963	25,001
Cash, cash equivalents, and restricted cash, beginning of the period	29,525	5,554
Cash, cash equivalents, and restricted cash, end of the period (1)	$37,488	$30,555
Supplementary disclosure of non-cash financing information		
Fully vested options issued to settle accrued liabilities	$1,860	$1,600

(1) Includes restricted cash of $150,000 (in long term restricted investments) included in the condensed balance sheets at both June 30, 2018 and June 30, 2017.

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

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 Epigenetics 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, 2018, the operating results and comprehensive loss for the three and six months ended June 30, 2018 and 2017, and cash flows for the six months ended June 30, 2018 and 2017. The balance sheet as of December 31, 2017 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, 2017 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.

Liquidity and Need to Raise Additional Capital

As of June 30, 2018, the Company had an accumulated deficit of $458.6 million as well as negative cash flows from operating activities for the six months ended June 30, 2018.

The Company historically has had negative cash flows from operating activities and expects its negative cash flows to continue. The Company will continue to require substantial funds to continue research and development, including clinical trials of its product candidates. Management's plans in order to meet its operating cash flow requirements include seeking additional collaborative agreements for certain of its programs and achieving milestone and other payments under its collaboration and licensing agreements as well as financing activities such as public offerings and private placements of its common stock, preferred stock offerings, issuances of debt and convertible debt instruments.

There are no assurances that such additional funding will be obtained and that the Company will succeed in its future operations. If the Company cannot successfully raise additional capital and implement its strategic development plan, its liquidity, financial condition and business prospects will be materially and adversely affected.

Inventories

Inventories are stated at the lower of cost or net realizable value, with cost determined on a first-in, first-out basis. Inventories, in part, include certain excipients that are sold to a customer for a currently marketed animal health product and included in several products in development or awaiting regulatory approval. These inventories are capitalized based on management's judgment of probable sale prior to their expiration dates. 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. As of June 30, 2018, the remaining

carrying value of the excipient in the Company's inventory was $70,000. 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. If the Company is able to subsequently sell products made with raw materials that were previously written down, the Company will report an unusually high gross profit as there will be no associated cost of goods for these materials.

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

	June 30, 2018 (unaudited)	December 31, 2017
Raw materials	$ 247	$ 282
Work in process	1,401	1,182
Finished goods	1,615	1,699
Total inventories	$ 3,263	$ 3,163

Revenue Recognition

Effective January 1, 2018, the Company adopted FASB ASC Topic 606, Revenue from Contracts with Customers, or ASC 606. In accordance with ASC 606, the Company changed certain characteristics of its revenue recognition accounting policy as described below. ASC 606 was applied using the modified retrospective method, where the cumulative effect of the initial application was recognized as an adjustment to opening retained earnings at January 1, 2018. Therefore, comparative prior periods have not been adjusted and continue to be reported under FASB ASC Topic 605, Revenue Recognition, or ASC 605. The Company recorded a net increase to opening retained earnings of $470,000 with an offset entry to a contra liability account as of January 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact relating to the Company's deferred collaborative research and development revenues. There was no impact to reported total assets, revenues and operating expenses for the three and six months ended June 30, 2018 as a result of applying Topic 606.

Product Revenue, Net

The Company 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.

Revenues from product sales are recognized when the customer obtains control of the Company's product, which occurs at a point in time, typically upon shipment to the customer. The Company expenses incremental costs of obtaining a contract as and when incurred if the expected amortization period of the asset that the Company would have recognized is one year or less.

Trade Discounts and Allowances: The Company provides certain customers with discounts that are explicitly stated in the Company's contracts and are recorded as a reduction of revenue in the period the related product revenue is recognized.

Product Returns: Consistent with industry practice, the Company generally offers customers a limited right of return for products that have been purchased from the Company. The Company estimates the amount of its product sales that may be returned by its customers and records this estimate as a reduction of revenue in the period the related product revenue is recognized. The Company currently estimates product return liabilities using its own historical sales information. The Company expects product returns to be minimal.

Collaborative Research and Development Revenues

The Company enters into license agreements which are within the scope of Topic 606, under which it licenses certain rights to its product candidates to third parties. The terms of these arrangements typically include payment to the Company of one or more of the following: non-refundable, up-front license fees; reimbursement of development costs incurred by the Company under approved work plans; development, regulatory and commercial milestone payments; payments for manufacturing supply services the Company provides through its contract manufacturers; and royalties on net sales of licensed products. Each of these payments results in collaborative research and development revenues, except for revenues from royalties on net sales of licensed products, which are classified as royalty revenues.

In determining the appropriate amount of revenue to be recognized as it fulfills its obligations under each of its agreements, the Company performs the following steps: (i) identification of the promised goods or services in the contract; (ii) determination of whether the promised goods or services are performance obligations including whether they are distinct in the context of the contract;

(iii) measurement of the transaction price, including the constraint on variable consideration; (iv) allocation of the transaction price to the performance obligations; and (v) recognition of revenue when (or as) the Company satisfies each performance obligation. As part of the accounting for these arrangements, the Company must develop assumptions that require judgment to determine the stand-alone selling price for each performance obligation identified in the contract. The Company uses key assumptions to determine the stand-alone selling price, which may include forecasted revenues, development timelines, reimbursement rates for personnel costs, discount rates and probabilities of technical and regulatory success. The Company expects to recognize revenue for the variable consideration currently being constrained when it is probable that a significant revenue reversal will not occur.

Licenses of intellectual property: If the license to the Company's intellectual property is determined to be distinct from the other performance obligations identified in the arrangement, the Company recognizes revenues from non-refundable, up-front fees allocated to the license when the license is transferred to the customer and the customer is able to use and benefit from the license. For licenses that are bundled with other promises, the Company utilizes judgment to assess the nature of the combined performance obligation to determine whether the combined performance obligation is satisfied over time or at a point in time and, if over time, the appropriate method of measuring progress for purposes of recognizing revenue from non-refundable, up-front fees. The Company evaluates the measure of progress each reporting period and, if necessary, adjusts the measure of performance and related revenue recognition.

Milestone Payments: At the inception of each arrangement that includes development milestone payments, the Company evaluates whether the milestones are considered probable of being reached and estimates the amount to be included in the transaction price using the most likely amount method. If it is probable that a significant revenue reversal would not occur, the associated milestone value is included in the transaction price. Milestone payments that are not within the control of the Company or the licensee, such as regulatory approvals, are not considered probable of being achieved until those approvals are received. The transaction price is then allocated to each performance obligation on a relative stand-alone selling price basis, for which the Company recognizes revenue as or when the performance obligations under the contract are satisfied. At the end of each subsequent reporting period, the Company re-evaluates the probability of achievement of such development milestones and any related constraint, and if necessary, adjusts its estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect collaborative research and development revenues and net income (loss) in the period of adjustment.

Manufacturing Supply Services: Arrangements that include a promise for future supply of drug product for either clinical development or commercial supply at the customer's discretion are generally considered as options. The Company assesses if these options provide a material right to the licensee and if so, they are accounted for as separate performance obligations. If the Company is entitled to additional payments when the customer exercises these options, any additional payments are recorded in collaborative research and development revenue when the customer obtains control of the goods, which is upon delivery.

Royalties and Earn-outs: For arrangements that include sales-based royalties or earn-outs, including milestone payments based on the level of sales, and the license is deemed to be the predominant item to which the royalties relate, the Company recognizes revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied). To date, the

Company has not recognized any significant royalty revenue resulting from our collaborative arrangements or any earn-out revenue from our patent purchase agreement with Indivior.

The Company receives payments from its customers based on development cost schedules established in each contract. Up-front payments and fees are recorded as deferred revenue upon receipt or when due, and may require deferral of revenue recognition to a future period until the Company performs its obligations under these arrangements. Amounts are recorded as accounts receivable when the Company's right to consideration is unconditional. The Company does not assess whether a contract has a significant financing component if the expectation at contract inception is such that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.

Total revenue by geographic region for the three and six months ended June 30, 2018 and 2017 are as follows (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
United States	$2,124	$2,273	$4,198	$5,374
Europe	745	1,200	1,503	1,677
Japan	285	407	572	770
Other	259	439	628	1,065
Total	$3,413	$4,319	$6,901	$8,886

The cumulative effect of the changes made to our January 1, 2018 balance sheet for the adoption of ASC 606 Revenue – Revenue from Contract with Customers was as follows (in thousands):

	Balance at December 31, 2017	Adjustments Due to ASC606	Balance at January 1, 2018
Condensed Balance Sheets			
Liabilities			
Deferred revenue, non-current portion	$1,093	$ 470	$623
Equity			
Accumulated deficit	$(443,772)	$ 470	$(443,302)

During the three and six months ended June 30, 2018, the Company did not recognize any revenue as a result of changes in the contract asset and the contract liability balances associated with the Company's deferred research and development revenues for the Company's collaboration agreements as a result of adoption of ASC 606.

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on condensed balance sheets, condensed statements of comprehensive loss, and condensed statements of cash flows for the period ended June 30, 2018 was as follows (in thousands):

	As of June 30, 2018		
	As reported	Balances without adoption of ASC 606	Effect of change Higher/(Lower)
Condensed Balance Sheets			
Liabilities			
Deferred revenue, non-current portion	$623	$ 1,093	$ (470)

	For the six months ended June 30, 2018		
	As reported	Balances without adoption of ASC 606	Effect of change Higher/(Lower)
Condensed Statements of Comprehensive Loss			
Collaborative research and development and other revenue	$1,741	$ 1,741	$ -
Product revenue, net	5,160	5,160	-
Total revenues	$6,901	$ 6,901	$ -

	For the six months ended June 30, 2018		
	As reported	Balances without adoption	Effect of change Higher/(Lower)

		of ASC 606	
Condensed Statements of Cash Flow			
Cash flow from Operating Activities			
Deferred revenue, non-current portion	$(479)	$ -	$ (479)

For the reporting periods before January 1, 2018, revenue was recognized under ASC 605, Revenue Recognition. For a detailed description for our revenue recognition policy prior to January 1, 2018, please see Note 1, “Revenue Recognition” to our audited financial statements included in our annual report on Form 10-K for the year ended December 31, 2017.

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 for all periods presented. Total comprehensive loss has been presented in the Company’s Statements of Comprehensive Loss.

Net Income (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.

The numerators and denominators in the calculation of basic and diluted net loss per share were as follows (in thousands except per share amounts):

	Three months ended		Six months ended	
	June 30, 2018	2017	June 30, 2018	2017
Numerators:				
Net loss	(7,011)	(9,927)	(15,308)	(18,041)
Denominator:				
Weighted average shares used to compute basic net loss per share	161,621	142,532	157,612	142,176
Dilutive common shares from stock options and ESPP	-	-	-	-
Weighted average shares used to compute diluted net loss per share	161,621	142,532	157,612	142,176
Net loss per share:				
Basic	$(0.04)	$(0.07)	$(0.10)	$(0.13)
Diluted	$(0.04)	$(0.07)	$(0.10)	$(0.13)

Options to purchase approximately 13.4 million and 14.7 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, 2018, respectively, as the effect would be anti-dilutive. Options to purchase approximately 26.2 million shares of common stock were excluded from the denominator in the calculation of diluted net loss per share for each of the three and six months ended June 30, 2017, respectively, as the effect would be anti-dilutive.

Recent Accounting Pronouncements

Recently Adopted Accounting Standards

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash.” The FASB issued the update to clarify how restricted cash or restricted cash equivalents should be presented in the statement of cash flows. The standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within those years, and the guidance will generally be applied retroactively. The Company has adopted the amendments provided in ASU 2016-18 in these condensed financial statements to provide financial statement users with more transparent disclosure about restricted cash and restricted cash equivalents. Upon adoption, the amendments provided in this update are applied using a retrospective transition method to each period presented. The cash, cash equivalents, restricted cash, and restricted cash equivalents balance included $150,000 of restricted cash and restricted cash equivalents as of both June 30, 2018 and June 30, 2017. Restricted cash and restricted cash equivalents are included in long-term restricted investments in the accompanying condensed balance sheets as of June 30, 2018 and December 31, 2017, respectively.

In March 2018, the FASB issued ASU 2018-05, “Income Taxes (Topic 740), Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118.” The ASU adds various Securities and Exchange Commission (“SEC”) paragraphs pursuant to the issuance of the December 2017 SEC Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which was effective immediately. The SEC issued SAB 118 to address concerns about reporting entities’ ability to timely comply with the accounting requirements to recognize all of the effects of the Tax Cuts and Jobs Act in the period of enactment. SAB 118 allows disclosure that timely determination of some or all of the income tax effects from the Tax Cuts and Jobs Act are incomplete by the due date of the financial statements and if possible to provide a reasonable estimate. The Company has accounted for the tax effects of the Tax Cuts and Jobs Act under the guidance of SAB 118, on a provisional basis. The Company’s accounting for certain income tax effects is incomplete, but the Company has determined reasonable estimates for those effects and has recorded provisional amounts in its condensed financial statements as of June 30, 2018 and December 31, 2017.

Recently Issued Accounting Standards

In June 2018, the FASB issued Accounting Standards Update (“ASU”) No. 2018-07, Compensation – Stock Compensation (Topic 718), which expands the scope of ASC 718 to include all share-based payment arrangements related to the acquisition of goods and services from both nonemployees and employees. Under the new standard, most of the guidance on stock compensation payments to nonemployees would be aligned with the requirements for share-based payments granted to employees. This standard is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within those years, with early adoption permitted. The Company is evaluating the impact that the adoption of this amendment will have on its financial position, results of operations, and disclosures.

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The FASB issued the update to provide amended guidance to "allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act." Additionally, under the new guidance an entity will be required to provide certain disclosures regarding stranded tax effects. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, and the guidance may be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal income tax rate in the Tax Cuts and Jobs Act is recognized. Early adoption is permitted. The Company is currently assessing the effect that the ASU will have on its financial position, results of operations, and disclosures.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The FASB issued the update to require the recognition of lease assets and lease liabilities on the balance sheet of lessees. The standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within such fiscal years. The ASU requires a modified retrospective transition method with the option to elect a package of practical expedients. Early adoption is permitted. The Company expects adoption to increase the assets and liabilities recorded on its condensed balance sheet and increase the level of disclosures related to leases. The Company is currently assessing the effect that the ASU will have on its financial position, results of operations, and disclosures and anticipates recognition of additional assets and corresponding liabilities related to leases on the Company's Condensed Balance Sheets upon adoption of the ASU.

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):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Collaborator				
Sandoz AG (Sandoz) (1)	$-	$769	$-	$769
Santen Pharmaceutical Co. Ltd. (Santen) (2)	-	54	1	148
Pain Therapeutics, Inc. (Pain Therapeutics)	-	81	-	105
Zogenix, Inc. (Zogenix) (3)	-	42	-	86
Others (4)	645	322	1,740	594
Total collaborative research and development and other revenue	$645	$1,268	$1,741	$1,702

(1) Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $769,000 for the corresponding periods in 2017.

(2) Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $48,000 and $105,000 for the corresponding periods in 2017.

(3) Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $42,000 and $84,000 for the corresponding periods in 2017. In August 2017, the Company and Zogenix terminated the Development and License Agreement between us dated July 11, 2011 relating to the

development and commercialization of Relday.

(4) Includes revenue recognized associated with the Company's feasibility agreements for each of the three and six months ended June 30 2018 and 2017.

Agreement with Sandoz AG

In May 2017, the Company and Sandoz AG ("Sandoz") entered into a license agreement to develop and market POSIMIR® (SABER®-bupivacaine) in the United States. Following expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR), the agreement became effective in June 2017. POSIMIR is the Company's investigational post-operative pain relief depot that utilizes the Company's patented SABER technology to deliver bupivacaine to provide up to three days of pain relief after surgery. The Company retains commercialization rights in the rest of the world. Under terms of the agreement, Sandoz made an upfront payment of $20 million, and the Company remains eligible for up to an additional $30 million in milestone payments based on successful development and regulatory milestones, and up to an additional $230 million in sales-based milestones. DURECT was responsible for the completion of the ongoing PERSIST Phase 3 clinical trial for POSIMIR as well as FDA interactions through potential approval. If approved, DURECT also has certain manufacturing obligations under this agreement. Sandoz will have exclusive commercialization rights in the United States upon regulatory approval with sole funding responsibility for commercialization activities. Sandoz will pay the Company a tiered double-digit royalty on product sales for a defined period, after

which the license granted to Sandoz shall convert to a non-exclusive, fully paid, royalty-free, irrevocable and perpetual license. The term of the agreement shall be for the duration of Sandoz's obligation to pay royalties for product sales under the Agreement. The agreement provides each party with specified termination rights, including the right of Sandoz to terminate at will after a specified period and each party to terminate the agreement upon material breach of the agreement by the other party. The failure of the PERSIST trial for POSIMIR to achieve its primary endpoint gives Sandoz a right to terminate our agreement with them on thirty days' notice, in addition to the rights they have to terminate for convenience on six months' notice. In May 2018, the Company and Sandoz entered into an amendment (the "Amendment") to the license agreement. Pursuant to the Amendment, the Company is eligible for up to $30 million in milestone payments based on NDA approval, and remains eligible for up to an additional $230 million in sales-based milestones. Pursuant to the Amendment, each party is also permitted to develop or commercialize competing products. The Amendment also includes modifications to the Company's development obligations and to both parties' termination provisions, including a right for the Company to terminate for convenience prior to NDA approval, and a new termination fee payable to the Company in the event that Sandoz terminates the agreement for convenience. Except as expressly set forth in the Amendment, the license agreement remains in full force and effect.

The Company evaluated the agreement under the accounting guidance for multiple element arrangements and identified three deliverables: the license to develop and market POSIMIR, the research and development services and the manufacturing services. Given that the delivery of the manufacturing services by the Company is dependent upon approval of POSIMIR by the FDA, and that the fee to be received by the Company for these services, should they be delivered, is consistent with their estimated selling price, the Company considers the manufacturing services to be a contingent deliverable and has excluded them from the initial measurement and allocation of the arrangement consideration. The Company evaluated the license deliverable and concluded that it did not have stand alone value separate from the research and development services and accordingly combined these deliverables into a single unit of accounting. The Company allocated the arrangement consideration, which consists of the $20.0 million upfront payment, to this single unit of accounting. As of December 31, 2017, all of the $20.0 million upfront fee had been recognized as revenue as the Company's contractual performance obligations had been fulfilled.

Total collaborative research and development revenue recognized by the Company for Sandoz was zero for each of the three and six months ended June 30, 2018, compared with $769,000 for the corresponding periods in 2017. The cumulative aggregate payments received by the Company from Sandoz as of June 30, 2018 were $20.0 million under this agreement.

Patent Purchase Agreement with Indivior

On September 26, 2017, the Company entered into a Patent Purchase Agreement (the "Agreement") with Indivior UK Limited ("Indivior"). Pursuant to the Agreement, the Company has assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS™ (risperidone), Indivior's extended-release injectable suspension for the treatment of schizophrenia in adults. In consideration for such assignment, Indivior made an upfront non-refundable payment to DURECT of $12.5 million. Indivior also agreed to make an additional $5.0 million payment to DURECT contingent upon NDA approval of PERSERIS, as well as quarterly earn-out payments that are based on a single digit percentage of U.S. net sales for certain products covered by the assigned patent rights, including PERSERIS. The assigned patent rights include granted patents extending through at least 2026. DURECT also receives a non-exclusive right under the assigned patents to develop and commercialize certain risperidone-containing products and products that do not contain risperidone or buprenorphine. The agreement contains customary representations, warranties and indemnities of the parties. The Company received the payment of $12.5 million from Indivior in September 2017 and recognized the $12.5 million as revenue from sale of intellectual property rights in 2017 as the Company did not have any continuing obligations under the purchase agreement.

On July 27, 2018, Indivior announced that the FDA had approved the NDA for PERSERIS thereby triggering the $5.0 million payment to DURECT.

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. This agreement currently covers only REMOXY ER.

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 $3.0 million in performance milestone payments based on the successful development and approval of REMOXY ER. Of these potential milestones, all $3.0 million are development-based milestones. There are no sales-based milestones under the agreement. As of June 30, 2018, the Company had received $1.5 million in cumulative milestone payments.

In March 2016, Pain Therapeutics resubmitted a New Drug Application (NDA) to the U.S. Food and Drug Administration (FDA), and in September 2016, Pain Therapeutics received a Complete Response Letter from the FDA for REMOXY ER. Based on its review, the FDA has determined that the NDA cannot be approved in its present form and specifies additional actions and data that are needed for drug approval. In February 2018, Pain Therapeutics stated that they had resubmitted the REMOXY ER NDA. On June 26, 2018, a joint meeting of the Anesthetic and Analgesic Drug Products Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA voted 14 to 3 against the approval of REMOXY ER. The PDUFA date for completion of the review is August 7, 2018.

Total collaborative research and development revenue recognized for REMOXY-related work performed by the Company for Pain Therapeutics was zero for each of the three and six months ended June 30, 2018 respectively, compared with $81,000 and $105,000 for the corresponding periods in 2017. The cumulative aggregate payments received by the Company from Pain Therapeutics as of June 30, 2018 were $40.4 million under this agreement.

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 was responsible for the clinical development and commercialization of a proprietary, long-acting injectable formulation of risperidone using the Company's SABER controlled-release formulation technology potentially in combination with Zogenix's DosePro® needle-free, subcutaneous drug delivery system. DURECT was responsible for non-clinical, formulation and CMC development activities. The Company was to 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 were considered integral to utilizing the licensed intellectual property and, accordingly, the deliverable was accounted for as a single unit of accounting. The $2.25 million upfront fee had been recognized as collaborative research and development revenue ratably over the term of the Company's research and development involvement with Zogenix with respect to this product candidate.

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 retained the right to supply Zogenix's Phase 3 clinical trial and commercial product requirements on the terms set forth in the Zogenix Agreement. Zogenix was permitted to terminate the Zogenix Agreement without cause at any time upon prior written notice, and either party was permitted to terminate the Zogenix Agreement upon certain circumstances including written notice of a material uncured breach.

In August 2017, the Company and Zogenix terminated the Zogenix Agreement. Under the mutual termination agreement, Zogenix's development and commercialization rights are returned to the Company, and Zogenix has transferred to the Company all regulatory filings and development information related to Relday. As a result of the termination of the Zogenix agreement, the Company recognized revenue during the third quarter of 2017 for the remaining $750,000 of deferred revenue related to the upfront fee as the Company had no remaining performance obligations under the agreement; this recognition of revenue did not result in additional cash proceeds to the Company.

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, 2018 were $20.1 million under these agreements.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Ratable recognition of upfront payment	$-	$ 42	$-	$ 84
Research and development expenses reimbursable by Zogenix	-	-	-	2
Total collaborative research and development revenue	$-	$ 42	$-	$ 86

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 controls and funds the development

and commercialization program, and the parties 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, 2018). 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. As of June 30, 2018, the cumulative aggregate payments received by the Company under this agreement were $3.3 million.

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,	
	2018	2017	2018	2017
Ratable recognition of upfront payment	$ -	$ 48	$ -	$ 105
Research and development expenses reimbursable by Santen	-	6	1	43
Total collaborative research and development revenue	$ -	$ 54	$ 1	$ 148

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, 2018 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.

The following is a summary of available-for-sale securities as of June 30, 2018 and December 31, 2017 (in thousands):

	June 30, 2018			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	$592	$ -	$ -	$592
Certificates of deposit	150	-	-	150
Commercial paper	40,477	-	-	40,477
	$41,219	$ -	$ -	$41,219
Reported as:				
Cash and cash equivalents	$36,008	$ -	$ -	$36,008
Short-term investments	5,061	-		5,061
Long-term restricted investments	150	-	-	150
	$41,219	$ -	$ -	$41,219

	December 31, 2017			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	$568	$ -	$ -	$568
Certificates of deposit	150	-	-	150
Commercial paper	33,307	-	-	33,307
Corporate debt	1,298	-	(1)	1,297
	$35,323	$ -	$ (1)	$35,322
Reported as:				
Cash and cash equivalents	$27,788	$ -	$ -	$27,788
Short-term investments	7,385	-	(1)	7,384
Long-term restricted investments	150	-	-	150
	$35,323	$ -	$ (1)	$35,322

The following is a summary of the cost and estimated fair value of available-for-sale securities at June 30, 2018, by contractual maturity (in thousands):

	June 30, 2018	
	Amortized Cost	Estimated Fair Value

Mature in one year or less	$40,627	$ 40,627
	$40,627	$ 40,627

There were no securities that have had an unrealized loss for more than 12 months as of June 30, 2018.

As of June 30, 2018, 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.

Note 4. Stock-Based Compensation

As of June 30, 2018, 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,	
	2018	2017	2018	2017
Cost of product revenues	$23	$28	$48	$56
Research and development	338	315	691	684
Selling, general and administrative	278	220	561	488
Total stock-based compensation	$639	$563	$1,300	$1,228

As of June 30, 2018 and December 31, 2017, $14,000 of stock-based compensation cost was capitalized in inventory on the Company's balance sheets.

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 and shares purchased under its employee stock purchase plan for the three and six months ended June 30, 2018 and 2017:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Stock Options				
Risk-free rate	2.8-3.0%	2.0-2.3%	2.7-3.0%	2.0-2.5%
Expected dividend yield	—	—	—	—
Expected life of option (in years)	7.5-10.0	6.8-10.0	7.0-10.0	6.8-10.0
Volatility	79-85%	75-81%	79-86%	75-82%

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Employee Stock Purchase Plan				
Risk-free rate	2.1%	1.0%	1.3-2.1%	0.7-1.0%
Expected dividend yield	—	—	—	—
Expected life of option (in years)	0.5	0.5	0.5	0.5

Volatility	66%	44%	66-146%	44-81%

Note 5. Term Loan

In July 2016, the Company entered a $20.0 million secured single-draw term loan with Oxford Finance LLC (Oxford Finance). The 2016 Loan Agreement 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 the term loan of August 1, 2020. The 2016 Loan Agreement also provides for a floating interest rate (7.95% initially and 9.40% as of June 30, 2018) 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. The facility fee and other debt offering/issuance costs have been recorded as debt discount on the Company’s balance sheet and together with the final $1.9 million payment are being amortized to interest expense during 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 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. The conditionally exercisable call option related to the event of default is considered to be an embedded derivative which is required to be bifurcated and accounted for as a separate financial instrument. In the periods presented, the value of the embedded derivative is not material, but could become material in future periods if an event of default became more probable than is currently estimated.

In February 2018, the Company and Oxford Finance entered into a First Amendment of the Loan Agreement, which modified the terms of the Loan Agreement to change the first principal payment date from March 1, 2018 to December 1, 2018 and to increase the additional payment due when the term loan becomes due or upon the prepayment of the facility from 9.25% of the principal amount of the term loan to 10% of such amount. The interest rate and the maturity date remain unchanged, and the Company paid Oxford Finance a loan modification fee of $100,000.

The fair value of the term loan approximates the carrying value. Future maturities and interest payments due under the term loan as of June 30, 2018, are as follows (in thousands):

Six months ended December 31, 2018	$2,711
2019	12,463
2020	8,845
Total minimum payments	24,019
Less amount representing interest	(4,019)
Gross balance of term loan	20,000
Less unamortized debt discount	(139)
Carrying value of term loan	19,861
Less term loan, current portion, net	(7,520)
Term loan, non-current portion, net	$12,341

As of June 30, 2018, the Company was in compliance with all material covenants under the Loan Agreement and there had been no material adverse change.

Note 6. Stockholders' Equity

During the three months ended June 30, 2018, the Company raised net proceeds (net of commissions) of approximately $3.1 million from the sale of 1,458,151 shares of the Company's common stock in the open market at a weighted average price of $2.22 per share, through its Controlled Equity Offering sales agreement with Cantor Fitzgerald, entered into in November 2015 (Controlled Equity Offering).

During the six months ended June 30, 2018, the Company raised net proceeds (net of commissions) of approximately $16.8 million from the sale of 9,629,426 shares of the Company's common stock in the open market at a weighted average price of $1.80 per share, through its Controlled Equity Offering sales agreement with Cantor Fitzgerald, entered into in November 2015 (Controlled Equity Offering).

Note 7. Subsequent Events

On July 27, 2018, Indivior announced that the FDA had approved the NDA for PERSERIS thereby triggering a $5 million milestone payment to DURECT.

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, 2018 and 2017 should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2017 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," "po 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:

- the clinical trial plans for DUR-928;
- potential regulatory filings for or approval of REMOXY ER, DUR-928, POSIMIR, or any of our or any third parties' 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 and our evaluation of additional 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 and timing of clinical trials, including for DUR-928, REMOXY ER and POSIMIR, the possible commencement of future clinical trials and announcements of the findings of our 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 license to third-party collaborators;
- 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;

- 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 Epigenetic 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, 2017 and in Note 2 of the financial statements included in Item 1 above.

Epigenetic Regulator Program and New Chemical Entities

DURECT's Epigenetic 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. Epigenetic regulation does not change DNA sequences, but regulates the pattern of DNA expression and subsequent cellular functions. 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.

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

During the course of this program, a number of compounds have been identified that may have therapeutic utility for various uncommon (orphan and rare) and common diseases, disorders or syndromes. The lead compound from this program (DUR-928) is an endogenous, orally available small molecule that modulates the activity of various nuclear receptors that play important regulatory roles in lipid homeostasis, inflammation and cell survival.

The biological activity of DUR-928 has been demonstrated in over 10 different animal disease models involving three animal species. Several of these disease models represent chronic metabolic disorders of hepatic lipid accumulation and dysfunction (e.g., nonalcoholic fatty liver disease (NAFLD) and nonalcoholic steatohepatitis (NASH) associated with diabetes) and several represent acute organ injuries (endotoxin shock, ischemic-reperfusion kidney injury, acute liver failure and stroke).

We are pursuing the development of DUR-928 through three programs for: (i) chronic metabolic disorders or liver diseases using oral administration, (ii) acute organ injury by injection or infusion, and (iii) local skin inflammatory disorders using topical application. We are also evaluating additional indications beyond these programs.

In pharmacokinetic and/or toxicity studies conducted in mice, hamsters, rats, rabbits, dogs, minipigs and monkeys, DUR-928 has been found to be orally available, locally tolerable and safe by all routes tested to date. These non-clinical results supported the initiation of DUR-928 into human safety/pharmacokinetics (PK)/proof-of-concept trials.

Chronic Metabolic Disease Program with Orally Administered DUR-928

Market Opportunity. Non-alcoholic fatty liver disease (NAFLD) affects approximately 30% of adults and 10% of children (about 81 million individuals) in the United States. There are many mechanisms, but only one phenotype of steatohepatitis. Non-alcoholic steatohepatitis (NASH), a more severe and progressive form of NAFLD, is one of the most common chronic liver diseases worldwide, with an estimated prevalence of more than 10% of adults in the United States, Europe, Japan and other developed countries. No drug is currently approved for NAFLD or NASH. Moreover, alcoholic fatty liver disease (AFLD), including its more advanced stage, alcoholic steatohepatitis (ASH), develops in approximately 90% of individuals who drink more than 60 grams/day of alcohol, but may occur in individuals who drink less, and is a major contributor to the global burden of liver cirrhosis. Alcoholic hepatitis (AH), an acute, inflammatory form of AFLD, occurs in approximately 20% of AFLD patients, and there are no effective therapeutics available to treat this condition. There is a growing appreciation for the pathological overlap between NASH and ASH. In addition to these liver diseases, there are a number of orphan liver diseases for which we may seek to develop DUR-928, such as primary sclerosing cholangitis (PSC).

Clinical Program. 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 PK of orally administered DUR-928. 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. Dose related increases in plasma concentrations were observed with peak plasma concentration at approximately 2-6 hours after dosing. We subsequently conducted a Phase 1 multiple-ascending-dose, randomized, double-blinded, placebo-controlled, oral administration trial in 20 healthy subjects (n=16 on drug, 4 on placebo). Following multiple dosing, DUR-928 was well-tolerated at all doses, with no serious drug-related adverse events reported and no accumulation in plasma concentrations observed with repeat dosing. We also conducted a food effect study with 8 healthy volunteers and observed no food effect on absorption.

Our first patient trial utilizing orally administered DUR-928 was an open-label, single-ascending-dose safety and PK Phase 1b trial in liver function impaired (NASH) patients and matched control subjects (MCS) (matched by age, body mass index and gender with normal liver function). This study was conducted in Australia in two successive dose cohorts (first a low dose of 50 mg and then a high dose of 200 mg) and NASH patients were confirmed to be either cirrhotic or non-cirrhotic. Both cohorts consisted of 10 NASH patients and 6 MCS. Data from this study was presented at the International Liver Congress™ 2017 organized by the European Association for the Study of the Liver (EASL) in Amsterdam on April 22, 2017.

All patients and MCS tolerated DUR-928 well. One patient (with a prior history of arrhythmia and an ongoing viral infection) in the high dose cohort experienced a serious adverse event (shortness of breath), which occurred without unusually abnormal biochemical changes and resolved without intervention but was considered possibly treatment related by the physician due to its temporal association with dosing. In both the low and high dose cohorts, the PK parameters were comparable between the NASH patients and the MCS. In addition, the systemic exposure following the low and high doses of DUR-928 was dose dependent.

While this study was not designed to assess efficacy, we observed a dose dependent reduction of certain biomarkers after a single oral dose of DUR-928. Exploratory biomarker analysis indicated that a single oral dose of DUR-928 resulted in statistically

significant reductions from baseline in the levels of both full-length and cleaved cytokeratin-18 (CK-18), bilirubin, hsCRP and IL-18 in the NASH patients. The mean decrease of full-length CK-18 (a generalized cell death marker) at the measured time point of greatest effect (12 hours after dosing) was 33% in the low dose cohort and 41% in the high dose cohort. The mean decrease of cleaved CK-18 (a cell apoptosis marker) at the measured time point of greatest effect (12 hours after dosing) was 37% in the low dose cohort and 47% in the high dose cohort. The mean reduction in total bilirubin (a liver function impairment marker) at the measured time point of greatest effect (12 hours after dosing) was 27% in the low dose cohort and 31% in the high dose cohort. The mean decrease of high sensitivity C-Reactive Protein (hsCRP), a marker of inflammation, at the measured time point of greatest effect (24 hours after dosing) was 8% on average in the low dose cohort and 13% in the high dose cohort. The mean decrease of IL-18, an inflammatory mediator implicated in both liver and kidney diseases, at the measured time point of greatest effect (8 hours after dosing) was 4% in the low dose cohort and 8% in the high dose cohort.

Collectively, the reduction of these biomarkers plus results from our animal and cell culture studies suggest potential therapeutic activity of DUR-928 for patients with liver diseases. However, additional studies are required to evaluate the safety and efficacy of DUR-928, and there is no assurance that these biomarker effects will be associated with clinically relevant benefits, or that DUR-928 will demonstrate safety or efficacy in treating liver diseases in larger controlled trials.

We are conducting a Phase 2a trial in PSC with orally administered DUR-928. The Phase 2a trial is a randomized, open label study with two cohorts (a cohort of 10 mg and a cohort of 50 mg), in which patients (n = 20 per cohort) receive oral dosing of DUR-928 for four weeks with follow-up for an additional four weeks. The objectives of this study include safety, PK and pharmacodynamic (PD) markers, including the percent change from baseline of serum alkaline phosphatase (ALP) and other biomarkers. As an open label study, we expect to generate interim data in 2018. PSC is a chronic liver disease characterized by a progression of cholestasis (decrease in bile flow) with inflammation and fibrosis of bile ducts. Over time, PSC leads to liver failure, infections and tumors of the bile duct or liver, and ultimately may require a liver transplant. There is no approved treatment for PSC at this time. We have received orphan drug designation for DUR-928 to treat patients with PSC. We believe that data generated from this trial will be relevant to other chronic inflammatory, fibrotic and cholestatic liver conditions.

Acute Organ Injury Program with Injectable DUR-928

Market Opportunity. Acute organ injury is another area of major unmet medical need for which effective pharmaceutical treatment is often lacking. Acute kidney injury (AKI) alone, for example, affects approximately 2.8 million patients per year in the United States and is associated with increased mortality, prolonged hospital stays, and progression to chronic kidney disease. In addition, AKI is a major cause of mortality in acute liver injury. Alcoholic hepatitis is a syndrome characterized by progressive inflammatory liver injury associated with long-term heavy intake of alcohol, and involves a spectrum that ranges from mild injury to severe, life threatening injury. The prevalence of alcoholic hepatitis has not been accurately determined, but it is believed to occur in 10-35% of heavy drinkers. There were over 320,000 hospitalizations related to alcoholic hepatitis in 2010, and the hospitalization costs amounted to nearly $50,000 per patient. There are various forms of acute organ injury affecting the liver, the kidney or multiple organs for which we may seek to develop DUR-928.

Clinical Program. The initial Phase 1 trial with injectable administration was a single-site, randomized, double-blinded, placebo-controlled, single-ascending-dose study that evaluated the safety, tolerability and PK of intramuscular (IM) injected DUR-928. The 24-subject study (16 healthy volunteers on the drug and 8 on placebo) of four escalating dose levels 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 IM-injected DUR-928 for 5 consecutive days (8 subjects on the 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 also conducted a single-ascending-dose intravenous infusion (IV) study with 16 healthy volunteers and observed no treatment related serious adverse events. The systemic exposure following IV infusion was dose proportional.

Our second Phase 1b study with injected DUR-928, also conducted in Australia, was an open-label, single-ascending-dose study in patients with impaired kidney function (stage 3 and 4 chronic kidney disease (CKD)) and matched control subjects (matched by age, body mass and gender with normal kidney function). This study was conducted in two successive cohorts (first a low dose of 30 mg and then a high dose of 120 mg) evaluating safety and PK of single-dose intramuscular injected DUR-928. The low dose cohort consisted of 6 patients with chronic kidney disease and 3 matched control subjects; the high dose cohort consisted of 5 patients with chronic kidney disease and 3 matched control subjects. In this trial, DUR-928 was well tolerated among all subjects and the PK parameters between the kidney function impaired patients and the matched control subjects were comparable. While the number of subjects involved was small and not designed to assess efficacy, we did observe decreases in bilirubin and CK-18 when those levels were meaningfully elevated pre-treatment, although these results were not statistically significant.

We have been working with our clinical advisors to design several Phase 2a studies for various acute organ injuries. We submitted an initial IND in late December 2016 for a proposed Phase 2a liver study. The FDA requested certain drug-drug interaction data and made suggestions for the proposed protocol. In response, we completed Phase 1 drug-drug interaction studies, which demonstrated that neither orally administered nor intravenously injected DUR-928 had an effect on the safety and PK of midazolam, a drug for detecting potential drug-drug interactions via the enzyme CYP3A4. This enzyme is commonly associated with clinically relevant drug-drug interactions.

We are conducting a Phase 2a trial in alcoholic hepatitis (AH) with DUR-928. The Phase 2a trial is an open label, dose escalation study conducted in two parts. Part A includes patients with moderate AH (as determined by MELD (Model for End-Stage Liver Disease) scores) and Part B will include patients with severe AH. The study is being conducted using three dose levels (30 mg, 90 mg and 150 mg) in Part A, with sequential dose escalation following review of safety and PK results of the prior dose level. Patients will receive DUR-928 by intravenous infusion, and the dose may be adjusted in Part B based on the findings from Part A. Patients will be enrolled at multiple clinical sites in the United States and the target number of participants to complete the study is 24-36. The objectives of this study include safety, PK and PD signals, as determined by improvement in liver biochemistry, MELD and Lille (a model for predicting mortality in patients with AH) scores and other biomarkers. As an open label study, we expect to generate interim data in 2018.

Skin Inflammatory Disorder Program with Topical DUR-928

Market opportunity. Skin inflammatory disorders, such as psoriasis or atopic dermatitis, affect approximately 7.5 million and 32 million Americans, respectively. Most currently available topical treatments, typically as first line therapy, either slow down excessive skin cell proliferation or reduce inflammation. Steroids are the most commonly used topical anti-inflammatory agents because they reduce the swelling and redness of lesions.

Clinical program. We have conducted an exploratory proof-of-concept (POC) Phase 1b trial in psoriasis patients (9 evaluable patients) in Australia. The decision to proceed with clinical testing was based on the anti-inflammatory activities of DUR-928, as well as the results of a psoriasis study with DUR-928 in mice. The double-blinded and placebo-controlled Phase 1b trial was conducted using a micro-plaque assay with intralesional injections of DUR-928. We feel that the initial results were encouraging and warrant further investigation. As a result, we are moving forward to initiate a placebo-controlled Phase 2a trial using a topical formulation of DUR-928 in patients with localized psoriasis. We have had pre-IND interactions with the FDA and recently completed the last non-clinical study requested by the FDA prior to submitting the IND for a Phase 2 proof-of-concept study with topically applied DUR-928. We expect to initiate this study in the third quarter of 2018.

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. In May 2017, we signed an agreement with Sandoz whereby Sandoz will have the exclusive commercialization rights to POSIMIR in the United States. DURECT retains the development and commercialization rights to POSIMIR in all other countries. Closing of this transaction occurred in June 2017 upon the expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976. In May 2018, the agreement with Sandoz was amended. Pursuant to the amendment, we are eligible for up to $30 million

in milestone payments based on NDA approval, and remain eligible for up to an additional $230 million in sales-based milestones. Pursuant to the amendment, each party is also permitted to develop or commercialize competing products. The amendment also includes modifications to our development obligations and to both parties' termination provisions, including a right for us to terminate for convenience prior to NDA approval, and a new termination fee payable to us in the event that Sandoz terminates the agreement for convenience. Except as expressly set forth in the amendment, the license agreement remains in full force and effect.

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 conducted 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 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 began implementing Part 2 of the PERSIST trial to evaluate POSIMIR against standard bupivacaine HCl rather than placebo as we had been doing initially in the study. Additionally, we switched 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 became the key secondary efficacy endpoint and other efficacy endpoints, including 72-hour opioid use, remained the same. In October 2017, we

reported that the PERSIST trial did not meet its primary efficacy endpoint of reduction in pain on movement over the first 48 hours after surgery as compared to standard bupivacaine HCl. While results trended in favor of POSIMIR versus the comparator, they did not achieve statistical significance. We continue to evaluate and consider potential next steps with the program.

PERSERIS™

In September 2017, we entered into an agreement with Indivior, under which we assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS, Indivior's extended-release injectable suspension for the treatment of schizophrenia in adults. In consideration for such assignment, Indivior made an upfront non-refundable payment to DURECT of $12.5 million. Indivior also agreed to make an additional $5 million payment to DURECT contingent upon FDA approval of PERSERIS, as well as quarterly earn-out payments that are based on a single digit percentage of U.S. net sales for certain products covered by the assigned patent rights, including PERSERIS. On July 27, 2018, Indivior announced that the FDA had approved the NDA for PERSERIS. On July 30, 2018 Indivior stated that it is reviewing the appropriate launch timing for PERSERIS; Indivior further stated that they commit to providing a launch timing as soon as reasonably practicable, but no later than when its Q3 2018 results are announced which is currently scheduled for November 1, 2018.

REMOXY® ER

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. This agreement currently covers only REMOXY ER. REMOXY ER, a novel long-acting oral formulation of the opioid oxycodone targeted to decrease the potential for oxycodone abuse, was developed under this agreement. Even where abuse deterrent properties exist, opioid drugs such as oxycodone still expose users to the risks of addiction, abuse and misuse. REMOXY ER is intended for patients who have pain serious enough to require daily, around-the-clock opioid treatment and for which alternative treatment options are inadequate. In November 2005, Pain Therapeutics and King Pharmaceuticals (King) entered into collaboration and license agreements for the development and commercialization of REMOXY ER by King. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to REMOXY ER and to the other ORADUR-based opioids. Pfizer subsequently relinquished their rights to Pain Therapeutics.

Pain Therapeutics submitted an NDA for REMOXY ER to the FDA in June 2008, and in November 2008 the FDA accepted the NDA and granted priority review. Following multiple complete response letters and additional studies, including on abuse-deterrence, on February 13, 2018, Pain Therapeutics stated that the REMOXY ER NDA had been resubmitted, and on March 1, 2018, Pain Therapeutics announced that the FDA had determined that the NDA was sufficiently complete to permit a substantive review. On June 26, 2018, a joint meeting of the Anesthetic and Analgesic Drug Products Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA voted 14 to 3 against the approval of REMOXY ER. The Prescription Drug User Fee Act (PDUFA) date for completion of the review is August 7, 2018.

ORADUR-ADHD Program

We have put effort into 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. The lead program is ORADUR-Methylphenidate.

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. We retain rights to North America, Europe, Japan and all other countries not specifically licensed to Orient Pharma. 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 conducted a Phase 3, multi-center, randomized, double-blind, placebo-controlled, two-way cross-over study designed to observe the efficacy and safety of ORADUR-Methylphenidate ER in children and adolescents with ADHD between the ages of 6 and 18 years. The study was conducted in Taiwan and enrolled 110 subjects, of which 99 evaluable subjects completed the study. The primary efficacy measure in this study was to demonstrate the superiority of ORADUR-Methylphenidate ER over placebo using the Swanson, Nolan, and Pelham-IV (SNAP-IV) teacher form score. The SNAP-IV rating scale contains 26 questions, classified as three components of ADHD symptoms (inattention, hyperactivity/impulsivity and oppositional defiant disorder). For the primary efficacy endpoint, ORADUR-Methylphenidate ER was superior to placebo in a statistically significant manner (p=0.0044 for

the intent to treat population and p=0.0032 for the per protocol population). There were no serious adverse events in this pivotal study. Orient Pharma's analysis indicates that the incidence of adverse events was generally consistent with other ADHD products.

We understand that Orient Pharma is pursuing a New Drug Application with the Taiwan FDA for ORADUR-Methylphenidate ER. DURECT is seeking potential development and commercialization partners for ORADUR-Methylphenidate ER for major markets not licensed to Orient Pharma.

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® osmotic pumps which are used for animal research;
- LACTEL® 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 ER 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, 2018, we had an accumulated deficit of $458.6 million. Our net loss was $7.0 million and $15.3 million for the three and six months ended June 30, 2018, respectively. Our net losses were $3.7 million and $34.5 million for the years ended December 31, 2017 and 2016, 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 in the near future to increase compared to the second

quarter of 2018 as we experience higher research and development expenses related to DUR-928. We expect selling, general and administrative expenses in the third quarter of 2018 to increase compared to the second quarter of 2018. We do not anticipate meaningful revenues from our products in development, should they be approved, for at least the next twelve months. Therefore, we expect to incur continuing losses and negative cash flows from operations for the foreseeable future.

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. For a description of our critical accounting policies and estimates affecting revenue from contracts with customers, see Note 1, “Revenue Recognition” to our unaudited condensed financial statements included in this Quarterly Report on Form 10-Q. Other than our critical accounting policies and estimates affecting revenue from contracts with customers, there have been no material changes to our other critical accounting policies and estimates as compared to the disclosures in our annual report on Form 10-K for the year ended December 31, 2017.

Results of Operations

Three and six months ended June 30, 2018 and 2017

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 third quarter of 2018 to increase compared to the second quarter of 2018. 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. The collaborative research and development and other revenues associated with our major collaborators are as follows (in thousands):

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Collaborator				
Sandoz AG (Sandoz) (1)	$-	$769	$-	$769
Santen Pharmaceutical Co. Ltd. (Santen) (2)	-	54	1	148
Pain Therapeutics, Inc. (Pain Therapeutics)	-	81	-	105
Zogenix, Inc. (Zogenix) (3)	-	42	-	86
Others (4)	645	322	1,740	594
Total collaborative research and development and other revenue	$645	$1,268	$1,741	$1,702

(1) Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $769,000 for the corresponding periods in 2017.

(2)

Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $48,000 and $105,000 for the corresponding periods in 2017.

(3) Amounts related to ratable recognition of upfront fees were zero for each of the three and six months ended June 30, 2018, compared to $42,000 and $84,000 for the corresponding periods in 2017. In August 2017, we and Zogenix terminated the Development and License Agreement between us dated July 11, 2011 relating to the development and commercialization of Relday.

(4) Includes revenue recognized associated with our feasibility agreements for each of the three and six months ended June 30, 2018 and 2017.

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 ER and in a currently marketed animal health product. Net product revenues were $2.8 million and $5.2 million in the three and six months ended June 30, 2018, respectively, compared to $3.1 million and $7.2 million for the corresponding periods in 2017. The decreases in the three and six months ended June 30, 2018 were primarily attributable to lower revenue from our LACTEL product line and from our ALZET mini pump product line as a result of lower units sold from these product lines compared to the corresponding periods in 2017. We did not generate any product revenue from the sale of a certain excipient included in REMOXY ER and in a currently marketed animal health product in the three and six months ended June 30, 2018 and 2017.

Cost of product revenues

Cost of product revenues were $1.1 million and $2.3 million for the three and six months ended June 30, 2018, respectively, compared to $924,000 and $2.5 million for the corresponding periods in 2017. The increase in the cost of product revenue in the three months ended June 30, 2018 was primarily the result of higher manufacturing costs for units sold related to our LACTEL product line and our ALZET product line compared to the corresponding period in 2017. The decrease in the cost of product revenue in the six months ended June 30, 2018 was primarily the result of lower cost of goods sold related to our LACTEL product line arising from lower units sold, partially offset by higher cost of goods sold related to our ALZET product line due to higher manufacturing costs for units sold in the six months ended June 30, 2018 compared to the corresponding period in 2017. 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 $23,000 and $48,000 for the three and six months ended June 30, 2018, respectively, compared to $28,000 and $56,000 for the corresponding periods in 2017.

We had 21 manufacturing employees as of June 30, 2018 and 2017. 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 $6.1 million and $13.1 million for the three and six months ended June 30, 2018, respectively, compared to $9.1 million and $16.6 million for the corresponding periods in 2017. The decrease in the three months ended June 30, 2018 was primarily attributable to lower research and development costs associated with POSIMIR, REMOXY ER, the Santen ophthalmic program, ORADUR-ADHD, Relday and other research programs, partially offset by higher research and development costs associated with DUR-928 and depot injectable programs compared to the corresponding period in 2017, as more fully discussed below. The decrease in the six months ended June 30, 2018 was primarily attributable to lower research and development costs associated with POSIMIR, REMOXY ER, the Santen ophthalmic program, Relday and other research programs, partially offset by higher research and development costs associated with DUR-928, depot injectable programs and ORADUR-ADHD compared to the corresponding period in 2017, as more fully discussed below. Stock-based compensation expense recognized related to research and development personnel was $338,000 and $691,000 for the three and six months ended June 30, 2018, respectively, compared to $315,000 and $684,000 for the corresponding periods in 2017. As of June 30, 2018, we had 48 research and development employees compared with 50 as of June 30, 2017. We expect research and development expenses in the near future to increase compared to the second quarter of 2018 as we expect to incur higher research and development expenses for 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,	
	2018	2017	2018	2017

DUR-928	$3,745	$3,548	$7,833	$6,602
POSIMIR	1,523	4,837	3,261	8,578
Depot injectable programs	714	488	1,687	944
ORADUR-ADHD	20	22	52	37
Santen ophthalmic program (1)	3	8	11	49
REMOXY ER (1)	7	61	11	96
Relday (1)	3	5	3	31
Others	105	110	214	290
Total research and development expenses	$6,120	$9,079	$13,072	$16,627

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

DUR-928

Our research and development expenses for DUR-928 were $3.7 million and $7.8 million in the three and six months ended June 30, 2018, respectively, compared to $3.5 million and $6.6 million for the corresponding periods in 2017. The increases in the

three and six months ended June 30, 2018 were primarily due to higher contract manufacturing expenses, higher non-clinical study expenses and higher employee-related expenses incurred for this drug candidate compared with the corresponding periods in 2017.

POSIMIR

Our research and development expenses for POSIMIR were $1.5 million and $3.3 million in the three and six months ended June 30, 2018, respectively, compared to $4.8 million and $8.6 million for the corresponding periods in 2017. The decreases in the three and six months ended June 30, 2018 were primarily due to lower clinical trial expenses and lower employee-related expenses for POSIMIR compared with the corresponding periods in 2017.

Depot injectable programs

Our research and development expenses for depot injectable programs were $714,000 and $1.7 million in the three and six months ended June 30, 2018, respectively, compared to $488,000 and $944,000 for the corresponding periods in 2017. The increases in the three and six months ended June 30, 2018 were primarily due to higher employee-related costs and higher costs related to research supplies for these programs compared with the corresponding periods in 2017.

ORADUR-ADHD

Our research and development expenses for ORADUR-ADHD were $20,000 and $52,000 in the three and six months ended June 30, 2018, respectively, compared to $22,000 and $37,000 for the corresponding periods in 2017. The decrease in the three months ended June 30, 2018 was primarily due to lower employee-related costs for the drug candidate compared with the corresponding periods in 2017. The increases in the six months ended June 30, 2018 were primarily due to higher employee-related costs for the drug candidate compared with the corresponding period in 2017.

Santen ophthalmic program

Our research and development expenses for the Santen ophthalmic program were $3,000 and $11,000 in the three and six months ended June 30, 2018, respectively, compared to $8,000 and $49,000 for the corresponding periods in 2017. The decreases in the three and six months ended June 30, 2018 were primarily due to decreased formulation development activities and lower employee-related costs associated with this drug candidate compared with the corresponding periods in 2017.

REMOXY ER

Our research and development expenses for REMOXY ER were $7,000 and $11,000 in the three and six months ended June 30, 2018, respectively, compared to $61,000 and $96,000 for the corresponding periods in 2017. The decreases in the three and six months ended June 30, 2018 were primarily due to lower employee-related costs for REMOXY ER compared with the corresponding periods in 2017.

Relday

Our research and development expenses for Relday were $3,000 in each of the three and six months ended June 30, 2018, respectively, compared to $5,000 and $31,000 for the corresponding periods in 2017. The decreases in the three and six months ended June 30, 2018 were primarily due to decreased development activities and lower employee-related costs incurred for this drug candidate compared with the corresponding periods in 2017. In August 2017, we and Zogenix terminated the Development and License Agreement between us dated July 11, 2011 related to the development and commercialization of Relday.

Other DURECT research programs

Our research and development expenses for all other programs were $105,000 and $214,000 in the three and six months ended June 30, 2018, respectively, compared to $110,000 and $290,000 for the corresponding periods in 2017, respectively. The decreases in the three and six months ended June 30, 2018 were primarily due to lower employee-related costs incurred as well as lower outside expenses associated with these programs compared with the corresponding periods in 2017.

We expect our research and development expenses in the near future to increase compared to the second quarter of 2018 as we expect to incur higher research and development expenses for DUR-928. 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 are 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 to and progress in 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 $2.8 million and $6.0 million for the three and six months ended June 30, 2018, respectively, compared to $3.7 million and $6.7 million for the corresponding periods in 2017. The decreases in selling, general and administrative expenses in the three and six months ended June 30, 2018 were primarily due to an advisory fee incurred in the three and six months ended June 30, 2017 that related to the licensing agreement with Sandoz. Stock-based compensation expense recognized related to selling, general and administrative personnel was $278,000 and $561,000 for the three and six months ended June 30, 2018, respectively, compared to $220,000 and $488,000 for the corresponding periods in 2017.

We had 24 selling, general and administrative employees as of June 30, 2018 and 2017. We expect selling, general and administrative expenses in the near future to be comparable to the second quarter of 2018.

Other income (expense). Interest and other income was $240,000 and $398,000 for the three and six months ended June 30, 2018, respectively, compared to $39,000 and $75,000 for the corresponding periods in 2017. The increases in interest and other income in the three and six months ended June 30, 2018 were primarily the result of higher interest income generated from our investments as a result of higher yields and higher average balances in the three and six months ended June 30, 2018 compared with the same periods in 2017.

Interest expense was $644,000 and $1.3 million for the three and six months ended June 30, 2018, respectively, compared to $601,000 and $1.2 million for the corresponding periods in 2017. The increases in interest and other expense in the three and six months ended June 30, 2018 were primarily due to higher interest rates associated with the term loan compared with the same periods in 2017.

Liquidity and Capital Resources

We had cash, cash equivalents and investments totaling $42.5 million at June 30, 2018 compared to $36.9 million at December 31, 2017. These balances include $150,000 of interest-bearing marketable securities classified as restricted investments on our balance sheets as of June 30, 2018 and December 31, 2017. The increase in cash, cash equivalents and investments during the six months ended June 30, 2018 was primarily due to the receipt of $18.5 million of cash from the sale of our common stock and from exercises of stock options and purchases under our employee stock purchase plan, and from payments received from collaboration partners and customers, partially offset by ongoing operating expenses and interest payments.

We used $12.6 million of cash in operating activities in the six months ended June 30, 2018 compared to $3.4 million received for the corresponding period in 2017. The increase in cash used in operating activities in the six months ended June 30, 2018 was primarily due to decreased payments received from collaboration partners and customers as we received the $20.0 million upfront fee from Sandoz in the six months ended June 30, 2017, partially offset by changes in accounts receivable, prepaid expenses and other assets, and accrued and other liabilities in the six months ended June 30, 2018 compared to the corresponding period in 2017.

We received $2.2 million of cash from investing activities for the six months ended June 30, 2018 compared to $16.6 million for the corresponding period in 2017. The decrease in cash received from investing activities was primarily due to a decrease in proceeds from maturities of available-for-sale securities for the six months ended June 30, 2018 compared to the corresponding period in 2017. We anticipate incurring capital expenditures of approximately $100,000 in 2018 to purchase research and development and other capital equipment.

We received $18.3 million of cash from financing activities for the six months ended June 30, 2018 compared to $5.0 million for the corresponding period in 2017. The increase in cash received from financing activities was primarily due to higher net proceeds received from issuances of common stock in the six months ended June 30, 2018 compared with the corresponding period in 2017. During the six months ended June 30, 2018, we raised net proceeds (net of commission) of approximately $16.8 million from the sale of 9.6 million shares of common stock at a weighted average price of $1.80 per share in the open market through our Controlled Equity Offering sales agreement with Cantor Fitzgerald, entered into in November 2015. As of July 30, 2018, we had up to approximately $514,000 of common stock available for sale under the Controlled Equity Offering program and approximately $67.8 million of common stock available for sale under our shelf registration statement.

We anticipate that cash used in operating activities in the third quarter of 2018 will decrease compared to the second quarter ended June 30, 2018 due to the $5 million milestone payment owed to DURECT from Indivior related to the July 2018 NDA approval of PERSERIS.

During the six months ended June 30, 2018, 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, 2017 except for the extension of a building lease.

We believe that our existing cash, cash equivalents and investments will be sufficient to fund our planned operations, existing debt and contractual commitments and planned capital expenditures through at least the next 12 months from the date the financial statements are filed. We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding. Additionally, we do not expect to generate significant revenues from our pharmaceutical products 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 and the extent to which we earn milestone revenues, 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, will earn milestone revenues or that 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, either 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 (assuming convertible debt securities were converted into shares).

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, 2018, 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, 2018, 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, 2017.

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.

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.

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. If any of the following risks actually occur, our business, financial condition, results of operations and growth prospects may be materially and adversely affected.

Risks Related To Our Business

New chemical entities derived from our Epigenetic 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 Epigenetic Regulator Program is in the early stages of development, involves a novel therapeutic approach and new chemical entities, 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 approaches. New chemical entities derived from our Epigenetic 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 Epigenetic 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 may 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. For example, we have yet to define the therapeutic dose or dosing regimen for DUR-928, the first drug candidate in our Epigenetic Regulator Program.

Also, because our Epigenetic Regulator Program is in early stages, we have not defined with precision those indications we wish to pursue, 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 indications of activity from Phase 1 clinical trials of DUR-928 may not predict the results of later trials

While Phase 1 clinical trials of DUR-928 have shown a dose dependent reduction of certain biomarkers after a single oral dose in patients with NASH or CKD, these trials are designed to assess the safety of DUR-928, and are not designed to evaluate its efficacy. Additional controlled Phase 2 and Phase 3 trials will be required to evaluate the safety and efficacy of DUR-928 to treat any indication, including NASH and CKD. There can be no assurance that these studies will demonstrate the safety or efficacy of DUR-928 in a statistically significant manner. The failure of DUR-928 to show efficacy in Phase 2 or Phase 3 clinical trials would significantly harm our business.

Plans and prospects for POSIMIR are uncertain following the failure of the PERSIST trial to achieve its primary endpoint

The failure of the PERSIST trial for POSIMIR to achieve its primary endpoint gives Sandoz a right to terminate our agreement with them on thirty days' notice. Sandoz may elect to terminate the agreement, in which case we will not

receive any milestone or royalty payments under the agreement and will be responsible for commercialization of POSIMIR in the United States, if approved. Even if Sandoz does not terminate the agreement, we remain responsible for obtaining approval of POSIMIR from the Food and Drug Administration. The decision whether to continue the development of POSIMIR and seek regulatory approval will require further analysis of the PERSIST trial data and other clinical data for POSIMIR, as well as possible regulatory approval strategies. We may elect to terminate development of POSIMIR. If we elect to continue to develop and seek approval for POSIMIR, we may be required to make a larger investment than previously planned, which would limit the funds available for other product development activities or require us to raise capital earlier than anticipated. It may also take longer to receive FDA approval than anticipated, and such approval may never occur.

If we experience delays or difficulties in the enrollment of subjects in clinical trials, our product development expenses may increase and receipt of necessary regulatory approvals could be delayed or prevented

Successful and timely completion of clinical trials will require that we enroll a sufficient number of subjects. Patient enrollment, a significant factor in the timing of clinical trials, is affected by many factors including the size and nature of the patient population and the ability of clinical sites to successfully recruit subjects to participate in clinical trials. Trials may be subject to delays as a result of patient enrollment taking longer than anticipated or patient withdrawal. We may not be able to initiate or continue clinical trials for our drug candidates if we are unable to locate and enroll a sufficient number of eligible subjects to participate in these trials as required by the FDA or similar regulatory authorities outside the United States. It is possible that the specific requirements by the FDA for our patients to be included in these trials may make the trials more difficult to conduct or may significantly extend the time required for enrollment of these trials.

We cannot predict how successful we will be at enrolling subjects in our clinical trials. Subject enrollment is affected by other factors including:

- the eligibility criteria for the trial in question;
- the prevalence and incidence of the conditions being studied in the clinical trials;
- the perceived risks and benefits of our product candidates;
- clinicians' and patients' perceptions as to the potential advantages of the product candidate being studied in relation to other available therapies, including any new drugs or therapeutic biologics that may be approved for the indications we are investigating;
- the efforts to facilitate timely enrollment in clinical trials;
- competition for patients from other clinical trials;
- the willingness of potential clinical trial subjects to provide informed consent to participate in the trial;
- the patient referral practices of physicians;
- the ability to monitor subjects adequately during and after treatment; and
- the proximity and availability of clinical trial sites for prospective subjects.

Our inability to enroll a sufficient number of subjects for clinical trials would result in significant delays and could require us to abandon one or more clinical trials altogether. Enrollment delays in these clinical trials may result in increased development costs for our drug candidates or delays in regulatory filings and progression, which would cause the value of our company to decline and limit our ability to obtain additional financing.

The FDA may require more information or clinical studies for all of our product candidates, and our product candidates may never be approved.

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 will result in delays to the regulatory approval or non-approvability of our product candidates, 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. For example, the Phase 3 PERSIST trial for POSIMIR did not meet its primary efficacy endpoint of reduction in pain on movement over the first 48 hours after surgery as compared to standard bupivacaine HCl. In addition, 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 or to abuse deterrent properties of opioid product candidates, as they have in their Complete Response Letters for REMOXY ER, 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. Additionally, even if our product candidates receive FDA approval, the FDA may require that we conduct additional clinical studies after such approval, place limitations on our products in applicable labels, delay approval to market our products or limit the use of our products, which may harm our business and results of operations.

We currently have a significant amount of 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 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 provided 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 and 9.40% as of June 30, 2018) 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. In February 2018, the Company and Oxford Finance entered into a First Amendment of the Loan Agreement, which modified the terms of the Loan Agreement to change the first principal payment date from March 1, 2018 to December 1, 2018 and to increase the additional payment due when the term loan becomes due or upon the prepayment of the facility from 9.25% of the principal amount of the term loan to 10% of such amount. The interest rate and the maturity date remain unchanged, and the Company paid Oxford Finance a loan modification fee of $100,000. Our debt repayment obligations under the 2016 Loan Agreement may prove a burden to the Company as they become due, particularly following the expiration of the interest-only period.

The 2016 Loan Agreement 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, the failure to deliver an unqualified audit report and board approved financial projections within time periods set forth in the Loan Agreement, 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.

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.

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 from the date the financial statements are filed. However, our actual capital requirements will depend on many factors, including:

- success in entering into collaboration agreements and meeting milestones under such agreements;
- the continuation of our collaborative agreements that provide financial funding for our activities;
- regulatory actions with respect to our product candidates;
- continued progress and cost of our research and development programs;
- 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 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.

We do not control development or commercialization of REMOXY ER or PERSERIS

We have relied on Pain Therapeutics, King, and Pfizer and its subsidiaries to devote time and resources to the development, manufacturing and commercialization of REMOXY ER. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY ER and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics. In September 2016, Pain Therapeutics received a Complete Response Letter for REMOXY ER, and following Pain Therapeutics resubmission of the NDA for REMOXY EY, a joint meeting of the Anesthetic and Analgesic Drug Products Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA on June 26, 2018, voted 14 to 3 against the approval of REMOXY ER. We are dependent on Pain Therapeutics to obtain FDA approval of REMOXY ER, and there can be no assurance that Pain Therapeutics will continue development of REMOXY ER or that an NDA for REMOXY ER will ever be approved by the FDA. Any further delay or discontinuation in the development of REMOXY ER will harm our prospects and would be likely to have a negative effect on the price of our common stock.

We rely on Indivior for the commercialization of PERSERIS. There can be no assurance that Indivior will launch PERSERIS commercially or it will obtain market acceptance and meaningful sales. If Indivior does not launch and successfully commercialize PERSERIS, we will not receive earn-out payments under our agreement with them or those earn-out payments may be limited.

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;
- 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 route of administration and 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;
- demonstrating abuse deterrent properties to the satisfaction of the FDA for certain products for which abuse-deterrence is considered an important feature by the FDA, 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. 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 ER, POSIMIR and ORADUR-Methylphenidate ER 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, POSIMIR, ORADUR-Methylphenidate ER or REMOXY ER, 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 DUR-928, REMOXY ER, POSIMIR 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 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 and 2017, we conducted a single-ascending-dose Phase 1b clinical trial with DUR-928 in patients with nonalcoholic steatohepatitis (NASH). This study was conducted in Australia in successive cohorts evaluating single-dose levels (first a low dose and then a high dose) of orally administered DUR-928. Both cohorts consisted of 10 NASH patients and 6 matched control subjects. One patient (with a prior history of arrhythmia and an ongoing viral infection) in the high dose cohort experienced a serious adverse event (shortness of breath) which occurred without unusual biochemical changes and resolved without intervention but was considered possibly treatment related by the physician due to its temporal association with dosing. In both the low and high dose cohorts, the PK parameters were comparable between the NASH patients and the matched control subjects. In addition, the systemic exposure following the low and high doses of DUR-928 was dose dependent. While this study was not designed to assess efficacy, we observed a dose dependent reduction of certain biomarkers after a single oral dose of DUR-928. Exploratory biomarker analysis indicated that a single

oral dose of DUR-928 resulted in statistically significant reductions from baseline in the levels of both full-length and cleaved cytokeratin-18 (CK-18), bilirubin, hsCRP and IL-18. We also conducted in Australia a Phase 1b open-label, single-ascending-dose study in patients with impaired kidney function (stage 3 and 4 chronic kidney disease) and matched control patients with injected DUR-928. This study was conducted in two successive cohorts (first a low dose and then a high dose) evaluating the safety and PK of single-dose intramuscular injected DUR-928. The low dose cohort consisted of 6 kidney function impaired patients and 3 matched control subjects; the high dose cohort consisted of 5 kidney function impaired patients and 3 matched control subjects. In this trial, DUR-928 was well tolerated among all subjects and the PK parameters between the kidney function impaired patients and the matched control subjects were comparable. While the number of subjects involved was small and not designed to assess efficacy, we did observe decreases in bilirubin and CK-18 when those levels were meaningfully elevated pre-treatment, although these results were not statistically significant. We are currently conducting a Phase 2a trial in patients with PSC

and a Phase 2a trial in patients with Alcoholic Hepatitis. In addition, we conducted an initial exploratory Phase 1b trial in psoriasis patients (9 evaluable patients) in Australia. The Phase 1b trial was conducted with intralesional micro injections of DUR-928, and we feel the results warrant further investigation. As a result, we have developed several topical formulations of DUR-928 and plan to evaluate our lead formulation in a future Phase 2 proof-of-concept trial. 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 conducted 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.

- PERSERIS—In September 2017, we entered into an agreement with Indivior, under which we assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS, Indivior's extended-release injectable suspension for the treatment of schizophrenia in adults. On July 27 2018, Indivior announced that the FDA had approved the NDA for PERSERIS. On July 30, 2018 Indivior stated that it is reviewing the appropriate launch timing for PERSERIS; Indivior further stated that they commit to providing a launch timing as soon as reasonably practicable, but no later than when its Q3 2018 results are announced which is currently scheduled for November 1, 2018. There can be no assurance that Indivior will commercially launch PERSERIS in a timely manner or at all, or that if launched, it will obtain market acceptance and meaningful sales.
- REMOXY ER—Following multiple complete response letters and additional studies, including on abuse-deterrence, Pain Therapeutics resubmitted the NDA for REMOXY ER in February 2018. On March 1, 2018, Pain Therapeutics announced that the FDA has determined that the NDA is sufficiently complete to permit a substantive review. On June 26, 2018, a joint meeting of the Anesthetic and Analgesic Drug Products Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA voted 14 to 3 against the approval of REMOXY ER. The Prescription Drug User Fee Act (PDUFA) date for completion of the review is August 7, 2018. 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 commercialization partner.
- 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 conducted a new 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 began implementing Part 2 of the PERSIST trial to evaluate POSIMIR against standard bupivacaine HCl rather than placebo as we had been doing in Part 1. Additionally, we switched 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 became the key secondary efficacy endpoint and other efficacy endpoints, including 72-hour opioid use, remained the same. In October 2017, we reported that PERSIST, the Phase 3 clinical trial for POSIMIR, did not meet its primary efficacy endpoint of reduction in pain on movement over the first 48 hours after surgery as compared to standard bupivacaine HCl. While results trended in favor of POSIMIR versus the comparator, they did not achieve statistical significance. We have been working to understand the trial results more fully and to consider potential next steps. There can be no assurance that Sandoz will continue as our commercial partner for POSIMIR in the United States, that we will continue to develop POSIMIR or that POSIMIR will ever successfully obtain regulatory approval from the FDA.
- ORADUR-ADHD—In 2013, we and Orient Pharma, our licensee in defined Asian and South Pacific countries, selected a lead formulation of ORADUR-Methylphenidate 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 2017, Orient Pharma completed a Phase 3, multi-center, randomized, double-blind, placebo controlled, two-way cross-over study designed to observe the efficacy and safety of ORADUR-Methylphenidate ER in children and adolescents with ADHD age 6 to 18 years old. Conducted in Taiwan, there were 110 subjects enrolled in this study, of which 99 evaluable subjects completed the study. The primary efficacy measure in this study was the superiority of ORADUR-Methylphenidate ER over placebo using the Swanson, Nolan, and Pelham-IV (SNAP-IV) teacher form score. The SNAP-IV rating

scale contains 26 questions, classified as three components of ADHD symptoms (inattention, hyperactivity/impulsivity and oppositional defiant disorder). For the primary efficacy endpoint, ORADUR-Methylphenidate was superior to placebo in a statistically significant manner (p=0.0044 for the intent to treat population and p=0.0032 for the per protocol population). There were no serious adverse events in this pivotal study. Orient Pharma's analysis indicates that the incidence of adverse events was generally consistent with other ADHD products. We understand that Orient Pharma is pursuing a New Drug Application with the Taiwan FDA for ORADUR-Methylphenidate ER. We are seeking development and commercialization partners for the major markets not licensed to Orient Pharma. There can be no assurance that we will be able to successfully develop ORADUR-Methylphenidate ER 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 licensed to Orient Pharma.

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.

Many of our drug candidates under development, including REMOXY ER 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

For several years, FDA has required companies engaged in manufacturing and sales of opioid products 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. All manufacturers of long-acting and extended-release opioids must ensure that training is provided to prescribers of these medications and develop information that prescribers can use when counseling patients about the risks and benefits of opioid use. The FDA has also 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 ER 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 Sandoz, Indivior,

Pain Therapeutics, 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 POSIMIR, REMOXY ER and other product candidates, subject to payments to us in the form of product royalties, earn-out 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.

Cancellation of collaborations regarding our product candidates may 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 July 2017, we were notified by Impax that they were terminating our agreement with respect to ELADUR, and in August 2017, we mutually agreed with Zogenix to terminate our agreement with respect to Relday. In both instances, the product rights reverted to us. Sandoz also has the right to terminate our agreement with them for commercialization of POSIMIR after a specified notice period. 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 Sandoz, Pain Therapeutics, Santen or Orient Pharma could have similar effects.

Our revenues depend on collaboration agreements with other companies. If we are unable to enter into new agreements or meet our obligations or manage our relationships with our collaborators under these agreements 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 have seen recent declines in revenues associated with our existing collaboration agreements, which reflect the current development stage of the product candidates subject to those agreements, and our collaborator's decreased needs for our services. We do not expect our collaboration revenues to increase unless we enter into new collaboration agreements, and there can be no assurance that we will do so. Even if we enter into new collaboration 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 Sandoz with respect to POSIMIR, Pain Therapeutics with respect to REMOXY ER, Orient Pharma with respect to ORADUR-Methylphenidate ER, 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. Acquisitions of our collaborators 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 we do not enter into new collaboration agreements, and 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, 2018, we had $826,000 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 generally necessary to the achievement of development-based milestones, the performance of our third-party collaborators is also generally required to achieve those milestones, and in the case of our agreement with Indivior, Indivior is solely responsible for the regulatory milestone as well. 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 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, including DUR-928, ORADUR-Methylphenidate ER in markets not already licensed to Orient Pharma, including the United States and Europe, and others. 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 as 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 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 DUR-928, REMOXY ER and POSIMIR. 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 and REMOXY ER. 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 have entered into a commercial manufacturing and packaging agreement with a third party manufacturer for future supply of POSIMIR. This third party is our sole source for the drug product required for development and commercialization of this drug candidate. 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. If we proceed with the development of POSIMIR, 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 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, 2018, had an accumulated deficit of approximately $458.6 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 ALZET product line, from the LACTEL product line and from 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. 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 our products in development, we may not be able to effectively launch these products. 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.

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 DUR-928, REMOXY ER and POSIMIR, 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 REMOXY ER, POSIMIR and certain other pharmaceutical product candidates we have under development, and a third party manufacturer is our sole supplier for future 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.

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 30, 2018, we owned or exclusively in-licensed over 50 unexpired issued U.S. patents and over 400 unexpired issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have over 25 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 is as follows:

Our Epigenetic Regulator Program includes ten in-licensed patent families and one patent family solely owned by us. Two patent families each include two granted patents 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, 2037, 2037, 2037, 2038, 2038 and 2039, respectively, plus any eligible patent term adjustments and extensions. Of the eleven patent families covering DUR-928 and/or other molecules in the Epigenetic Regulator Program, two were only filed in the United States, and the other nine 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 United States under Myriad Genetics and other recent court decisions. One of the U.S. patents issued before Myriad Genetics, and three 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.

In the United States, our REMOXY ER patent portfolio includes four patent families. Three patent families include granted patents expiring in at least 2025, 2031, and 2034, respectively. The patent family providing protection until at least 2025 includes twelve granted patents. The patent family providing protection until at least 2031 includes two granted patents. The patent family providing protection until at least 2034 includes four granted patents. The fourth 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. We currently have pending U.S. applications for each of these four patent families. There can be no assurance that the pending patent applications will be granted. In Europe, REMOXY ER is covered by six granted patents with two expiring in 2023, three expiring in 2026, and one expiring in 2028, plus any eligible patent term extensions.

In the United States, 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 six granted patents with three expiring in 2025 and three expiring in 2026, plus any eligible patent term extensions.

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 United States 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, constitutionality of inter partes reviews, 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, changed patent priority from “first to invent” to “first to file,” implemented a post-grant opposition system for patents and provided 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.

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 Sandoz, Pain Therapeutics, Orient Pharma 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.

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 ER, and certain other product candidates we may develop 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 our goodwill, 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. 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, 2018. 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 2017 and determined that goodwill was not impaired as of December 31, 2017. 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 $926,000, of which approximately $426,000 related to the write-down of the cost basis of inventory and approximately $500,000 related to the prepaid inventory for the minimum purchase commitment for an excipient in the year ended December 31, 2016 as a result of a change in the forecasted demand for the excipients after Pain Therapeutics received a Complete Response Letter from the FDA on its resubmission of the NDA for REMOXY ER. In addition, during the year ended December 31, 2017, we recorded charges to cost of goods sold of approximately $2.0 million, of which approximately $503,000 related to the write-down of the cost basis of inventory on hand, $500,000 related to the prepaid inventory for the minimum purchase commitment for the excipient, and $1.0 million related to the recognition of our remaining minimum purchase commitment for the same excipient after we announced that PERSIST, the Phase 3 clinical trial for POSIMIR, did not meet its primary efficacy endpoint.

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, 2018, 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 develop and expand our Epigenetic 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 involve 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.

Cyber-attacks or other failures in telecommunications or information technology systems could result in information theft, data corruption and significant disruption of our business operations

We utilize information technology, systems and networks to process, transmit and store electronic information in connection with our business activities. As use of digital technologies has increased, cyber incidents, including deliberate attacks and attempts to gain unauthorized access to computer systems and networks, have increased in frequency and sophistication. These threats pose a risk to the security of our systems and networks and the confidentiality, availability and integrity of our data, and may cause a disruption in our operations, harm our reputation and increase our stock trading risk. There can be no assurance that we will be successful in preventing cyber-attacks or successfully mitigating their effects. Similarly, there can be no assurance that our third-party collaborators, distributors and other contractors and consultants will be successful in protecting our clinical and other data that is stored on their systems. Any cyber-attack or destruction or loss of data could have a material adverse effect on our business and prospects. In addition, we may suffer reputational harm or face litigation or adverse regulatory action as a result of cyber-attacks or other data security breaches and may incur significant additional expense to implement further data protection measures.

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

Our corporate headquarters, certain 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.

Risks Related To Our Industry

The market for our pharmaceutical product candidates and ALZET and LACTEL product lines 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. 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, Bristol Myers Squibb, Novartis, Terns Pharmaceuticals, Galmed Pharmaceuticals, Enanta Pharmaceuticals, Novo Nordisk, Takeda, Vital Therapies, Allergan, Akarna Therapeutics, Inventiva Pharma, Genkyotex, VBL Therapeutics, NGM Biopharmaceuticals, Gemphire Therapeutics, Albireo Pharma, CymaBay Therapeutics, Madrigal Pharmaceuticals, Viking Therapeutics, CohBar, FALK Pharma, Acorda, and others have development plans for products to treat

NAFLD/NASH, PSC or other liver diseases. AbbVie, Ischemix, Thrasos Therapeutics, AM-Pharma, Complexa, Quark Pharmaceuticals and others have development plans for products to treat acute kidney injury. Bristol Myers Squibb, Novartis, Eli Lilly, Almirall, LEO Pharma, Pfizer, Janssen, AbbVie, Boerhinger-Ingelheim, Amgen, Sandoz, Astra-Zeneca, Valeant, Takeda, Merck, Idera Pharmaceuticals and others have development plans for products to treat psoriasis.

POSIMIR and REMOXY ER, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, 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, Inspirion Delivery Technologies, Mylan, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis, Egalet, Teva Pharmaceuticals, Collegium Pharmaceutical and others. Purdue Pharma, Sandoz, Actavis, Collegium Pharmaceutical, Pfizer, Elite Pharmaceuticals, Intellipharmaceutics, Egalet, Teva Pharmaceuticals and others have also announced regulatory approval or development plans for abuse deterrent opioid products. PERSERIS will compete with currently marketed or approved products by Johnson & Johnson, Eli Lilly, Otsuka, Alkermes, Merck,

Allergan, Novartis, and others. 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.

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, Intellipharmaceutics, Collegium Pharmaceutical, Heron Therapeutics, Charleston Laboratories, Daiichi Sankyo 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.

Competition for our ALZET product line primarily consists of customers choosing to utilize delivery methods for their research projects other than an osmotic pump. Competition for our LACTEL product line comes from companies including Evonik, Corbion, FUJIFILM Wako Pure Chemical Corporation, PCAS and others. 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. We may in the future face competition from other companies including low cost foreign competitors.

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.

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.

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

In the United States and some non-U.S. jurisdictions, there have been, and we expect there will continue to be, a number of legislative and regulatory changes to the healthcare system that could prevent or delay marketing approval of our product candidates, restrict or regulate post approval activities, affect our ability to profitably sell any product candidates for which we obtain marketing and otherwise affect our future revenue and profitability and the future revenue and profitability of our collaborators or potential collaborators.

For example, in March 2010, the Affordable Care Act was enacted in the United States to broaden access to health insurance, reduce or constrain the growth of healthcare spending, enhance remedies against fraud and abuse, add new transparency requirements for healthcare and health insurance industries, impose new taxes and fees on the health industry and impose additional health policy reforms. The law has continued the downward pressure on the pricing of medical items and services, especially under the Medicare program, and increased the industry's regulatory burdens and operating costs. Among the provisions of the Affordable Care Act of importance to us are the following:

- imposes a non-deductible annual fee on pharmaceutical manufacturers or importers who sell "branded prescription drugs" and biologic agents;
- imposes an annual excise tax of 2.3% on any entity that manufactures or imports medical devices offered for sale in the United States;
- 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;
- extends manufacturers' Medicaid rebate liability to individuals enrolled in Medicaid managed care organizations;
- mandates a further shift in the burden of Medicaid payments to the states;
- expands the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;
- establishes a new requirement to annually report drug samples that manufacturers and distributors provide to physicians;
- establishes a new Patient Centered Outcomes Research Institute to oversee, identify priorities in and conduct comparative clinical effectiveness research, along with funding for such research; and
- establishes an independent payment advisory board that will submit recommendations to Congress to reduce Medicare spending if projected Medicare spending exceeds a specified growth rate.

Since its enactment, there have been judicial and Congressional challenges to certain aspects of the Affordable Care Act, and we expect there will be additional challenges and amendments to the Affordable Care Act in the future. The new Presidential Administration and U.S. Congress will likely continue to seek to modify, repeal, or otherwise invalidate all, or certain provisions of, the Affordable Care Act. It is uncertain the extent to which any such changes may impact our business or financial condition.

In addition, other legislative changes have been proposed and adopted since the Affordable Care Act was enacted. These changes include the Budget Control Act of 2011, which, among other things, resulted in reductions to Medicare payments to providers of 2% per fiscal year and will remain in effect through 2025; the American Taxpayer Relief Act of 2012, which, among other things, further reduced Medicare payments to several types of providers and increased the statute of limitations period for the government to recover overpayments to providers from three to five years; and the Medicare Access and CHIP Reauthorization Act of 2015, which, among other things, ended the use of the sustainable growth rate formula and provides for a 0.5% update to physician payment rates for each calendar year through 2019, after which there will be a 0% annual update each year through 2025. More recently, there has been heightened governmental scrutiny over the manner in which manufacturers set prices for their marketed products, which has resulted in several Congressional inquiries and proposed bills designed to, among other things, bring more transparency to product pricing, review the relationship between pricing and manufacturer patient programs, and reform government program reimbursement methodologies for pharmaceutical products.

Individual states in the United States have also become increasingly aggressive in passing legislation and implementing regulations designed to control pharmaceutical product and medical device pricing, including price or patient reimbursement constraints, discounts, restrictions on certain product access and marketing cost disclosure and transparency measures, and, in some cases, designed to encourage importation from other countries and bulk purchasing. For example, in October 2017, California passed a new law, to become effective in January 2019, which will require transparency from biopharmaceutical companies regarding price increases for prescription drugs. In addition, regional healthcare authorities and individual hospitals are increasingly using bidding procedures to determine what pharmaceutical products and medical devices to purchase and which suppliers will be included in their prescription drug and other healthcare programs.

We expect that the Affordable Care Act, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria, new payment methodologies and in additional downward pressure on the price that we receive for any approved or cleared product. Any reduction in reimbursement from Medicare or other government programs may result in a similar reduction in payments from private payors. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the United States or abroad. If we are slow or unable to adapt to new requirements or policies, or if we are not able to maintain regulatory compliance, our products and product candidates may lose any

regulatory approval that may have been obtained and we may not achieve or sustain profitability, which would adversely affect our business.

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 DUR-928, REMOXY ER and POSIMIR, if approved. 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; 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.

In addition, market adoption of POSIMIR may depend on what data from clinical studies is included in the product label and market adoption of REMOXY ER may depend on the extent to which the product label includes claims for abuse deterrence, and there can be no assurance as to what the final product labels will contain. 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.

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. In April 2016, we completed an underwritten public offering in which we raised net proceeds of $16.1 million (after deducting underwriting discounts and commissions and offering expenses) through the sale of an aggregate of approximately 13.8 million shares of our common stock pursuant to an effective registration statement at a price to the public of $1.25 per share. In 2016, we raised net proceeds (net of commissions) of approximately $7.6 million from the sale of approximately 5.2 million shares of our common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of $1.50 per share. In 2017, we raised net proceeds (net of commissions) of approximately $12.0 million from the sale of approximately 8.9 million shares of our common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of $1.39 per share. In the first half of 2018, we raised net proceeds (net of commissions) of approximately $16.8 million from the sale of approximately 9.6 million shares of our common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of $1.80 per share. As of July 30, 2018, we had up to approximately $514,000 of common stock available for sale under the Controlled Equity Offering program and approximately $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 Controlled Equity Offering program 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 DUR-928 or other product candidates;
- announcements of FDA non-approval of our product candidates, or delays in the FDA or other foreign regulatory agency review process;
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- 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.

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.

Our bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees

Our bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for any derivative action or proceeding brought on behalf of the Company, any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Company, any action asserting a claim arising pursuant to any provision of the General Corporation Law of Delaware or our Certificate of Incorporation or bylaws or any action asserting a claim governed by the internal affairs doctrine. The choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and other employees.

Alternatively, if a court were to find the choice of forum provision contained in our certificate of incorporation to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could adversely affect our business and financial condition.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
None

Item 3. Defaults Upon Senior Securities
None

Item 4. Mine Safety Disclosures
Not applicable

Item 5. Other Information
None

Item 6. Exhibits

Exhibit Number	Exhibit Name
3.1	Certificate of Amendment to the Amended and Restated Certificate of Incorporation of Durect Corporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the SEC on June 20, 2018).
10.1	Addendum III to Lease between the Company and Northwest Asset Management Company dated as of April 10, 2018.
10.2+	First Amendment to the Development and Commercialization Agreement between the Company and SANDOZ AG effective as of May 4, 2018.

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

+ Confidential treatment has been requested with respect to portions of this exhibit. The redacted information has been filed separately with the SEC

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, 2018

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

Chief Financial Officer and Principal

Accounting Officer

Date: August 2, 2018