DURECT CORP
Form 10-Q
May 06, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from _____ to _____

Commission file number 000-31615

DURECT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**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 x No ¨

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

Indicate by 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 x
Non-accelerated filer ¨	Smaller reporting company ¨

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

As of May 2, 2016, there were 137,362,363 shares of the registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DURECT CORPORATION

CONDENSED BALANCE SHEETS

(in thousands)

	March 31, 2016 (unaudited)	December 31, 2015 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,853	$ 3,583
Short-term investments	20,181	25,457
Short-term restricted investments	100	
Accounts receivable (net of allowances of $147 at March 31, 2016 and $161 at December 31, 2015)	1,722	2,222
Inventories	4,007	3,917
Prepaid expenses and other current assets	3,074	3,142
Total current assets	32,937	38,321
Property and equipment (net of accumulated depreciation of $21,065 and $20,971 at March 31, 2016 and December 31, 2015, respectively)	1,477	1,566
Goodwill	6,399	6,399
Long-term restricted investments	150	250
Other long-term assets	236	236
Total assets	$ 41,199	$ 46,772
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 994	$ 1,286
Accrued liabilities	4,552	4,970
Contract research liabilities	454	575
Deferred revenue, current portion	464	616
Current portion of long-term debt, net	1,826	
Total current liabilities	8,290	7,447
Deferred revenue, non-current portion	2,206	2,269
Long-term debt, net	17,892	19,684
Other long-term liabilities	2,585	2,489
Commitments and contingencies		

Stockholders equity:		
Preferred stock		
Common stock	12	12
Additional paid-in capital	423,631	420,453
Accumulated other comprehensive income	3	(14)
Accumulated deficit	(413,420)	(405,568)
Stockholders equity	10,226	14,883
Total liabilities and stockholders equity	$ 41,199	$ 46,772

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

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DURECT CORPORATION

CONDENSED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands, except per share amounts)

(unaudited)

	Three months ended March 31,	
	2016	**2015**
Collaborative research and development and other revenue (see Note 2)	$ 419	$ 1,738
Product revenue, net	3,189	3,035
Total revenues	3,608	4,773
Operating expenses:		
Cost of product revenues	1,242	1,006
Research and development	6,625	5,367
Selling, general and administrative	3,062	2,820
Total operating expenses	10,929	9,193
Loss from operations	(7,321)	(4,420)
Other income (expense):		
Interest and other income	27	128
Interest expense	(558)	(561)
Net other income (expense)	(531)	(433)
Net loss	$ (7,852)	$ (4,853)
Net change in unrealized gain (loss) on available-for-sale securities, net of reclassification adjustments and taxes	17	(85)
Total comprehensive loss	$ (7,835)	$ (4,938)
Net loss per share		
Basic	$ (0.06)	$ (0.04)
Diluted	$ (0.06)	$ (0.04)
Weighted-average shares used in computing net loss per share		
Basic	122,149	113,793
Diluted	122,149	113,793

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

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DURECT CORPORATION

CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three months ended March 31,	
	2016	**2015**
Cash flows from operating activities		
Net loss	$ (7,852)	$ (4,853)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	101	144
Stock-based compensation	710	650
Amortization of debt issuance cost	34	19
Realized gain from sale of marketable equity security, net of tax		(117)
Changes in assets and liabilities:		
Accounts receivable	500	(121)
Inventories	(91)	(165)
Prepaid expenses and other assets	68	(368)
Accounts payable	(292)	(131)
Accrued and other liabilities	827	(729)
Contract research liabilities	(121)	(51)
Deferred revenue	(215)	376
Total adjustments	1,521	(493)
Net cash used in operating activities	(6,331)	(5,346)
Cash flows from investing activities		
Purchases of property and equipment	(12)	(9)
Purchases of available-for-sale securities	(5,186)	(2,995)
Proceeds from maturities of available-for-sale securities	10,479	7,243
Proceeds from sales of short-term investment		178
Net cash provided by investing activities	5,281	4,417
Cash flows from financing activities		
Payments on equipment financing obligations	(6)	(4)
Net proceeds from issuances of common stock	1,326	242
Net cash provided by financing activities	1,320	238

Net increase (decrease) in cash and cash equivalents	270	(691)
Cash and cash equivalents, beginning of the period	3,583	2,680
Cash and cash equivalents, end of the period	$ 3,853	$ 1,989

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

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DURECT CORPORATION

NOTES TO UNAUDITED CONDENSED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Nature of Operations

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

Basis of Presentation

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

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

Inventories

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

by the necessary regulatory bodies, or new information that suggests that the inventory will not be saleable. In addition, these circumstances may cause the Company to record a liability related to minimum purchase agreements that the Company has in place for raw materials. In 2014, the Company recorded charges to cost of goods sold of approximately $1.6 million, of which approximately $1.1 million related to the write-down of the cost basis of inventory and $500,000 related to the accrual of a liability for the minimum purchase commitment for the excipients. As of March 31, 2016, the remaining carrying value of the excipients in the Company s inventory was $1.2 million. In addition, the Company has remaining unrecorded future purchase commitments totaling $1.5 million through 2018. In the event that management determines that the Company will not utilize all of these materials, there could be a potential write-off related to this inventory and a reserve for future purchase commitments.

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

	March 31, 2016 (unaudited)	December 31, 2015
Raw materials	$ 1,168	$ 1,168
Work in process	1,415	1,412
Finished goods	1,424	1,337
Total inventories	$ 4,007	$ 3,917

Revenue Recognition

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

Comprehensive Income (Loss)

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

Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing the net income (loss) by the weighted-average number of common shares outstanding. Diluted net income (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 and warrants.

Options to purchase approximately 20.4 million and 23.3 million shares of common stock were excluded from the denominator in the calculation of diluted net loss per share for the three months ended March 31, 2016 and 2015, respectively, as the effect would be anti-dilutive.

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU No. 2016-02, *Leases* (Topic 842), which amends the existing accounting standards for leases. The new standard requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet (with the exception of short-term leases). For lessees, leases will continue to be classified as either operating or financing in the income statement. This ASU becomes effective for the Company in the first quarter of fiscal year 2019 and early adoption is permitted. This ASU is required

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

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

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

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

Note 2. Strategic Agreements

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

	Three months ended March 31,	
	2016	**2015**
Collaborator		
Zogenix, Inc. (Zogenix) (1)	$ 246	$ 1,158
Santen Pharmaceutical Co. Ltd. (Santen) (2)	162	307
Pain Therapeutics, Inc. (Pain Therapeutics)	4	
Others	7	273
Total collaborative research and development and other revenue	$ 419	$ 1,738

(1) Amounts related to ratable recognition of upfront fees were $52,000 and $64,000 for the three months ended March 31, 2016 and 2015, respectively.

(2) Amounts related to ratable recognition of upfront fees were $57,000 and $71,000 for the three months ended March 31, 2016 and 2015, respectively.

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 and other oral sustained release, abuse deterrent opioid products incorporating four specified opioid drugs, using the ORADUR technology. Total collaborative research and development revenue recognized under the agreements with Pain Therapeutics was $4,000 and zero for the three months ended March 31, 2016 and 2015, respectively. In May 2015, Pain Therapeutics sent a letter to the Company that provided the Company with formal written notice that Pain Therapeutics was deleting, effective as of January 12, 2015, the opioid drug hydrocodone (and only hydrocodone) as a licensed product under the agreement. The letter did not alter the terms of the agreement regarding the remaining three licensed products (REMOXY, hydromorphone or oxymorphone) or otherwise amend the agreement. Under the agreement with Pain Therapeutics, subject to and upon the achievement of predetermined development and regulatory milestones for the three drug candidates, the Company is entitled to receive milestone payments of up to $7.2 million in the aggregate. The cumulative aggregate payments received by the Company from Pain Therapeutics as of March 31, 2016 were $39.0 million under this agreement.

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Under the terms of this agreement, Pain Therapeutics paid the Company an upfront license fee of $1.0 million, with the potential for an additional $7.2 million in performance milestone payments based on the successful development and approval of the three ORADUR-based opioids. Of these potential milestones, all $7.2 million are development-based milestones. There are no sales-based milestones under the agreement. As of March 31, 2016, the Company had received $1.7 million in cumulative milestone payments.

In March 2009, King Pharmaceuticals (King) assumed the responsibility for further development of REMOXY from Pain Therapeutics. As a result of this change, the Company continued to perform REMOXY-related activities in accordance with the terms and conditions set forth in the license agreement between the Company and Pain Therapeutics. King was substituted in lieu of Pain Therapeutics with respect to interactions with the Company in its performance of those activities including the obligation to pay the Company with respect to all REMOXY-related costs incurred by the Company. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to REMOXY; accordingly, amounts attributed to King are shown as Pfizer figures. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to discontinue development of REMOXY, and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics and that Pfizer would continue ongoing activities under the agreement until the scheduled termination date in April 2015. In July 2015, Pain Therapeutics stated that it had substantially completed the transition of REMOXY from Pfizer. In March 2016, Pain Therapeutics announced that it had resubmitted the NDA to the FDA, and in April 2016, Pain Therapeutics announced that the FDA had determined that the NDA was sufficiently complete to permit a substantive review. Pain Therapeutics further stated that September 25, 2016 is the target action date under the Prescription Drug User Fee Act (PDUFA).

Total collaborative research and development revenue recognized for REMOXY-related work performed by the Company for Pfizer was zero for both three months ended March 31, 2016 and 2015. The cumulative aggregate payments received by the Company from Pfizer as of March 31, 2016 were $7.1 million under this agreement. Total collaborative research and development revenue recognized for REMOXY-related work performed by the Company for Pain Therapeutics was $4,000 and zero for the three months ended March 31, 2016 and 2015, respectively. Prior to March 2009 and after November 2014, the Company recognized collaborative research and development revenue for REMOXY-related work for Pain Therapeutics. The cumulative aggregate payments received by the Company from Pain Therapeutics as of March 31, 2016 were $39.0 million under this agreement.

Long Term Supply Agreement with King (Pfizer)

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

Total revenues recognized related to these excipients was $279,000 and $96,000 for the three months ended March 31, 2016 and 2015, respectively. The associated cost of goods sold was $124,000 and $51,000 for the three months ended March 31, 2016 and 2015, respectively. Recent orders for these excipients from Pain Therapeutics have been processed through mutually agreeable purchase orders, in the absence of an existing long-term contract. Pursuant to the Company s 2002 agreement with Pain Therapeutics, we are to be the exclusive supplier of certain defined excipients for products in our collaboration.

Agreement with Zogenix, Inc.

On July 11, 2011, the Company and Zogenix, Inc., (Zogenix), entered into a Development and License Agreement (the Zogenix Agreement). The Company and Zogenix had previously been working together under a feasibility agreement pursuant to which the Company s research and development costs were reimbursed by Zogenix. Under the Zogenix Agreement, Zogenix will be responsible for the clinical development and commercialization of a proprietary, long-acting injectable formulation of risperidone using the Company s SABER controlled-release formulation technology in combination with Zogenix s DosePro® needle-free, subcutaneous drug delivery system. DURECT will be responsible for non-clinical, formulation and CMC development activities. The Company will be reimbursed by Zogenix for its research and development efforts on the product.

Zogenix paid a non-refundable upfront fee to the Company of $2.25 million in July 2011. The Company s research and development services are considered integral to utilizing the licensed intellectual property and, accordingly, the deliverables are accounted for as a single unit of accounting. The $2.25 million upfront fee is being recognized as collaborative research and development revenue ratably over the term of the Company s continuing research and development involvement with Zogenix with

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respect to this product candidate. Zogenix is obligated to pay the Company up to $103 million in total future milestone payments with respect to the product subject to and upon the achievement of various developments, regulatory and sales milestones. Of these potential milestones, $28 million are development-based milestones (none of which has been achieved as of March 31, 2016), and $75 million are sales-based milestones (none of which had been achieved as of March 31, 2016). Zogenix is also required to pay a mid single-digit to low double-digit percentage patent royalty on annual net sales of the product determined on a jurisdiction-by-jurisdiction basis. The patent royalty term is equal to the later of the expiration of all DURECT technology patents or joint patent rights in a particular jurisdiction, the expiration of marketing exclusivity rights in such jurisdiction, or 15 years from first commercial sale in such jurisdiction. After the patent royalty term, Zogenix will continue to pay royalties on annual net sales of the product at a reduced rate for so long as Zogenix continues to sell the product in the jurisdiction. Zogenix is also required to pay to the Company a tiered percentage of fees received in connection with any sublicense of the licensed rights.

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

The following table provides a summary of collaborative research and development revenue recognized under the agreements with Zogenix (in thousands). The cumulative aggregate payments received by the Company as of March 31, 2016 were $19.7 million under these agreements.

	Three months ended March 31,	
	2016	2015
Ratable recognition of upfront payment	$ 52	$ 64
Research and development expenses reimbursable by Zogenix	194	1,094
Total collaborative research and development revenue	$ 246	$ 1,158

Agreement with Santen Pharmaceutical Co., Ltd.

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

In connection with the Santen agreement, Santen agreed to pay the Company an upfront fee of $2.0 million in cash and to make contingent cash payments to the Company of up to $76.0 million upon the achievement of certain milestones, of which $13.0 million are development-based milestones and $63.0 million are commercialization-based

milestones including milestones requiring the achievement of certain product sales targets (none of which has been achieved as of March 31, 2016). Santen will also pay for certain Company costs incurred in the development of the licensed product. If the product is commercialized, the Company would also receive a tiered royalty on annual net product sales ranging from single-digit to the low double digits, determined on a country-by-country basis. Santen may terminate the Santen Agreement without cause at any time upon prior written notice, and either party may terminate the Santen Agreement upon certain circumstances including written notice of a material uncured breach. As of March 31, 2016, the cumulative aggregate payments received by the Company under this agreement were $2.7 million.

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

	Three months ended March 31,	
	2016	2015
Ratable recognition of upfront payment	$ 57	$ 71
Research and development expenses reimbursable by Santen	105	236
Total collaborative research and development revenue	$ 162	$ 307

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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 March 31, 2016 is less than twelve months and these investments are rated by S&P and Moody s at AAA or AA- for securities and A1 or P1 for commercial paper.

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

	March 31, 2016			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	$ 86	$	$	$ 86
Certificates of deposit	250			250
Commercial paper	2,844			2,844
Corporate debt	4,241		(1)	4,240
U.S. Government agencies	14,570	6	(2)	14,574

	$ 21,991	$ 6	$ (3)	$ 21,994
Reported as:				
Cash and cash equivalents	$ 1,563	$	$	$ 1,563
Short-term investments	20,178	6	(3)	20,181
Short-term restricted investments	100			100
Long-term restricted investments	150			150
	$ 21,991	$ 6	$ (3)	$ 21,994

	December 31, 2015			
	Amortized Cost	**Unrealized Gain**	**Unrealized Loss**	**Estimated Fair Value**
Money market funds	$ 81	$	$	$ 81
Certificates of deposit	250			250
Commercial paper	898			898
Corporate debt	5,215	1	(5)	5,211
U.S. Government agencies	19,558	1	(11)	19,548
	$ 26,002	$ 2	$ (16)	$ 25,988

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	December 31, 2015			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Reported as:				
Cash and cash equivalents	$ 281	$	$	$ 281
Short-term investments	25,471	2	(16)	25,457
Long-term restricted investments	250			250
	$ 26,002	$ 2	$ (16)	$ 25,988

The following is a summary of the cost and estimated fair value of available-for-sale securities at March 31, 2016, by contractual maturity (in thousands):

	March 31, 2016	
	Amortized Cost	Estimated Fair Value
Mature in one year or less	$ 21,905	$ 21,908
Mature after one year through five years		
	$ 21,905	$ 21,908

There were no securities that have had an unrealized loss for more than 12 months as of March 31, 2016.

As of March 31, 2016, unrealized losses on available-for-sale investments are not attributed to credit risk and are considered to be temporary. The Company believes that it is more-likely-than-not that investments in an unrealized loss position will be held until maturity or the recovery of the cost basis of the investment. To date, the Company has not recorded any impairment charges on marketable securities related to other-than-temporary declines in market value.

Note 4. Stock-Based Compensation

As of March 31, 2016, the Company had 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 March 31,	
	2016	2015
Cost of product revenues	$ 27	$ 29
Research and development	353	351
Selling, general and administrative	330	270
Total stock-based compensation	$ 710	$ 650

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

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

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The Company used the following assumptions to estimate the fair value of stock options granted (including fully vested options issued in January 2016 and 2015) and shares purchased under its employee stock purchase plan for the three months ended March 31, 2016 and 2015:

	Stock Options Three months ended March 31,		Employee Stock Purchase Plan Three months ended March 31,	
	2016	2015	2016	2015
Risk-free rate	1.6-1.9%	1.4-2.0%	0.3%	0.1%
Expected dividend yield				
Expected life of option (in years)	6.5-9.3	6.5-10.0	0.5	0.5
Volatility	77-83%	78-85%	68%	95%
Forfeiture rate	4.2%	6.0%		

Note 5. Long-Term Debt

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

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

The term loan is secured by substantially all of the assets of the Company, except that the collateral does not include any intellectual property (including licensing, collaboration and similar agreements relating thereto), and certain other excluded assets. The 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 Loan Agreement also contains customary indemnification obligations and customary events of default, including, among other things, our failure to fulfill certain obligations of the Company under the Loan Agreement and the occurrence of a material adverse change which 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 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 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.

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In July 2015, the Company and Oxford Finance entered into the First Amendment of the Loan Agreement and modified the terms to the Loan Agreement to change the maturity date from July 1, 2018 to July 1, 2019 and to change the first principal payment date from February 1, 2016 to February 1, 2017. The interest rate remains unchanged, the Company paid a loan modification fee of $240,000 and the additional payment originally equal to 8% of the principal amount of the term loan, which is due when the term loan becomes due or upon the prepayment of the facility, was increased to 10%. Consistent with the accounting treatment noted above for the final payment, the loan modification fee has been recorded on the balance sheet as a debt discount and will be amortized to interest expense over the remaining life of the term loan using the effective interest method.

As of March 31, 2016, the Company was in compliance with all material covenants under the Loan Agreement and there had been no material adverse change.

As of March 31, 2016, the carrying value of the term loan approximated its fair value based on Level 3 unobservable inputs involving discounted cash flows and the estimated market rate of borrowing that could be obtained by companies with credit risk similar to the Company s credit risk. Future maturities and interest payments under the term loan as of March 31, 2016, are as follows (in thousands):

Nine months ended December 31, 2016	$ 1,193
2017	8,848
2018	8,848
2019	6,424
Total minimum payments	25,313
Less amount representing interest	(5,313)
Gross balance of long-term debt	20,000
Less unamortized debt discount	(282)
Carrying value of long-term debt	19,718
Less current portion of long-term debt	(1,826)
Long-term debt, less current portion and unamortized debt discount	$ 17,892

Interest expense, including amortization of the debt discount, related to the long-term debt was $557,000 for both the three months ended March 31, 2016 and 2015, respectively. Accrued interest, which is included in other long-term liabilities, was approximately $952,000 as of March 31, 2016.

Note 6. Subsequent Event

During April 2016, the Company raised net proceeds (net of commission) of approximately $948,000 from the sale of 730,048 shares of its common stock at a weighted average price of $1.34 per share in the open market through its Controlled Equity Offering^{SM} sales agreement with Cantor Fitzgerald, entered into in November 2015. The shares were issued pursuant to a registration statement on Form S-3 declared effective in November 2015. As of May 2, 2016, the Company had up to $35.7 million of common stock available for sale under the Controlled Equity Offering^{SM} program.

In April 2016, the Company completed an underwritten public offering in which we sold an aggregate of 13.8 million shares of our common stock pursuant to an effective registration statement at a price to the public of $1.25. We received net proceeds of approximately $16.1 million after deducting underwriting discounts and commissions and offering expenses. As of May 2, 2016, the Company had up to $67.8 million of common stock available for sale under effective registration statement in addition to what is available under the Controlled Equity Offering program.

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

This Management s Discussion and Analysis of Financial Condition and Results of Operations for the three months ended March 31, 2016 and 2015 should be read in conjunction with our annual report on Form 10-K for the year ended December 31, 2015 filed with the Securities and Exchange Commission and Risk Factors section included elsewhere in this Form 10-Q. This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. When used in this report, the words believe, anticipate, intend, plan, estimate, expect, may, will, could similar expressions are forward-looking statements. Such forward-looking statements are based on current expectations and beliefs. Any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors.

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

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

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

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

the potential benefits and uses of our products;

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

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

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

market opportunities for products in our product pipeline;

the progress and results of our research and development programs;

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

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

conditions for obtaining regulatory approval of our product candidates;

submission and timing of applications for regulatory approval;

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

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

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

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

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

the possibility that we may develop additional manufacturing capabilities;

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

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

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

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

the composition of future revenues; and

accounting policies and estimates, including revenue recognition policies.

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

Overview

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

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

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

Epigenomic Regulator Program and New Chemical Entities

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

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

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

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The biological activity of DUR-928 has been demonstrated in 8 different animal disease models involving three animal species. Four of these models represent chronic disorders of hepatic lipid accumulation and dysfunction (e.g., nonalcoholic fatty liver disease (NAFLD) and nonalcoholic steatohepatitis (NASH) associated with diabetes) and four represent acute organ injuries (endotoxin shock, kidney, liver and brain).

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

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

Chronic Metabolic Disease Program with DUR-928

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

In January 2016, we initiated a single-ascending-dose Phase 1b clinical trial with DUR-928 in patients with nonalcoholic steatohepatitis (NASH). This open-label Phase 1b trial of DUR-928 is a safety and pharmacokinetic study of DUR-928 in subjects with NASH and matched control subjects. This study may be conducted in three successive cohorts evaluating three single-dose levels of oral DUR-928. After a PK/safety review at each dose, the study can proceed to the next higher dose. Assuming all three cohorts are dosed, the study will comprise approximately 48 subjects, of which approximately 30 will have received DUR-928. The study is being conducted in Australia, and we anticipate that we will obtain results from this trial starting in the second quarter of 2016. We anticipate that the single-ascending-dose Phase 1b clinical trial described above will enable and inform a multiple-dose study in NASH patients or patients with other liver function impairment.

Acute Organ Injury Program with DUR-928

In addition to the oral administration clinical studies described above, we have conducted a Phase 1 single-site, randomized, double-blinded, placebo-controlled, single-ascending-dose study that evaluated the safety, tolerability and pharmacokinetics of four doses of DUR-928 when administered by injection. The 24-subject study evaluated DUR-928 in four cohorts of healthy volunteers receiving DUR-928 (16 subjects on the drug, 8 on placebo) at escalating doses that resulted in dose proportionality of systemic exposure. DUR-928 was well-tolerated at all dose

levels, with no serious treatment-related adverse events reported. We also conducted a multiple-dose study involving 10 healthy volunteers, in which participants received DUR-928 for 5 consecutive days (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 anticipate commencing a Phase 1b single-ascending-dose, injectable administration trial in renal function impaired patients in the second quarter of 2016, with data expected to be available from the study in 2016. This trial is anticipated to be a single-site, open-label safety and pharmacokinetics study. This trial will enable and inform subsequent patient studies in acute kidney injury and/or other kidney function impairment.

REMOXY® and other ORADUR®-based opioid products licensed to Pain Therapeutics

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

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

Phase I clinical trials have been conducted for two of the other ORADUR-based opioid product candidates (hydrocodone and hydromorphone), and an Investigational New Drug (IND) application has been accepted by the FDA for the fourth ORADUR-based opioid (oxymorphone). In October 2013, Pain Therapeutics stated that it had regained all rights from Pfizer with respect to the three other ORADUR-based opioid drug candidates (hydrocodone, hydromorphone and oxymorphone). In 2015, Pain Therapeutics returned to us all of Pain Therapeutics rights and obligations under our license agreement to develop and commercialize ORADUR-based formulations of hydrocodone but without impacting the rights and obligations of the two parties with respect to REMOXY (oxycodone), hydromorphone and oxymorphone.

POSIMIR® (SABER® -Bupivacaine)

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

In April 2013, we submitted an NDA as a 505(b)(2) application, which relies in part on the FDA s findings of safety and effectiveness of a reference drug. In February 2014 we received a Complete Response Letter from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial (the PERSIST trial) consisting of approximately 306 patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. In a previous trial of 50 patients undergoing laparoscopic cholecystectomy, POSIMIR demonstrated in a post hoc analysis an approximately 25% reduction in pain intensity on movement for the first 3 days after surgery (p=0.024) against the active control bupivacaine HCl, using the same statistical methodology specified for the PERSIST trial. We began recruiting patients for this trial in November 2015 with an intent to compare 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. This change will add to the time and cost to complete the PERSIST trial, but we believe that a positive outcome from this trial design would result in a stronger NDA filing and potentially commercial advantages. This clinical trial is designed to generate data necessary to support an NDA resubmission.

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ELADUR ® (TRANSDUR®-Bupivacaine)

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

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

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

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

ORADUR-ADHD Program

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

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

Relday (risperidone) Program

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

On January 3, 2013, Zogenix reported positive single-dose pharmacokinetic (PK) results from the Phase 1 clinical trial of Relday. According to Zogenix, adverse events in the Phase 1 trial in patients diagnosed with schizophrenia were generally mild to moderate and consistent with other risperidone products. The Phase 1 clinical trial for Relday was conducted as a single-center, open-label, safety and PK trial of 30 patients with chronic, stable schizophrenia or schizoaffective disorder. Per Zogenix, based on the favorable safety and PK profile demonstrated with the 25 mg and 50 mg once-monthly doses tested in the Phase 1 trial, Zogenix extended the study to include a 100 mg dose of the same formulation. In May 2013, Zogenix announced positive results with the 100 mg arm, demonstrating dose proportionality across the full dose range that would be anticipated to be used in clinical practice. In March 2015, Zogenix commenced a Phase 1b multi-dose parallel clinical trial, enrolling 60 subjects, for which Zogenix announced positive top line

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results in September 2015. According to Zogenix, the results for Relday demonstrated that risperidone plasma concentrations in the therapeutic range were achieved on the first day of dosing, reached steady state levels following the second dose and consistently maintained therapeutic levels throughout the four-month period. Also according to Zogenix, Relday was generally safe and well-tolerated, with results consistent with the profile of risperidone and the previous Phase 1 single-dose clinical trial. Zogenix further stated that it has now initiated efforts to secure a development and commercialization partner for Relday, and that Relday is well-positioned to begin a Phase 3 program once a partner is secured.

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 for animal research use;
- 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 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 March 31, 2016, we had an accumulated deficit of $413.4 million. Our net loss was $7.9 million for the three months ended March 31, 2016. Our net losses were $22.7 million and $22.1 million for the years ended December 31, 2015 and 2014, respectively. These losses have resulted primarily from costs incurred to research and develop our product candidates and to a lesser extent, from selling, general and administrative costs associated with our operations and product sales. We expect our research and development expenses to increase in the near future compared to the first quarter of 2016. We expect selling, general and administrative expenses to be comparable in the near future compared to the first quarter of 2016. We do not anticipate meaningful revenues from our pharmaceutical product candidates, should they be approved, for at least the next twelve months. Therefore, we expect to incur continuing losses and negative cash flow from operations for the foreseeable future.

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Critical Accounting Policies and Estimates

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

Results of Operations

Three months ended March 31, 2016 and 2015

Collaborative research and development and other revenue

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

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

	Three months ended March 31,	
	2016	**2015**
Collaborator		
Zogenix, Inc. (Zogenix) (1)	$ 246	$ 1,158
Santen Pharmaceutical Co. Ltd. (Santen) (2)	162	307
Pain Therapeutics, Inc. (Pain Therapeutics)	4	
Others	7	273
Total collaborative research and development and other revenue	$ 419	$ 1,738

(1) Amounts related to ratable recognition of upfront fees were $52,000 and $64,000 for the three months ended March 31, 2016 and 2015, respectively.

(2) Amounts related to ratable recognition of upfront fees were $57,000 and $71,000 for the three months ended March 31, 2016 and 2015, respectively.

Product revenue

A portion of our revenues is derived from product sales, which include our ALZET mini pump product line, our LACTEL biodegradable polymer product line and certain excipients that are included in REMOXY and another product. Net product revenues were $3.2 million and $3.0 million in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily attributable to higher product revenue from the sale of certain excipients included in REMOXY partially offset by lower revenue from our ALZET mini pump product line and LACTEL polymer product line as a result of lower units sold compared to the corresponding period in 2015.

Cost of product revenues. Cost of product revenues were $1.2 million and $1.0 million for the three months ended March 31, 2016 and 2015, respectively. The increase in the cost of product revenue was primarily related to our LACTEL product line, our ALZET mini pump product line as well as certain excipients included in REMOXY arising from higher manufacturing costs for products sold in the first quarter of 2016 compared to the corresponding period in 2015. Cost of product revenues and gross profit margin will fluctuate from period to period depending upon the product mix in a particular period and unit volumes sold. Stock-based compensation expense recognized related to cost of product revenues was $27,000 and $29,000 for the three months ended March 31, 2016 and 2015, respectively.

As of March 31, 2016, we had 20 manufacturing employees compared with 22 as of March 31, 2015. We expect the number of employees involved in manufacturing will remain comparable in the near future.

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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 $6.6 million and $5.4 million for the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily attributable to higher research and development costs associated with POSIMIR, DUR-928, REMOXY and ORADUR-ADHD, partially offset by lower research and development costs associated with Relday, the Santen ophthalmic program, other ORADUR-based opioid products licensed to Pain Therapeutics, and ELADUR compared to the corresponding period in 2015 as more fully discussed below. Stock-based compensation expense recognized related to research and development personnel was $353,000 and $351,000 for the three months ended March 31, 2016 and 2015, respectively. As of March 31, 2016, we had 54 research and development employees compared with 56 as of March 31, 2015. We expect research and development expenses to increase in the near future compared to the first quarter of 2016 as we increase development activities for POSIMIR and DUR-928.

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

	Three months ended March 31,	
	2016	**2015**
POSIMIR	$ 2,726	$ 946
DUR-928	2,460	2,173
Depot injectable programs	495	494
Relday (1)	237	1,010
REMOXY (1)	226	65
Santen ophthalmic program (1)	116	249
ORADUR-ADHD	96	79
Other ORADUR-based opioid products licensed to Pain Therapeutics (1)	35	84
ELADUR (1)	21	59
Others	213	208
Total research and development expenses	$ 6,625	$ 5,367

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

POSIMIR

Our research and development expenses for POSIMIR were $2.7 million and $946,000 in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily due to higher employee-related costs, clinical trial expenses, contract manufacturing expense, chemical and drug supplies expenses as well as outside consulting expenses for POSIMIR compared with the corresponding period in 2015.

DUR-928

Our research and development expenses for DUR-928 were $2.5 million and $2.2 million in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily due to higher employee-related costs, clinical trial expenses and non-clinical related expenses, contract manufacturing and contract research expenses incurred for this drug candidate compared with the corresponding period in 2015.

Depot Injectable Programs

Our research and development expenses for depot injectable programs were $495,000 and $494,000 in the three months ended March 31, 2016 and 2015, respectively. The expenses were essentially unchanged for these programs compared with the corresponding period in 2015.

Relday

Our research and development expenses for Relday were $237,000 and $1.0 million in the three months ended March 31, 2016 and 2015, respectively. The decrease in the three months ended March 31, 2016 was primarily due to decreased development activities and lower employee-related costs incurred for this drug candidate compared with the corresponding period in 2015.

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REMOXY

Our research and development expenses for REMOXY were $226,000 and $65,000 in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily due to higher employee-related costs for REMOXY in the first quarter of 2016 compared with the corresponding period in 2015.

Santen ophthalmic program

Our research and development expenses for the Santen ophthalmic program were $116,000 and $249,000 in the three months ended March 31, 2016 and 2015, respectively. The decrease in the three months ended March 31, 2016 was primarily due to decreased formulation development activities associated with this drug candidate compared with the corresponding period in 2015.

ORADUR-ADHD

Our research and development expenses for ORADUR-ADHD were $96,000 and $79,000 in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily due to higher employee-related costs for these drug candidates in the first quarter of 2016 compared with the corresponding period in 2015.

Other select ORADUR-based opioid products licensed to Pain Therapeutics

Our research and development expenses for other ORADUR-based opioid products licensed to Pain Therapeutics were $35,000 and $84,000 in the three months ended March 31, 2016 and 2015, respectively. The decrease in the three months ended March 31, 2016 was primarily due to lower employee-related costs as well as lower outside expenses associated with these product candidates in the first quarter of 2016 compared with the corresponding period in 2015.

ELADUR

Our research and development expenses for ELADUR were $21,000 and $59,000 in the three months ended March 31, 2016 and 2015, respectively. The decrease in the three months ended March 31, 2016 was primarily due to lower employee-related costs associated with this product candidate compared with the corresponding period in 2015.

Other DURECT research programs

Our research and development expenses for all other programs were $213,000 and $208,000 in the three months ended March 31, 2016 and 2015, respectively. The increase in the three months ended March 31, 2016 was primarily due to slightly higher employee-related costs incurred for these programs compared with the corresponding period in 2015.

We cannot reasonably estimate the timing and costs of our research and development programs due to the risks and uncertainties associated with developing pharmaceuticals, as outlined in the Risk Factors section of this report. The duration of development of our research and development programs may span as many as ten years or more, and estimation of completion dates or costs to complete would be highly speculative and subjective due to the numerous risks and uncertainties associated with developing pharmaceutical products, including significant and changing government regulation, the uncertainties of future preclinical and clinical study results, the uncertainties with our

collaborators commitment and progress to the programs and the uncertainties associated with process development and manufacturing as well as sales and marketing. In addition, with respect to our development programs subject to third-party collaborations, the timing and expenditures to complete the programs are subject to the control of our collaborators. Therefore, we cannot reasonably estimate the timing and estimated costs of the efforts necessary to complete the research and development programs. For additional information regarding these risks and uncertainties, see Risk Factors below.

Selling, general and administrative. Selling, general and administrative expenses are primarily comprised of salaries, benefits, stock-based compensation and other compensation cost associated with finance, legal, business development, sales and marketing and other administrative personnel, overhead and facility costs, and other general and administrative costs. Selling, general and administrative expenses were $3.1 million and $2.8 million for the three months ended March 31, 2016 and 2015, respectively. The increase in selling, general and administrative expenses in the three months ended March 31, 2016 was primarily due to higher salaries and benefits expenses, higher patent related expense, and higher market research and analytics expenses compared to the corresponding period in 2015. Stock-based compensation expense recognized related to selling, general and administrative personnel was $330,000 and $270,000 for the three months ended March 31, 2016 and 2015, respectively.

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As of March 31, 2016, we had 26 selling, general and administrative employees compared with 25 as of March 31, 2015. We expect selling, general and administrative expenses to be comparable in the near future compared to the first quarter of 2016.

Other income (expense). Interest and other income (expense) was $27,000 and $128,000 for the three months ended March 31, 2016 and 2015, respectively. The decrease in interest and other income was primarily the result of a realized gain from the sale of a marketable equity security in the first quarter of 2015.

Interest expense was $558,000 and $561,000 for the three months ended March 31, 2016 and 2015, respectively.

Liquidity and Capital Resources

We had cash, cash equivalents and investments totaling $24.3 million at March 31, 2016 compared to $29.3 million at December 31, 2015. These balances include $250,000 of interest-bearing marketable securities classified as restricted investments on our balance sheets as of March 31, 2016 and December 31, 2015. The decrease in cash, cash equivalents and investments during the three months ended March 31, 2016 was primarily the result of ongoing operating expenses, partially offset by payments received from collaboration partners and customers.

We used $6.3 million of cash in operating activities for the three months ended March 31, 2016 compared to $5.3 million for the corresponding period in 2015. The cash used for operations was primarily to fund operations as well as our working capital requirements which involved an increase in net loss of $3.0 million, partially offset by the changes in account receivable, prepaid expenses and other assets, and accrued and other liabilities.

We received $5.3 million of cash in investing activities for the three months ended March 31, 2016 compared to $4.4 million for the corresponding period in 2015. The increase in cash received in investing activities was primarily due to an increase in net proceeds from maturities of available-for-sale securities for the three months ended March 31, 2016 compared to the corresponding period in 2015. We anticipate incurring capital expenditures of approximately $100,000 in 2016 to purchase research and development and other capital equipment. The amount and timing of these capital expenditures will depend on, among other things, the timing of clinical trials for our products and our collaborative research and development activities.

We received $1.3 million of cash from financing activities for the three months ended March 31, 2016 compared to $238,000 for the corresponding period in 2015. During the first quarter of 2016, we raised net proceeds (net of commission) of approximately $1.3 million from the sale of approximately 857,000 shares of common stock at a weighted average price of $1.60 per share in the open market through our Controlled Equity Offering sales agreement with Cantor Fitzgerald, entered into in November 2015.

We anticipate that cash used in operating and investing activities will increase in the near future compared to the first quarter of 2016, pending our efforts to sign new collaborators or experience an increase in partner funded research and development activities under existing collaborations.

During the three months ended March 31, 2016, there have been no significant changes in our commercial commitments and contractual obligations as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

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. We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding.

Additionally, we do not expect to generate meaningful revenues from our pharmaceutical product candidates currently under development for at least the next twelve months, if at all. Depending on whether we enter into additional collaborative agreements in the near term, we may be required to raise additional capital through a variety of sources, including:

- the public equity markets;
- private equity financings;
- collaborative arrangements; and/or
- public or private debt.

There can be no assurance that we will enter into additional collaborative agreements in the near term or additional capital will be available on favorable terms, if at all. If adequate funds are not available, we may be required to significantly reduce or refocus our operations or to obtain funds through arrangements that may require us to relinquish rights to certain of our products, technologies or potential markets, 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.

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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 March 31, 2016, we did not have any off-balance sheet arrangements, as defined under SEC Regulation S-K Item 303(a)(4)(ii).

Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

Item 4. Controls and Procedures

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

Changes in Internal Control Over Financial Reporting: There were no significant changes in the Company s internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the Company s most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

We are not a party to any material legal proceedings.

Item 1A. Risk Factors.

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

Risks Related To Our Business

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

In February 2014, we received a Complete Response Letter to our NDA for POSIMIR from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. We began recruiting patients for this trial in November 2015 with an intent to compare POSIMIR to placebo. Based on advice received from the FDA subsequent to the start of the trial, in April 2016 we decided to amend the PERSIST trial including by incorporating standard bupivacaine HCl as an active control. This change will add to the time and cost to complete the PERSIST trial, and there can be no assurance that this clinical trial will be completed in a timely manner or generate data necessary to support a successful NDA resubmission. There can also be no assurance that the results of this trial will be sufficient to support FDA approval. The failure to adequately demonstrate the safety and effectiveness of a pharmaceutical product candidate under development to the satisfaction of FDA and other regulatory agencies has, with respect to POSIMIR and could, with respect to other product candidates, delay or prevent regulatory clearance of the potential product candidate, resulting in delays to the commercialization of our product candidate, and could materially harm our business. Clinical trials may not demonstrate the sufficient levels of safety and efficacy necessary to obtain the requisite regulatory approvals for our product candidates, or may require such significant numbers of patients or additional costs to make it impractical to satisfy the FDA s requirements, and thus our product candidates may not be approved for marketing. During the review process, the FDA may request more information regarding the safety of our product candidates, as they have in their Complete Response Letter for POSIMIR, and answering such questions could require significant additional work and expense, and take a significant amount of time, resulting in a material delay of approval or the failure to obtain approval. During the review process, the FDA may also request more information regarding the chemistry, manufacturing or controls related to our product candidates, as they have in their Complete Response Letter for REMOXY, and answering such questions could require significant additional work and expense, and take a significant amount of time, resulting in a material delay of approval or the failure to obtain approval.

Development of REMOXY may be significantly delayed and adversely affected by Pfizer s discontinuation of its development

We have relied on Pfizer and its subsidiaries to devote time and resources to the development, manufacturing and commercialization of REMOXY. In October 2014, Pfizer notified Pain Therapeutics that Pfizer had decided to

discontinue development of REMOXY and that Pfizer would return all rights, including responsibility for regulatory activities, to Pain Therapeutics. There can be no assurance that the transition of all required information and assets necessary for the timely and successful resubmission of the NDA has been completed successfully. There can also be no assurance that Pain Therapeutics will continue development of REMOXY, or if Pain Therapeutics continues development of REMOXY, there can be no assurance that their resubmission of the NDA will satisfy the FDA s requirements. Pain Therapeutics and its subsidiaries and affiliates may commercialize, develop or acquire drugs or drug candidates that may compete indirectly or compete for resources with REMOXY. Any further delay or discontinuation in the development of REMOXY will significantly harm our prospects and would be likely to have a negative effect on the price of our common stock.

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

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

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

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

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

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

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

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

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

The time frame necessary to achieve these developmental milestones for any individual product is long and uncertain, and we may not successfully complete these milestones for any of our products in development. We have not yet completed development of any of our product candidates, including REMOXY, POSIMIR, DUR-928, ORADUR-ADHD and other ORADUR-based opioid products, Relday, or ELADUR, and we have limited experience in developing such products. We may not be able to finalize the design or formulation of any of these product candidates. 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 REMOXY, POSIMIR, DUR-928, ORADUR-ADHD and other ORADUR-based opioid products, Relday, or ELADUR, or other product candidates, we will not be able to earn revenue from them, which would materially harm our business.

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

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

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

POSIMIR In April 2013, we submitted a new drug application as a 505(b)(2) application, which relies in part on the FDA s findings of safety and effectiveness of a reference drug. In February 2014, we received a Complete Response Letter from the FDA. Based on the Complete Response Letter and subsequent communications with the FDA, we are conducting a new POSIMIR Phase 3 clinical trial consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. We began recruiting patients for this trial in November 2015 with an intent to compare 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. This change will add to the time and cost to complete the PERSIST trial, and could add to the risk of the trial. There can be no assurance that the trial will enroll on the timetable we anticipate, that we will be able to adequately or timely address all of FDA s concerns and suggestions regarding POSIMIR, that the FDA

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will grant regulatory approval of POSIMIR, that adverse effects will not arise from additional testing or use of POSIMIR, or that the data we have generated or may generate will be deemed sufficient by FDA or other regulatory agencies to support regulatory approval of POSIMIR.

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

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

Relday In January 2013, Zogenix announced positive single-dose pharmacokinetic (PK) results from a Phase 1 clinical trial of Relday. Per Zogenix, based on the favorable safety and PK profile demonstrated with the 25 mg and 50 mg once-monthly doses tested in the Phase 1 trial, Zogenix extended the study to include a 100 mg dose of the same formulation. In May 2013, Zogenix announced positive results with the 100 mg arm, demonstrating dose proportionality across the full dose range that would be anticipated to be used in clinical practice. According to Zogenix, the positive results from this study extension positioned Zogenix to begin a multi-dose clinical trial, which would provide the required steady-state pharmacokinetic and safety data prior to initiating Phase 3 development studies. In September 2015 Zogenix announced positive top line results from this multi-dose clinical trial. According to Zogenix, the results for Relday demonstrated that

risperidone plasma concentrations in the therapeutic range were achieved on the first day of dosing, reached steady state levels following the second dose and consistently maintained therapeutic levels throughout the four-month period. Also according to Zogenix, Relday was generally safe and well-tolerated, with results consistent with the profile of risperidone and the previous Phase 1 single-dose clinical trial. Zogenix further stated that it has now initiated efforts to secure a development and commercialization partner for Relday, and that Relday is well-positioned to begin a Phase 3 program once a partner is secured. There can be no assurance that Zogenix will secure a development and commercialization partner for Relday or that Relday will begin the Phase 3 program or that if such a program is begun it will generate data sufficient to support a successful NDA.

ELADUR A Phase 2a clinical trial in post-herpetic neuralgia (PHN or post-shingles pain) was completed and positive efficacy trends were reported in the fourth quarter of 2007. King, which assumed worldwide development and commercialization rights for ELADUR through its acquisition of Alpharma, conducted a Phase 2 clinical trial to evaluate ELADUR for the treatment of chronic low back pain and reported in April 2011 that the primary efficacy endpoint for the trial was not met. In February 2012, Pfizer, which assumed worldwide development and commercialization rights to ELADUR through its acquisition of King, notified us that they were returning their worldwide development and commercialization rights to ELADUR. In January 2014, we and Impax entered into an agreement, pursuant to which we have granted Impax an exclusive worldwide license to our proprietary TRANSDUR transdermal delivery technology and other intellectual property to develop and commercialize ELADUR. There can be no assurance that Impax will continue to develop ELADUR or will be able to successfully develop ELADUR to obtain marketing approval by the FDA or other regulatory agencies.

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

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

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

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

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

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

While some clinical trials of our product candidates have shown indications of safety and efficacy of our product candidates, there can be no assurance that these results will be confirmed in subsequent clinical trials or provide a sufficient basis for regulatory approval. In addition, side effects observed in clinical trials, or other side effects that appear in later clinical trials, may adversely affect our or our collaborators ability to obtain regulatory approval or

market our product candidates. For example, the finding that DUR-928 appears safe in the initial Phase 1 trials may not be confirmed in subsequent Phase 1 or other clinical trials. In the Phase 2b hysterectomy trial and the BESST Phase 3 abdominal surgery trial of POSIMIR, transient local hematoma-like discolorations were observed near the surgical site. Side effects such as these, toxicity or other safety issues associated with the use of our drug candidates could require us to perform additional studies or halt development of our drug candidates. We or our collaborators may be required by regulatory agencies to conduct additional animal or human studies regarding the safety and efficacy of our pharmaceutical product candidates which we have not planned or anticipated. For example, the FDA s Complete Response Letter raised concerns related to, among other matters, the Chemistry, Manufacturing, and Controls section of the NDA for REMOXY. There can be no assurance that Pain Therapeutics will resolve these issues to the satisfaction of the FDA in a timely manner or ever, which could harm our business, prospects and financial condition. Further, the FDA s Complete Response Letter for POSIMIR raised concerns that insufficient safety data had been provided and FDA has indicated that an additional clinical trial for POSIMIR needs to be conducted. There can be no assurance that the additional clinical trial we are conducting for POSIMIR will be sufficient to obtain FDA approval, and any additional trials would entail added expense and further delay or may preclude product approval, harming our business, prospects and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our performance depends to a large extent on the ability of our third-party collaborators to successfully develop and obtain approvals for our pharmaceutical product candidates. We have entered into agreements with Pain Therapeutics, Zogenix, Impax, Santen, Orient Pharma and others under which we granted such third parties the right to develop, apply for regulatory approval for, market, promote or distribute REMOXY and certain other ORADUR-based products, Relday, ELADUR and other product candidates, subject to payments to us in the form of product royalties and other payments. We have limited or no control over the expertise or resources that any collaborator may devote to the development, clinical trial strategy, regulatory approval, marketing or sale of these product candidates, or the timing of their activities. Any of our present or future collaborators may not perform their obligations as expected. These collaborators may breach or terminate their agreement with us or otherwise fail to conduct their collaborative activities successfully and in a timely manner. Enforcing any of these agreements in the event of a breach by the other

party could require the expenditure of significant resources and consume a significant amount of management time and attention. Our collaborators may also conduct their activities in a manner that is different from the manner we would have chosen, had we been developing such product candidates ourselves. Further, our collaborators may elect not to develop or commercialize product candidates arising out of our collaborative arrangements or not devote sufficient resources to the development, clinical trials, regulatory approval, manufacture, marketing or sale of these product candidates. If any of these events occur, we may not recognize revenue from the commercialization of our product candidates based on such collaborations. In addition, these third parties may have similar or competitive products to the ones which are the subject of their collaborations with us, or relationships with our competitors, which may reduce their interest in developing or selling our product candidates. We may not be able to control public disclosures made by some of our third-party collaborators, which could negatively impact our stock price.

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

Third-party collaboration agreements typically allow the third party to terminate the agreement (or a specific program within an agreement) by providing notice. For example, in January 2012, we were notified that Nycomed was terminating the Development and License Agreement between Nycomed and us relating to the development and commercialization of POSIMIR in Europe and their

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

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

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

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

Our cash flows are likely to differ from our reported revenues

Our revenues will likely differ from our cash flows from revenue-generating activities. Upfront payments received upon execution of collaborative agreements are recorded as deferred revenue and generally recognized on a straight-line basis over the period of our continuing involvement with the third-party collaborator pursuant to the applicable agreement. The period of continuing involvement may also be revised on a prospective basis. As of

March 31, 2016, we had $2.7 million of deferred revenue which will be recognized in future periods and may cause our reported revenues to be greater than cash flows from our ongoing revenue-generating activities.

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

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

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

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

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

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

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

- regulatory actions with respect to our product candidates;
- continued progress and cost of our research and development programs;
- the continuation of our collaborative agreements that provide financial funding for our activities;
- success in entering into collaboration agreements and meeting milestones under such agreements;
- progress with preclinical studies and clinical trials;
- the time and costs involved in obtaining regulatory clearance;

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

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

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

competing technological and market developments;

market acceptance of our product candidates;

costs for recruiting and retaining employees and consultants; and

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

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

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

We or our third-party collaborators to whom we have assigned such responsibility must manufacture our pharmaceutical product candidates and components in clinical and commercial quantities, either directly or through third parties, in compliance with regulatory requirements and at an acceptable cost. The manufacturing processes associated with our product candidates are complex. We and our third-party collaborators, where relevant, have not yet completed development of the manufacturing process for any product candidates or components, including POSIMIR, REMOXY and our other ORADUR-based drug candidates, ELADUR,

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Relday and DUR-928. If we and our third-party collaborators, where relevant, fail to timely complete the development of the manufacturing process for our product candidates, we and our third-party collaborators, where relevant, will not be able to timely produce product for clinical trials and commercialization of our product candidates. We have also committed to manufacture and supply product candidates or components under a number of our collaborative agreements with third-party companies. We have limited experience manufacturing pharmaceutical products, and we may not be able to timely accomplish these tasks. If we and our third-party collaborators, where relevant, fail to develop manufacturing processes to permit us to manufacture a product candidate or component at an acceptable cost, then we and our third-party collaborators may not be able to commercialize that product candidate or we may be in breach of our supply obligations to our third-party collaborators.

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

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

We had entered into a supply agreement with Hospira Worldwide, Inc. for clinical and commercial supplies of POSIMIR. This third party was our sole source for drug product required for development and commercialization of this drug candidate. Our agreement with Hospira terminated at the end of 2015 and we have entered into a manufacturing development agreement with a different contract manufacturing organization for future supply of POSIMIR. There may be technical risks associated with establishing an alternative commercial manufacturer that could entail delays in supply, quality issues or delays in the possible regulatory approval of POSIMIR. Furthermore, we and our contract manufacturer may also need or choose to subcontract with additional third-party contractors to perform manufacturing steps of POSIMIR or supply required components for POSIMIR. Where third party contractors perform manufacturing services for us, we will be subject to the schedule, expertise and performance of third parties as well as incur significant additional costs. Failure of third parties to perform their obligations could adversely affect our operations, development timeline and financial results. We expect to put in place in the future second source supply arrangements, which may be costly and time consuming.

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

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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 March 31, 2016, had an accumulated deficit of approximately $413.4 million. We expect to continue to incur significant operating losses over the next several years as we continue to incur significant costs for research and development, clinical trials, manufacturing, sales, and general and administrative functions. Our ability to achieve profitability depends upon our ability, alone or with others, to successfully complete the development of our proposed product candidates, obtain the required regulatory clearances, and manufacture and market our proposed product candidates. Development of pharmaceutical product candidates is costly and requires significant investment. In addition, we may choose to license from third parties either additional drug delivery platform technology or rights to particular drugs or other appropriate technology for use in our product candidates. The license fees for these technologies or rights would increase the costs of our product candidates.

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

We may develop our own sales force and commercial group to market future products but we have limited