

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

**Form 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2019

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-31615

**DURECT CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

10260 Bubb Road  
Cupertino, CA 95014

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (408) 777-1417

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class  
Common Stock \$0.0001 par value per share

Trading Symbol(s)

Name of Each Exchange on Which Registered  
The NASDAQ Stock Market LLC

DRRX

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES  NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 of the Act. YES  NO

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). YES  NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Emerging growth company

Accelerated filer

Smaller reporting company

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$105,942,850 as of June 30, 2019 based upon the closing sale price on The Nasdaq Global Market reported for such date. Shares of Common Stock held by each officer and director and by each person who may be deemed to be an affiliate have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

There were 195,818,780 shares of the registrant's Common Stock issued and outstanding as of February 28, 2020.

**DOCUMENTS INCORPORATED BY REFERENCE**

Part III incorporates information by reference from the definitive Proxy Statement for the 2020 annual meeting of stockholders, which is expected to be filed not later than 120 days after the Registrant's fiscal year ended December 31, 2019.

**DURECT CORPORATION**  
**ANNUAL REPORT ON FORM 10-K**  
**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2019**  
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**Item 1. Business.****Overview**

We are a biopharmaceutical company with research and development programs broadly falling into two categories: (i) new chemical entities derived from our Epigenetic Regulator Program, in which we attempt to discover and develop molecules which have not previously been approved and marketed as therapeutics, and (ii) proprietary pharmaceutical 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, 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.

Our product pipeline currently consists of multiple investigational drug candidates in development. DUR-928, a new chemical entity in Phase 1 and Phase 2 development for two different indications, is the lead candidate in DURECT's Epigenetic Regulator Program. An endogenous, orally bioavailable, small molecule, DUR-928 has been shown in preclinical studies to play an important regulatory role in lipid homeostasis, inflammation, and cell survival. Human applications may include acute organ injury such as alcoholic hepatitis (AH) and acute kidney injury (AKI) and chronic metabolic diseases such as nonalcoholic steatohepatitis (NASH), nonalcoholic fatty liver disease (NAFLD), and other liver diseases. DURECT's proprietary drug delivery technologies are designed to enable new indications and enhanced attributes for small-molecule and biologic drugs. One late-stage development program in this category is POSIMIR® (bupivacaine extended-release solution), an investigational analgesic product intended to deliver bupivacaine to provide up to 3 days of pain relief after surgery. Another program in this category is an early-stage long-acting injectable HIV product utilizing our SABER® technology, which is in development under a July 2019 license agreement with Gilead.

As a result of the assignment of certain patent rights, DURECT receives single digit sales-based earn-out payments from U.S. net sales of Indivior's PERSERIS™ (risperidone) drug for schizophrenia, which was approved in July 2018. Indivior commenced the full commercial launch of PERSERIS in February 2019 and Indivior has indicated that it expects 2020 sales in the range of \$15-\$25 million. In addition, in September 2018, our licensee, Orient Pharma informed us that it had obtained marketing authorization for Methydur Sustained Release Capsules from the Ministry of Health and Welfare in Taiwan. Methydur Sustained Release Capsules are indicated for the treatment of attention deficit hyperactivity disorder (ADHD) and will be available in three strengths (22 mg, 33 mg and 44 mg) in Taiwan. Orient Pharma has stated that it expects to make Methydur Sustained Release Capsules commercially available in Taiwan in 2020, while seeking a partner in China and pursuing regulatory approvals in selected other countries in Southeast Asia where it has commercialization rights and a commercialization presence. We will receive a single digit royalty on sales of Methydur Sustained Release Capsules by Orient Pharma and retain rights to this product in markets not specifically licensed to Orient Pharma.

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 royalties on product sales. At the same time, we have retained the rights to other programs, which are the basis of potential future collaborations and which over time may provide a pathway for us to develop our own commercial, sales and marketing organization.

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*NOTE: POSIMIR®, SABER®, CLOUD™, ORADUR™, ALZET® and LACTEL® are trademarks of DURECT Corporation. Other trademarks referred to belong to their respective owners. Full prescribing information for PERSERIS, including BOXED WARNING and Medication Guide can be found at [www.perseris.com](http://www.perseris.com).*

## Epigenetic Regulator Program and New Chemical Entities

Epigenetic regulation involves biochemical modification of either DNA itself or proteins that are intimately associated with DNA. These modifications lead to changes in gene expression that facilitate downstream biological effects.

DURECT's Epigenetic Regulator Program involves a multi-year collaborative effort with the Department of Internal Medicine at Virginia Commonwealth University (VCU), the VCU Medical Center and the McGuire VA Medical Center. The knowledge base supporting this program is a result of more than 30 years of lipid research by Shunlin Ren, M.D., Ph.D., Professor of Internal Medicine at the VCU Medical Center. The lead compound from this program, DUR-928, is an endogenous, orally bioavailable, small molecule that modulates the gene expression of various nuclear receptors that play important regulatory roles in lipid homeostasis, inflammation, and cell survival. Under a license with VCU, we hold the exclusive royalty-bearing worldwide right to develop and commercialize DUR-928 and related molecules discovered in the program.

The biological activity of DUR-928 has been demonstrated in over a dozen different animal disease models involving three animal species. Some of these models represent acute organ injuries (e.g., endotoxin shock, acute oxidative damage, ischemic-reperfusion kidney injury, and stroke models) and several represent chronic metabolic disorders involving hepatic lipid accumulation and dysfunction (e.g., NASH and NAFLD).

Our major product research and development efforts for DUR-928 are set forth in the following table:

### Summary of 2020 DUR-928 Clinical Trials

Indication	Predinical	Phase 1	Phase 2	Design/Timing	Patient Population
Alcoholic Hepatitis (Injectable)				Planned Phase 2b trial initiation mid-2020; assuming reasonable enrollment, to p-line data would be available 2022. Potential to be life saving, which could lead to accelerated regulatory path.	>117,000 hospitalized in the U.S. <sup>1</sup>
NASH (Oral)				28-day daily dosing, Phase 1b open-label study to evaluate safety, PK and signals of biological activity. Expected completion 1H2020	9-16 million in the U.S. <sup>2</sup>

(1) US Department of Health and Human Services' Healthcare Cost and Utilization Project reports <https://hcupnet.org> (accessed Sept 2019). (2) Estes C, et al. Hepatology, 2018;67:123-133.

In pharmacokinetic and toxicology studies conducted in mice, hamsters, rats, rabbits, dogs, minipigs and monkeys, DUR-928 has been found to be tolerable and safe by all routes of administration tested to date. These results support the use of DUR-928 in the completed, ongoing and planned human safety, pharmacokinetics (PK), proof-of-concept, and efficacy trials. The chronic toxicity of DUR-928 was further assessed in a 6-month oral study in rats and in a 9-month oral study in dogs. These studies were completed successfully and support human clinical trials of DUR-928 of any duration.

**Market Opportunity.** Alcoholic hepatitis (AH) is an acute form of alcoholic liver disease (ALD) associated with long-term heavy intake of alcohol, and often occurs after a recent period of increased alcohol consumption. AH is typically characterized by recent onset jaundice and hepatic failure. An analysis of 77 studies published between 1971 and 2016, which included data from a total of 8,184 patients, showed the overall mortality from AH was 26% at 28 days. According to the most recent data provided by the Agency for Healthcare Research and Quality (AHRQ), a part of the US Department of Health and Human Services (HHS), there were over 117,000 hospitalizations for patients with alcoholic hepatitis in 2016. From a recent publication analyzing the mortality and costs associated with alcoholic hepatitis, the cost per patient is estimated at over \$50,000 in the first year. ALD is one of the leading causes of liver transplants in the US, each of which cost over \$800,000. Acute kidney injury (AKI), a sudden loss of kidney function due to renal failure or injury, affects approximately 2.8 million patients per year in the United States and is associated with increased mortality, prolonged hospital stays, kidney dialysis and progression to chronic kidney disease. There are various forms of acute organ injury affecting the liver, the kidney or other organs for which we are or may seek to develop DUR-928.

**Clinical Program.** In 2019, we completed a Phase 2a clinical trial evaluating intravenously infused DUR-928 in patients with moderate and severe AH. This was an open label, dose escalation (30, 90 and 150 mg), multi-center U.S. study, originally designed to be conducted in two sequential parts. Part A included patients with moderate AH and Part B included patients with severe AH. Severity of AH was determined by the Model of End-Stage Liver Disease (MELD) scores, a common scoring system to assess the severity and prognosis of AH patients; moderate was defined as MELD 11-20 and severe as MELD 21-30.

In the Phase 2a trial, dose escalation was permitted following review of safety and pharmacokinetic (PK) results of the prior dose level by a Dose Escalation Committee (DEC). The target number of patients for the study was 4 per dose group. Final enrollment included 19 patients with moderate and severe AH, who were administered DUR-928 intravenously at three different doses. Eight patients (four moderate and four severe) were dosed at 30mg, seven patients (three moderate and four severe) were dosed at 90mg and four patients (all severe) were dosed at 150mg. After being discharged on day two, one patient did not return for the scheduled day seven and day 28 follow-up visits; therefore Lille, bilirubin and MELD data reported below are based on 18 patients. The objectives of this study included assessment of safety, PK and pharmacodynamic (PD) signals, including liver biochemistry, biomarkers, and prognostic scores, including the Lille score, following DUR-928 treatment.

In November 2019, DURECT announced the results from our Phase 2a clinical trial of DUR-928 in alcoholic hepatitis (AH), presented as a late-breaking oral presentation at The Liver Meeting®. The study results were also selected for inclusion in the 'Best of The Liver Meeting' summary slide presentation in the alcohol-related liver disease category.

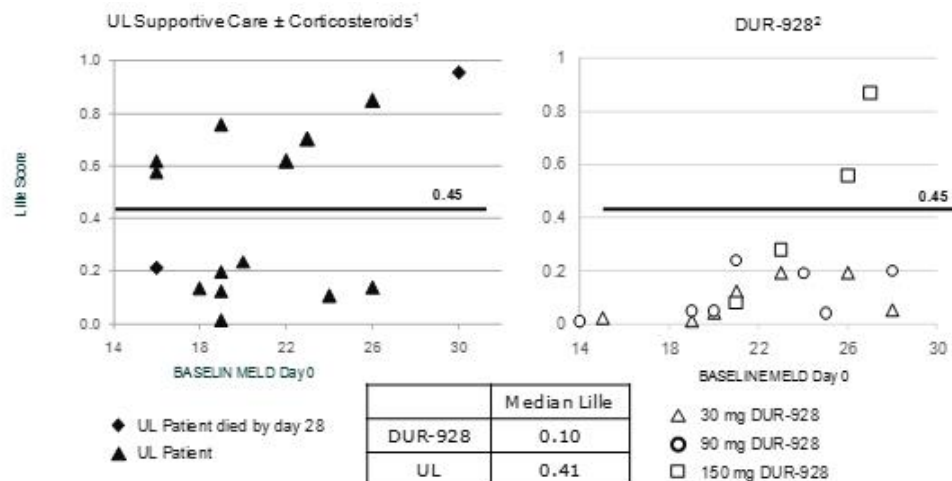
All 19 patients treated with DUR-928 in this trial survived the 28-day follow-up period and there were no drug-related serious adverse events. Patients treated with DUR-928 had a statistically significant reduction from baseline in bilirubin at day 7 and 28 and MELD at day 28. Lille scores were also statistically significantly lower than those from a well-matched group of patients in a contemporary ongoing trial as well as several published historical controls. 74% of all DUR-928 treated patients and 67% of those with severe AH were discharged from the hospital within four days of receiving a single dose of DUR-928.

#### Lille

Lille scores are used in clinical practice to help determine the prognosis and response of AH patients after seven days of treatment. The lower the Lille score, the better the prognosis. Patients with a Lille score below 0.45 have a six-month survival rate of 85% compared to those with Lille scores above 0.45, who have only a 25% six-month survival rate.<sup>1</sup> The chart below shows the Lille scores for individual AH patients treated with DUR-928 plotted as a function of their baseline MELD scores. In our study, the median Lille score for patients treated with DUR-928 was 0.10. The median Lille score among a cohort of 15 patients treated with standard of care at the University of Louisville (UL) was 0.41 (shown as historical control).

<sup>1</sup> Louvet A et al. *Hepatology* 2007; 45: 1348-54.

The chart below shows individual patient Lille scores plotted as a function of their baseline MELD scores.



- 1) Our advisor, Dr. Craig McClain from the University of Louisville (UL), shared anonymized data from his study, in which 15 AH patients with initial MELD scores ranging from 15-30 received either supportive care alone (n=8 moderate AH patients) or supportive care with corticosteroids (n=7 severe AH patients). Two of the UL control patients died by day 28.
- 2) One patient in the DUR-928 group did not return for the day 7 or 28 visit. All 19 patients, including this one, treated with DUR-928 in this trial survived the 28-day follow-up period.
- 3) Lille scores in the DUR-928 group were significantly lower than that of the UL patients (p=0.01; Wilcoxon's Rank Sum Test).

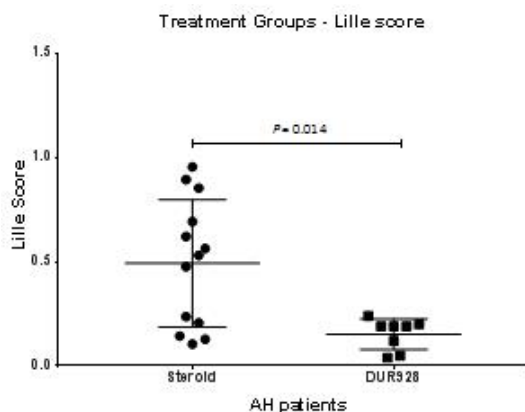
As shown below, 100% of patients in the 30 mg and 90 mg DUR-928 dosing groups were treatment responders based on their Lille scores. 89% of the overall DUR-928 patient population were treatment responders. Patients with severe AH, as defined by Maddrey's Discriminant Function >32 or MELD 21-30, and baseline serum bilirubin above 8 mg/dL, had similarly high response rates to DUR-928 treatment.

AH Patient Category	n <sup>1</sup>	Responders (Lille<0.45)	Lille Median (Quartile)
All Patients <sup>2</sup>	18	89%	0.10 (0.04, 0.20)
30 or 90 mg DUR-928 <sup>3</sup>	14	100%	0.05 (0.04, 0.19)
DF>32 (SAH) <sup>2, 4</sup>	15	87%	0.19 (0.05, 0.22)
30 or 90 mg DUR-928 <sup>3</sup>	11	100%	0.12 (0.05, 0.19)
MELD 21-30 <sup>2</sup>	12	83%	0.19 (0.11, 0.25)
30 or 90 mg DUR-928 <sup>3</sup>	8	100%	0.19 (0.10, 0.19)
Baseline bilirubin >8mg/dl <sup>2</sup>	11	82%	0.10 (0.05, 0.20)
30 or 90 mg DUR-928 <sup>3</sup>	8	100%	0.10 (0.05, 0.19)

- 1) One patient did not return for Day 7 and 28 visits;
- 2) Including patients receiving 30, 90 and 150 mg of DUR-928;
- 3) Excluding patients receiving 150 mg of DUR-928.
- 4) Maddrey's Discriminant Function (DF) is calculated using the patient's prothrombin time and serum bilirubin level. DF was introduced in 1978 as a predictor of significant mortality risk for AH patients. A DF>32 identified AH patients with a 30-day mortality rate of ≥50%.

The Lille scores of patients treated with DUR-928 in this trial were also significantly lower than several selected published historical studies (*Hepatology* 2007, 45:1348-1354; *Gut* 2011, 60:255-260), in which patients had similar baseline bilirubin, albumin, creatinine, prothrombin time and DF scores, and were treated with standard of care with or without corticosteroids. Of course, due to the historical nature of these studies, such comparisons should be taken cautiously.

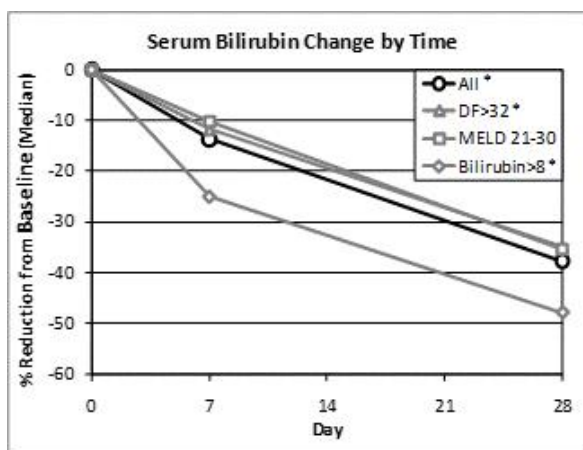
A sub-group analysis was conducted to compare severe AH patients in the 30 mg and 90 mg dosing groups (n=8) with well-matched severe AH patients (n=13) who received corticosteroids for 28 days in a contemporaneous study at the University of Louisville (UL). Patients shown below in the UL steroid group had a mean baseline MELD of 24.46 and mean baseline Maddrey's DF score of 62.98. The 8 patients in the DUR-928 group had baseline mean MELD of 24.50 and mean baseline Maddrey's DF score of 61.25. All patients treated with DUR-928 survived the 28-day follow up period, while 3 patients in the UL steroid group died within the first 28 days.



The steroid group in the above graph includes the 7 severe AH patients treated with steroids from the UL group shown in the MELD vs Lille graph above plus an additional 6 severe AH patients subsequently treated in the UL study.

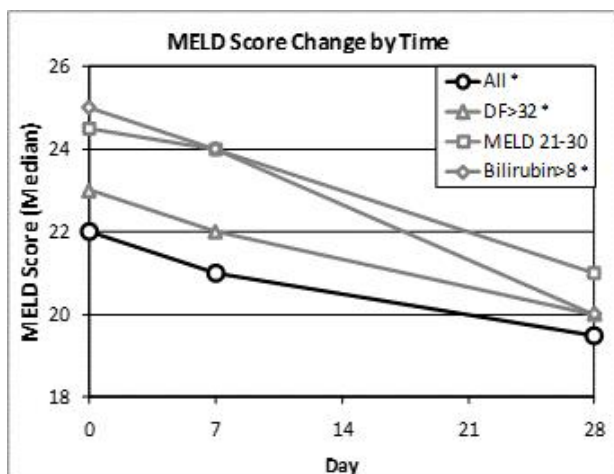
### Bilirubin

Bilirubin is formed by the breakdown of red blood cells in the body. The level of total bilirubin in the blood is an indication of how the liver is functioning. In this trial, patients treated with DUR-928 had a significant early reduction from baseline in bilirubin by day 7. Patients with more elevated bilirubin at baseline (serum bilirubin >8 mg/dL) had a median reduction from baseline of 25% by day 7 and 48% by day 28.



\*p<0.05 compared to baseline (Wilcoxon's Signed Rank Test)

MELD is another common scoring system used to assess the severity and prognosis of AH patients. Patients with MELD scores of 11-20 are classified as having moderate AH and patients with MELD scores of 21-30 are classified as having severe AH. As with Lille scores, the lower the MELD score, the better the prognosis for the AH patient. In this study (shown in the chart below), the median reduction from baseline in MELD among all DUR-928 treated patients was >2 points and among those with baseline bilirubin levels >8 mg/dL was 5 points by day 28.



\* $p < 0.05$  compared to baseline (Wilcoxon's Signed Rank Test)

MELD is calculated based on (a) bilirubin, (b) serum creatinine (sCr), and (c) International Normalized Ratio (INR), which is a measure of prothrombin time.

### Safety and Pharmacokinetics

In the Phase 2a study, DUR-928 was well tolerated at all doses tested. There were no drug-related serious adverse events and only three adverse events designated as possibly related to DUR-928: one occurrence of moderate generalized pruritus, one mild rash and one grade two alkaline phosphatase. There were no discontinuations, early withdrawals or termination of study drug or study participation due to adverse events. All patients treated with DUR-928 survived through the 28-day follow-up period. Drug exposures were dose proportional and were not affected by the severity of the disease.

We are working with the FDA and our advisors to finalize the design of a multi-center, international, randomized, double blind, placebo-controlled Phase 2b clinical trial of DUR-928 in AH patients. We are planning to initiate the trial in mid-2020 and, based on our current working assumptions related to trial design, number of clinical trial sites and enrollment rates, top-line data for this trial may be available in 2022.

Phase 1 trials of DUR-928 administered through injection have supported the development of DUR-928 in AH. The initial Phase 1 trial in healthy subjects was a single-site, randomized, double-blinded, placebo-controlled, single-ascending-dose study that evaluated the safety, tolerability and PK of intramuscular (IM) injected DUR-928. The 24-subject study (16 healthy volunteers on the drug and 8 on placebo) of four escalating dose levels resulted in dose proportional systemic exposure of DUR-928 with peak plasma concentrations greater than 1000-fold higher than endogenous levels. 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 subjects, in which participants received IM-injected DUR-928 for 5 consecutive days (8 subjects on the drug, 2 on placebo) using the next to highest dose from the single dose study. No serious treatment related adverse events were reported, no subjects withdrew from the study, no accumulation in plasma concentrations were observed with repeat dosing, and the pain scores and injection site reactions were minimal. We also conducted a single-ascending dose intravenous (IV) infusion study with 16 healthy subjects and observed no treatment-related serious adverse events. The systemic exposure following IV infusion was dose proportional.

A Phase 1 drug-drug interaction study conducted in healthy subjects demonstrated that neither orally administered nor intravenously injected DUR-928 at doses tested affected the safety and PK of midazolam, a drug metabolized by CYP3A4, which is one of the important enzymes associated with clinically relevant drug-drug interactions.



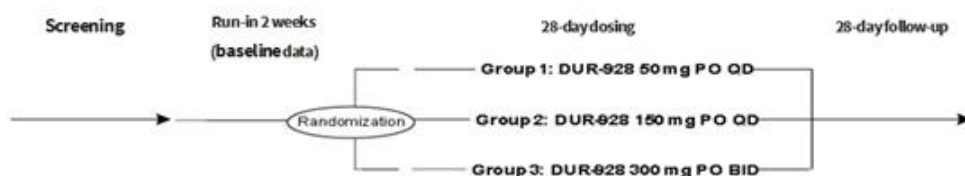
We have also conducted a Phase 1b study with injected DUR-928 in patients with impaired kidney function (stage 3 and 4 chronic kidney disease (CKD)) and matched control subjects (MCS), matched by age, body mass and gender with normal kidney function. This study was a single-site, open-label, single-ascending-dose study in two successive cohorts (first a low dose of 30 mg and then a high dose of 120 mg) evaluating safety and PK of intramuscular injected DUR-928. The low dose cohort consisted of 6 patients with CKD and 3 MCS; the high dose cohort consisted of 5 CKD patients and 3 MCS. In this trial, DUR-928 was well tolerated among all subjects and the PK parameters between the kidney function impaired patients and the MCS were comparable. The results of this Phase 1b trial were presented at Kidney Week 2018 in San Diego.

#### *Chronic Liver Disease Program with Orally Administered DUR-928*

**Market Opportunity.** Non-alcoholic fatty liver disease (NAFLD) is the most common form of chronic liver disease in both children and adults. It is estimated that NAFLD affects approximately 30% to 40% of adults and 10% of children in the United States. Non-alcoholic steatohepatitis (NASH), a more severe and progressive form of NAFLD, is one of the most common chronic liver diseases worldwide, with an estimated prevalence of 3-5% globally. No drug is currently approved for treatment of NAFLD or NASH. Moreover, alcoholic fatty liver disease (AFLD), including its more advanced stage, alcoholic steatohepatitis (ASH), develops in approximately 90% of individuals who drink more than 60 grams/day of alcohol, but may occur in individuals who drink less, and is a major contributor to the global burden of liver cirrhosis. In addition to these liver diseases, there are a number of orphan liver diseases for which we may seek to develop DUR-928.

**Clinical Program.** In March 2019 we began enrolling patients in a Phase 1b randomized and open-label clinical study being conducted in the U.S. to evaluate safety, pharmacokinetics and signals of biological activity of DUR-928 in NASH patients with stage 1-3 fibrosis. DUR-928 (at doses of 50 mg QD, 150 mg QD and 300 mg BID) is administered orally for 28 consecutive days with approximately 20 patients per dose group for a total of approximately 60 patients in the trial as shown below. Key endpoints include safety and pharmacokinetics (PK), clinical chemistry and biomarkers (e.g., bilirubin, lipids, liver enzymes, CK-18s, and inflammatory cytokines) as well as liver fat content by imaging and liver stiffness. We are currently finalizing enrollment in this trial and expect all patients to complete their dosing and follow up visits in the first half of 2020. We plan to announce top line study results following completion of the trial.

### DUR-928 Phase 1b 28-Day Daily Oral Dosing Clinical Trial Schema



We have completed multiple Phase I trials in healthy subjects with orally administered DUR-928. These included single-ascending-dose and multiple-ascending-dose studies as well as a food effect study. In all of these studies DUR-928 was well-tolerated at all dose levels, with no serious treatment-related adverse events reported. Dose related increases in plasma concentrations were observed and no accumulation in plasma concentrations or food effects were observed with repeat dosing.

We also conducted a Phase 1b trial in cirrhotic and non-cirrhotic NASH patients and matched control subjects (MCS) (matched by age, body mass index and gender with normal liver function) utilizing orally administered DUR-928. This was an open-label, single-ascending-dose safety and PK study conducted in Australia in two successive dose cohorts (first a low dose of 50 mg and then a high dose of 200 mg). Both cohorts consisted of 10 NASH patients and 6 MCS. Data from this study was presented at the International Liver Congress™ 2017 organized by the European Association for the Study of the Liver (EASL) in Amsterdam on April 22, 2017. All patients and MCS in this study tolerated DUR-928 well. One patient (with a prior history of arrhythmia and an ongoing viral infection) in the high dose cohort experienced a serious adverse event (shortness of breath), which occurred without unusual biochemical changes and resolved without intervention but was considered possibly treatment related by the physician due to its temporal association with dosing. In both low and high dose cohorts, the PK parameters were comparable between the NASH patients and the MCS. In addition, the systemic exposure following the low and high doses of DUR-928 was dose dependent.

While this study was not designed to assess efficacy, we observed statistically significant reductions from baseline of several biomarkers after both doses of DUR-928. A single oral dose of DUR-928 significantly reduced the levels of both full-length and cleaved cytokeratin-18 (CK-18), bilirubin, hsCRP, and IL-18 in these subjects. The mean decrease of full-length CK-18 (a generalized cell death marker) at the measured time point of greatest effect (12 hours after dosing) was 33% in the low dose cohort and 41% in the high dose cohort. The mean decrease of cleaved CK-18 (a cell apoptosis marker) at the measured time point of greatest effect (12 hours after dosing) was 37% in the low dose cohort and 47% in the high dose cohort. The mean reduction of total bilirubin (a liver function marker) at the measured time point of greatest effect (12 hours after dosing) was 27% in the low dose cohort and 31% in the high dose cohort. The mean decrease of high sensitivity C-Reactive Protein (hsCRP) (a marker of inflammation) at the measured time point of greatest effect (24 hours after dosing) was 8% in the low dose cohort and 13% in the high dose cohort. The mean decrease of IL-18 (an inflammatory mediator) at the measured time point of greatest effect (8 hours after dosing) was 4% in the low dose cohort and 8% in the high dose cohort.

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

#### *Skin Inflammatory Disorder Program with Topical DUR-928*

*Clinical program.* Following an exploratory Phase 1b trial in psoriasis patients (9 evaluable patients) in Australia, we conducted a Phase 2a, randomized, double-blind, vehicle-controlled proof-of-concept clinical trial, in which DUR-928 was applied topically once-daily for 28 days in patients with mild to moderate plaque psoriasis. The trial was conducted at multiple clinical sites in the U.S., and twenty-two patients completed the study. Patients served as their own controls, applying DUR-928 to the plaque on one arm and the vehicle (placebo) to a similar plaque on the other arm. After the treatment period, patients were followed for an additional four weeks. The primary efficacy endpoint was change in local psoriasis severity index (LPSI) scores from baseline in the DUR-928-treated plaques compared to that in the vehicle-treated plaques. In January 2020, we announced that DUR-928 did not demonstrate a benefit over vehicle (placebo) based on Investigator's Global Assessment (IGA) or LPSI scores, or in any of the secondary analyses. However, at the end of the 4-week daily application period, plaques in both the DUR-928 and vehicle treatment groups were significantly improved over baseline with respect to both IGA and LPSI scores. In fact, 90% of plaques in both groups had at least a 1 point reduction in LPSI score after the 4-week daily application period. Daily topical application of DUR-928 was well tolerated with no meaningful differences in adverse events between the treatment and vehicle (placebo) groups. There were no AEs attributed to the study drug. Based on the top-line data, we do not plan to continue development of topical DUR-928 in psoriasis at this time and will focus our near term development activities on alcoholic hepatitis and NASH.

### Selected Programs

Product / Indication	Pre-Clinical	Clinical	NDA Filed / CRL	Approved	Commercial	Comments
POSIMIR® (Post-operative pain)	▶					NDA resubmission filed; 6-6 vote at FDA Advisory Committee meeting on January 16, 2020
Long-Acting SABER®-Based Investigational Product (HIV)	▶					Investigational product under development in collaboration with Gilead
PERSERIS™ (Schizophrenia)	▶					Indivior launched in Feb. 2019, projects \$200-\$300M peak year sales <sup>(1)</sup>
Methydur Sustained Release Capsules (ADHD)	▶					Approved in Taiwan. Expected launch in 2020 <sup>(1)</sup>

<sup>1</sup> DURECT to receive earn-outs on royalties based on net sales of Indivior and Orlen Pharma. For PERSERIS prescribing information, including BOXED WARNING and Medication Guide visit [www.perseris.com](http://www.perseris.com).

#### POSIMIR® (bupivacaine extended-release solution)

POSIMIR is our investigational post-operative pain relief depot product that utilizes our patented SABER® technology. POSIMIR is designed to be administered directly into the surgical site to deliver bupivacaine for up to three days after surgery, which we believe coincides with the time period of the greatest need for post-surgical pain control in most patients.

**Status.** In April 2013, we submitted an NDA as a 505(b)(2) application, which relied in part on the FDA’s findings of safety and effectiveness of a reference drug. In February 2014, we received a Complete Response Letter (CRL) from the FDA. Based on the CRL and subsequent communications with the FDA, we conducted a new Phase 3 clinical trial (the PERSIST trial) consisting of patients undergoing laparoscopic cholecystectomy (gallbladder removal) surgery to further evaluate the benefits and risks of POSIMIR. In October 2017, we reported that the PERSIST trial did not meet its primary efficacy endpoint. While results trended in favor of POSIMIR versus the comparator, they did not achieve statistical significance. After carefully reviewing the existing POSIMIR data and evaluating the feedback we had received from the FDA, including the CRL and other correspondence, we submitted a full response to the CRL to the FDA in June 2019 seeking FDA approval of POSIMIR. In October 2019, the FDA notified the Company that its resubmission for POSIMIR would be discussed at a meeting of the Anesthetic and Analgesic Drug Products Advisory Committee (AADPAC). The FDA had previously assigned a user fee goal date of December 27, 2019; a new user fee goal date has not been assigned. At the AADPAC meeting, six advisory committee members voted to recommend that the efficacy, safety, and overall risk-benefit profile of POSIMIR support approval, while six did not support approval based on the information presented. Although the FDA considers the recommendations of the AADPAC, the recommendations by the panel are non-binding. The final decision regarding pending regulatory actions for a product is made by the FDA. Since the Advisory Committee meeting, we have continued to interact with FDA as they continue their review.

In total, we have completed 16 clinical studies in the POSIMIR program, in seven different surgical procedures, including inguinal hernia repair, shoulder surgery (primarily subacromial decompression), appendectomy, abdominal hysterectomy, open laparotomy, laparoscopic cholecystectomy, and laparoscopic colectomy. The incision lengths treated ranged from a few centimeters for laparoscopic portals, to open laparotomy incisions of up to 35 cm. The seriousness of the surgery ranged from day surgery hernia repair in relatively healthy patients to major abdominal surgery for colon cancer in elderly patients with substantial co-morbidity who were often hospitalized for a week or more. The safety experience from this variety of procedures and patients was designed to allow for extrapolation of the safety and efficacy data to a broad surgical population. Our POSIMIR clinical development program has been devised to establish the safety and efficacy of POSIMIR for the treatment of post-surgical pain for up to 3 days. POSIMIR has not been approved by the FDA for marketing in the U.S. for any indication.

**Market Opportunity.** According to data published by the Center for Disease Control and Prevention, there are approximately 72 million ambulatory and inpatient surgical procedures performed annually in the U.S. Insufficient postoperative pain control remains a significant problem, with studies indicating that roughly 65% of patients experience moderate-to-extreme pain after surgery. The current standard of care for post-surgical pain includes a variety of opiate and non-opiate analgesics and muscle relaxants. While systemic opioids can effectively reduce post-surgical pain, they commonly cause side effects including drowsiness, constipation, nausea and vomiting, and cognitive impairment. Post-surgical pain also can be treated effectively with local anesthetics; however, their usefulness often is limited by their short duration of action.

#### ***Long-Acting SABER-Based Investigational Product (HIV)***

In July 2019, we entered into a license agreement with Gilead, pursuant to which we granted Gilead the exclusive worldwide rights to develop and commercialize a long-acting injectable HIV product utilizing DURECT's SABER technology. Gilead also received exclusive access to the SABER platform for HIV and Hepatitis B Virus (HBV) and the exclusive option to license additional SABER-based products directed to HIV and HBV.

Under the terms of the Gilead Agreement, Gilead made an upfront payment to us of \$25 million, with the potential for up to an additional \$75 million in development and regulatory milestones, up to an additional \$70 million in sales-based milestones, as well as tiered single-digit royalties on product sales for a defined period. Gilead has the exclusive option to license additional SABER-based products directed to HIV and HBV for an additional \$150 million per product in upfront, development, regulatory and sales-based milestones as well as tiered single-digit royalties on sales. In September 2019, the Company earned a \$10 million development milestone payment from Gilead which was received in October 2019. The Gilead Agreement contains customary representations, warranties and indemnification provisions. The term of the agreement is for the duration of Gilead's obligation to pay royalties for product sales, and the agreement provides each party with specified termination rights, including the right of Gilead to terminate at will with advance notice to us and of each party to terminate the agreement upon material breach by the other party.

We are performing specified development activities with Gilead funding certain portions of the development program. The lead formulation is currently being re-formulated and will undergo additional pre-clinical development work.

#### ***PERSERIS™(risperidone)***

In September 2017, we entered into an agreement with Indivior, under which we assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS, Indivior's extended-release injectable suspension for the treatment of schizophrenia in adults. In consideration for such assignment, Indivior made an upfront non-refundable payment to DURECT of \$12.5 million. Indivior also paid a \$5 million milestone payment to DURECT in August 2018 following the FDA approval of PERSERIS. Under the terms of the agreement with Indivior, DURECT receives quarterly earn-out payments that are based on a single digit percentage of U.S. net sales of PERSERIS into 2026.

Indivior commercially launched PERSERIS in the U.S. in February 2019. While Indivior has disclosed guidance for \$15 to \$25 million sales in 2020 for PERSERIS, there can be no assurance such revenues will be achieved.

#### ***ORADUR-ADHD Program***

In collaboration with Orient Pharma, we developed a drug candidate based on our ORADUR technology for the treatment of ADHD. This drug candidate is intended to provide once-a-day dosing 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, as amended, with Orient Pharma, 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 ER. We retain rights to North America, Europe and all other countries not specifically licensed to Orient Pharma.

In September 2018, Orient Pharma informed us that it had obtained marketing authorization for Methydur Sustained Release Capsules from the Ministry of Health and Welfare in Taiwan. Methydur Sustained Release Capsules are indicated for the treatment of ADHD and will be available in three strengths (22 mg, 33 mg and 44 mg) in Taiwan. Orient Pharma also has stated that it expects to make Methydur Sustained Release Capsules commercially available in Taiwan in 2020, while seeking a partner in China and pursuing regulatory approvals in selected other countries in Southeast Asia where it has commercialization rights and a commercialization presence. We will receive a single digit royalty on sales of Methydur Sustained Release Capsules by Orient Pharma and retain rights to this product in markets not specifically licensed to Orient Pharma.

### **Drug Delivery Technologies and Programs**

Our drug delivery technologies are designed to deliver the right drug to the right place, in the right amount and at the right time to treat a variety of chronic, acute and episodic diseases and conditions. We aim to improve therapy for a given disease or patient population by controlling the rate and duration of drug administration. In addition, if advantageous for the therapy, our technologies can target the delivery of the drug to its intended site of action.

Our technologies are suitable for providing long-term drug therapy because they can often store highly concentrated, stabilized drugs in a small volume and protect the drug from degradation by the body. This, in combination with the ability to continuously deliver desired doses of a drug, can extend the therapeutic value of a wide variety of drugs, including, in some cases, those which would otherwise be ineffective, too unstable, too potent or cause adverse side effects. In some cases, delivering the drug directly to the intended site of action can improve efficacy while minimizing unwanted side effects elsewhere in the body, which often limit the long-term use of many drugs. Our pharmaceutical systems may thus provide better therapy for chronic diseases or conditions, or for certain acute conditions where longer drug dosing is required or advantageous, by replacing multiple injection therapy or oral dosing, improving drug efficacy, reducing side effects and ensuring dosing compliance. Our technology may thereby improve patients' quality of life by eliminating more repetitive treatments, reducing dependence on caregivers and allowing patients to lead more independent lives.

We currently have several major active drug delivery technology platforms:

#### *The SABER and CLOUD Bioerodible Injectable Depot Systems*

Our bioerodible injectable depot systems include our SABER and CLOUD platform technologies. SABER uses a high viscosity base component, such as sucrose acetate isobutyrate (SAIB), to provide controlled release of a drug. When the high viscosity SAIB is formulated with drug, biocompatible excipients and other additives, the resulting formulation is easily injectable with standard syringes and needles. After injection of a SABER formulation, the excipients diffuse away over time, leaving a viscous depot which provides controlled sustained release of drug. CLOUD is a class of bioerodible injectable depot technology which generally does not contain SAIB but includes various other release rate modifying excipients and/or bioerodible polymers to achieve the delivery of drugs for periods of days to months from a single injection.

The SABER technology is the basis of POSIMIR (described above). The SABER technology is also utilized in our long-acting HIV program with Gilead and our ophthalmic program with Santen Pharmaceutical Co., Ltd. (Santen), as well as in feasibility programs.

The SABER technology is also the basis for SucroMate™ Equine, an injectable animal health drug utilizing our SABER technology to deliver the peptide deslorelin. This was the first FDA approved SABER injectable product when it was launched in 2011 by CreoSalus, Inc.

#### *The ORADUR Sustained Release Gel Cap Technology*

We believe that our ORADUR sustained release technology can transform short-acting oral capsule dosage forms into sustained release oral products. Products based on our ORADUR technology can take the form of an easy to swallow capsule that uses a high-viscosity base component such as sucrose acetate isobutyrate (SAIB) to provide controlled release of active ingredients for an extended period of time. Oral dosage forms based on the ORADUR gel-cap may also have the added benefit of being less prone to abuse (e.g., by crushing and then snorting, smoking, injecting or extracting by mixing with alcohol or water). These properties have the potential to make ORADUR-based products an attractive option for pharmaceutical companies that seek to develop abuse-deterrent oral products.

The ORADUR technology is the basis of our ORADUR-Methylphenidate ER program (described above).

## **DURECT Strategy**

Our objective is to develop multiple pharmaceutical products that address significant unmet medical needs and improve patients' quality of life. To achieve this objective, our strategy includes the following key elements:

*Focus on Areas with the Potential for Significant Value Creation.* We view patients, physicians, the healthcare system, payers, and strategic partners, as all being important stakeholders in our company. We believe that developing the products in our pipeline, which may address significant unmet medical needs and may create value for our stakeholders, also has the potential to create value for our shareholders.

*Apply our Drug Development Expertise to New Chemical Entities Derived from our Epigenetic Regulator Program.* We have assembled a core team of employees with considerable experience in drug development, and it is our intent to leverage their capabilities by developing pharmaceuticals derived from our Epigenetic Regulator Program. We believe that these new chemical entities may have utility in acute organ injuries such as AH and AKI, in various orphan diseases, and for several metabolic diseases such as NASH, NAFLD and other liver conditions. We believe that these product candidates may be of interest to other pharmaceutical companies and that it may be possible to license the rights to certain products, formulations, indications or territories from this program while retaining the rights to other product candidates, formulations, indications or territories for either our own development and commercialization or for licensing at a later stage of development.

*Focus on Certain Acute Indications, Chronic Debilitating Medical Conditions and Certain Local Pain Conditions.* Many of the diseases and disorders that present great challenges to medicine include acute organ injury, metabolic disorders, pain management, CNS disorders, cardiovascular disease, ophthalmic conditions and other chronic diseases. Our current efforts focus on exploiting our Epigenetic Regulator Program through which we have identified new chemical entities that may have utility in conditions such as acute organ injuries and chronic metabolic/lipid disorders and on using our versatile drug delivery platform technologies to develop products that improve current treatment options.

*Diversify Risk by Pursuing Multiple Programs in Development.* In order to reduce the risks inherent in pharmaceutical product development, we have diversified our product pipeline such that, between our own programs and those where we have collaborated, we have multiple programs with the potential to generate significant value. We believe that having multiple programs in development helps mitigate the negative consequences to us of any setbacks or delays in any one of our programs.

*Enable Product Development Through Strategic Agreements.* We believe that entering into selective strategic collaborations and other arrangements with respect to our product development programs and technology can enhance the success of our product development and commercialization, leverage the value of our intellectual property portfolio, mitigate our risk and enable us to better manage our operating costs. Additionally, such collaborations and arrangements enable us to leverage investment by third parties and reduce our net cash burn, while retaining significant economic rights.

*Build Our Own Commercial Organization.* In the future, we may elect to build our own commercial, sales and marketing capability in order to capture more of the economic value of certain products that we may develop. If we choose to enter into third-party collaborations to commercialize our pharmaceutical product candidates, we may in the future enter into these alliances under circumstances that allow us to participate in the sales and marketing of these products.

## **Strategic Agreements**

We have entered into the following strategic collaboration and other key agreements:

*Virginia Commonwealth University Intellectual Property Foundation.* We have entered into an exclusive in-license and research and development agreement with the Virginia Commonwealth University Intellectual Property Foundation regarding the new chemical entities under development through our Epigenetic Regulator Program, including DUR-928. Under this licensing arrangement, we have agreed to undertake certain efforts to bring licensed products to market, pay for prosecution of related patents and report on progress to VCU. In addition, we are obligated to pay low single-digit percentage patent royalties on net sales of licensed products, subject to annual minimum payments and additional milestone payments. This license includes rights to seven patent families. We may terminate this agreement at any time by written notice, and VCU may terminate this agreement by written notice if there is an uncured material breach.

*Gilead Sciences, Inc.* In July 2019, we entered into a license agreement (the “Gilead Agreement”) with Gilead Sciences, Inc. (“Gilead”). Pursuant to the Gilead Agreement, we granted Gilead the exclusive worldwide rights to develop and commercialize a long-acting injectable HIV product utilizing our SABER® technology. Gilead also received exclusive access to the SABER platform for HIV and Hepatitis B Virus (HBV) and the exclusive option to license additional SABER-based products directed to HIV and HBV.

Under the terms of the Gilead Agreement, Gilead made an upfront payment to us of \$25 million, with the potential for up to an additional \$75 million in development and regulatory milestones, up to an additional \$70 million in sales-based milestones, as well as tiered single-digit royalties on product sales for a defined period. Gilead has the exclusive option to license additional SABER-based products directed to HIV and HBV for up to an additional \$150 million per product in upfront, development, regulatory and sales-based milestones as well as tiered single-digit royalties on sales. In September 2019, we earned a \$10 million development milestone payment from Gilead; this payment was received in October 2019. The Gilead Agreement contains customary representations, warranties and indemnification provisions. The term of the Gilead Agreement is for the duration of Gilead’s obligation to pay royalties for product sales under the Gilead Agreement. The Gilead Agreement provides each party with specified termination rights, including the right of Gilead to terminate at will with advance notice to us and each party to terminate the Gilead Agreement upon material breach of the Gilead Agreement by the other party.

We are performing specified development activities with Gilead funding certain portions of the development program. The lead formulation is currently being re-formulated and will undergo additional pre-clinical development work.

*Indivior UK Ltd.* In September 2017, we entered into a patent purchase agreement (the “Indivior Agreement”) with Indivior. Pursuant to the Indivior Agreement, we assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS, Indivior’s once-monthly injectable risperidone product for the treatment of schizophrenia. In consideration for such assignment, Indivior made an upfront non-refundable payment to us of \$12.5 million, and also agreed to make an additional \$5 million payment to us contingent upon FDA approval of PERSERIS, as well as quarterly earn-out payments based on a single digit percentage of U.S. net sales for certain products covered by the assigned patent rights, including PERSERIS. The assigned patent rights include granted patents extending into at least 2026. We also receive a non-exclusive right under the assigned patents to develop and commercialize certain risperidone-containing products and products that do not contain risperidone or buprenorphine. The agreement contains customary representations, warranties and indemnities of the parties. We received the non-refundable payment of \$12.5 million from Indivior in September 2017 and recognized this amount as revenue from sale of intellectual property rights in the year ended December 31, 2017 as we did not have any continuing obligations under the purchase agreement. In July 2018, Indivior announced that the FDA had approved the NDA for PERSERIS thereby triggering the \$5.0 million payment, which was received by DURECT in August 2018. Indivior launched PERSERIS in the U.S. in February 2019.

*Santen Pharmaceutical Co., Ltd.* In December 2014, we and Santen entered into a definitive agreement (the “Santen Agreement”). Pursuant to the Santen Agreement, we have granted Santen an exclusive worldwide license to our proprietary SABER formulation platform and other intellectual property to develop and commercialize a sustained release product utilizing our SABER technology to deliver an ophthalmology drug. Santen controls and funds 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 Agreement.

In connection with the license agreement, Santen paid us a non-refundable upfront fee of \$2.0 million in cash and agreed to make contingent cash payments to us of up to \$76.0 million upon the achievement of certain milestones, of which \$13.0 million are development-based milestones (none of which has been achieved as of December 31, 2019), 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 December 31, 2019). Santen will also pay for certain of our costs incurred in the development of the licensed product. If the product is commercialized, we 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 Agreement without cause at any time upon prior written notice, and either party may terminate the Agreement upon certain circumstances including a material uncured breach. As of December 31, 2019, the cumulative aggregate payments received by us under this agreement were \$3.3 million. In January 2018, we were notified by Santen that due to a shift in near term priorities, Santen has elected to reallocate research and development resources and put our program on pause until further notice. While the main program is on pause, the parties are working together on a limited set of research and development activities funded by Santen.

*Sandoz AG.* In May 2017, the Company and Sandoz AG (“Sandoz”) entered into a license agreement to develop and market POSIMIR in the United States. POSIMIR is the Company’s investigational post-operative pain relief depot that utilizes the Company’s patented SABER technology to deliver bupivacaine to provide up to three days of pain relief after surgery. Under terms of the agreement, Sandoz made an upfront payment of \$20 million and the Company was eligible for additional milestone and royalty payments. In May 2018, the Company and Sandoz entered into an amendment to the license agreement, under which, among other things, both parties’ termination provisions were modified. In January 2019, Sandoz AG provided notice that it was returning to DURECT all of its U.S. development and commercialization rights to POSIMIR. The parties are in dispute with regard to Sandoz’s obligation to pay a termination fee to DURECT. DURECT has initiated a formal dispute resolution process related to the termination fee.

## **Commercial Product Lines**

### *ALZET*

The ALZET product line consists of miniature, implantable osmotic pumps and accessories used for research in mice, rats and other laboratory animals. These pumps are neither approved nor intended for human use. ALZET pumps continuously deliver drugs, hormones and other test agents at controlled rates from one day to six weeks without the need for external connections, frequent handling or repeated dosing. In laboratory research, these infusion pumps can be used for systemic administration when implanted under the skin or in the body. They can be attached to a catheter for intravenous, intracerebral, or intra-arterial infusion or for targeted delivery, where the effects of a drug or test agent are localized in a particular tissue or organ. The wide use and applications of the ALZET product line is evidenced by the more than 19,000 scientific references that now exist.

### *LACTEL Absorbable Polymers*

We currently design, develop and manufacture a wide range of standard and custom biodegradable polymers based on lactide, glycolide and caprolactone under the LACTEL brand for pharmaceutical and medical device clients for use as raw materials in their products. These materials are manufactured and sold by us directly from our facility in Alabama and are used by us and our third-party customers for a variety of controlled-release and medical-device applications, including several FDA-approved commercial products.

## **Marketing and Sales**

Historically, we have established strategic distribution and marketing alliances for our product candidates to leverage the established sales organizations that certain pharmaceutical companies have in markets we are targeting. In the future, we may elect to build our own commercial, sales and marketing capability in order to capture more of the economic value of certain products that we may develop. If we choose to enter into third-party collaborations to commercialize our pharmaceutical product candidates, we may in the future enter into these alliances under circumstances that allow us to participate in the sales and marketing of these products. We will continue to pursue strategic alliances and collaborators from time to time consistent with our strategy to leverage the established sales organizations of third-party collaborators.

We market and sell our ALZET and LACTEL product lines through a direct sales force in the U.S. and through a network of distributors outside of the U.S.

## **Suppliers**

As needed, we purchase sucrose acetate isobutyrate, a raw material for our ORADUR and SABER-based pharmaceutical systems, including Methydrur Sustained Release Capsules, POSIMIR, and SucroMate, from Eastman Chemical Company. We expect that we will continue to be able to obtain sufficient supply of these raw materials to meet our needs for the foreseeable future. We do not have in place long term supply agreements with respect to all of the components of any of our pharmaceutical product candidates, however, and are subject to the risk that we may not be able to procure all required components in adequate quantities with acceptable quality, within acceptable time frames or at reasonable cost.

## **Customers**

Our product revenues principally are derived from sales of the ALZET product line to academic and pharmaceutical industry researchers, the LACTEL product lines to pharmaceutical and medical device customers, and from the sale of certain key excipients that are included in Methydrur Sustained Release Capsules, SucroMate and other products. Until such time that we are able to bring our pharmaceutical product candidates to market, if at all, we expect these to be our principal sources of product revenue. We also receive revenue from collaborative research and development arrangements with our third-party collaborators. In 2019, Gilead accounted for 58% of the Company’s total revenue. In 2018, Indivior and Gilead accounted for 27% and 14% of our total revenues, respectively. In 2017, Sandoz and Indivior accounted for 41% and 25% of our total revenues, respectively.



## **Manufacturing**

The process for manufacturing our pharmaceutical product candidates is technically complex, requires special skills, and must be performed in qualified facilities. We have entered into development and commercial manufacturing agreements with third parties for the manufacture of DUR-928 and POSIMIR. In addition, we have a small multi-discipline manufacturing facility in California that we have used to manufacture research and clinical supplies of several of our pharmaceutical product candidates under GMP, including DUR-928 and POSIMIR. In the future, we may develop additional manufacturing capabilities for our pharmaceutical 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 current facilities in California and/or Alabama. We manufacture our ALZET product line and certain key components for POSIMIR and Methydrur at one of our California facilities and our LACTEL product line at our Alabama facility.

## **Patents and Proprietary Rights**

Our success depends in part on our ability to obtain patents, to protect trade secrets, to operate without infringing upon the proprietary rights of others and to prevent others from infringing on our proprietary rights. Our policy is to seek to protect our proprietary position by, among other methods, filing U.S. and foreign patent applications related to our proprietary molecules and technology, inventions and improvements that are important to the development of our business. As of February 28, 2020, we owned or exclusively in-licensed over 40 unexpired issued U.S. patents and over 185 unexpired issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have over 40 pending U.S. patent applications and over 145 foreign applications pending in Europe, Australia, Japan, Canada and other countries.

Proprietary rights relating to our planned and potential products will be protected from unauthorized use by third parties only to the extent that they are covered by valid and enforceable patents or are effectively maintained as trade secrets. Patents owned by or licensed to us may not afford protection against competitors, and our pending patent applications now or hereafter filed by or licensed to us may not result in patents being issued. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as do the laws of the U.S.

The patent positions of biopharmaceutical companies involve complex legal and factual questions and, therefore, their enforceability cannot be predicted with certainty. Our patents or patent applications, or those licensed to us, if issued, may be challenged, invalidated or circumvented, and the rights granted thereunder may not provide proprietary protection or competitive advantages to us against competitors with similar technology. Furthermore, our competitors may independently develop similar technologies or duplicate any technology developed by us. Because of the extensive time required for development, testing and regulatory review of a potential product, it is possible that, before any of our products can be commercialized, any related patent may expire or remain in existence for only a short period following commercialization, thus reducing any advantage of the patent, which could adversely affect our ability to protect future product development and, consequently, our operating results and financial position.

Because patent applications in the U.S. are typically maintained in secrecy for at least 18 months after filing and since publication of discoveries in the scientific or patent literature often lag behind actual discoveries, we cannot be certain that we were the first to make the inventions covered by each of our issued or pending patent applications or that we were the first to file for protection of inventions set forth in such patent applications.

Our planned or potential products may be covered by third-party patents or other intellectual property rights, in which case we would need to obtain a license to continue developing or marketing these products. Any required licenses may not be available to us on acceptable terms, if at all. If we do not obtain any required licenses, we could encounter delays in product introductions while we attempt to design around these patents, or could find that the development, manufacture or sale of products requiring such licenses is foreclosed. Litigation may be necessary to defend against or assert such claims of infringement, to enforce patents issued to us, to protect trade secrets or know-how owned by us, or to determine the scope and validity of the proprietary rights of others. In addition, interference, derivation, post-grant oppositions, and similar proceedings may be necessary to determine rights to inventions in our patents and patent applications. Litigation or similar proceedings could result in substantial costs to and diversion of effort by us, and could have a material adverse effect on our business, financial condition and results of operations. These efforts by us may not be successful.

We may rely, in certain circumstances, on trade secrets to protect our technology. However, trade secrets are difficult to protect. We seek to protect our proprietary technology and processes, in part, by confidentiality agreements with our employees and certain contractors. There can be no assurance that these agreements will not be breached, that we will have adequate remedies for any breach, or that our trade secrets will not otherwise become known or be independently discovered by competitors. To the extent that our employees, consultants or contractors use intellectual property owned by others in their work for us, disputes may also arise as to the rights in related or resulting know-how and inventions.

## Government Regulation

*The Food and Drug Administration.* The FDA and comparable regulatory agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the development, manufacture and marketing of pharmaceutical products. These agencies and other federal, state and local entities regulate research and development activities and the testing, manufacture, quality control, safety, effectiveness, labeling, storage, distribution, record keeping, approval, advertising and promotion of our products. We believe that our products in development will be regulated as drugs by the FDA rather than as biologics or devices.

The process required by the FDA under the new drug provisions of the Federal Food, Drug and Cosmetics Act (the Act) before our products in development may be marketed in the U.S. generally involves the following:

- preclinical laboratory and animal tests;
- submission of an Investigational New Drug (IND) application which must become effective before clinical trials may begin;
- adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed pharmaceutical products candidates in their intended uses; and
- FDA approval of a new drug application.

Section 505 of the Act describes three types of new drug applications: (1) an application that contains full reports of investigations of safety and effectiveness (section 505(b)(1)); (2) an application that contains full reports of investigations of safety and effectiveness but where at least some of the information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference (section 505(b)(2)); and (3) an application that contains information to show that the proposed product is identical in active ingredient, dosage form, strength, route of administration, labeling, quality, performance characteristics and intended use, among other things, to a previously approved product (section 505(j)). We expect that most of the Drug Delivery Program product candidates will be evaluated for approval after submission of a new drug application under section 505(b)(2) and that our drug candidates deriving from our Epigenetic Regulator Program will be evaluated for approval after submission of a new drug application under section 505(b)(1).

The testing and approval process require substantial time, effort, and financial resources, and we cannot be certain that any approval will be granted on a timely basis, if at all. Even though several of our pharmaceutical products candidates utilize active drug ingredients that are commercially marketed in the United States in other dosage forms, we need to establish safety and effectiveness of those active ingredients in the formulation and dosage forms that we are developing.

Preclinical tests include laboratory evaluation of the product, its chemistry, formulation and stability, as well as animal studies to assess the potential safety and efficacy of the pharmaceutical product candidate. We then submit the results of the preclinical tests, together with manufacturing information and analytical data, to the FDA as part of an IND, which must become effective before we may begin human clinical trials. Each subsequent new clinical protocol must also be submitted to the FDA under the IND. An IND automatically becomes effective 30 days after receipt by the FDA, unless the FDA, within the 30-day time period, raises concerns or questions about the conduct of the trials as outlined in the IND and imposes a clinical hold. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before clinical trials can begin. Our submission of an IND may not result in FDA authorization to commence clinical trials. Further, an independent Institutional Review Board at each medical center proposing to conduct the clinical trials must review and approve any clinical study as well as the related informed consent forms and authorization forms that permit us to use individually identifiable health information of study participants.

Human clinical trials are typically conducted in three sequential phases which may overlap:

- Phase 1: The drug is initially introduced into healthy human subjects or patients and tested for safety, dosage tolerance, absorption, metabolism, distribution and excretion.
- Phase 2: Involves clinical trials in a limited patient population to identify possible adverse effects and safety risks, to determine the efficacy of the product for specific targeted diseases and to determine dosage tolerance and optimal dosage.
- Phase 3: When Phase 2 clinical trials demonstrate that a dosage range of the product is effective and has an acceptable safety profile, Phase 3 clinical trials are undertaken to further evaluate dosage, clinical efficacy and to further test for safety in an expanded patient population, at multiple, geographically dispersed clinical study sites.

In the case of products for severe diseases, such as chronic pain, or life-threatening diseases such as cancer, the initial human testing is often conducted in patients with disease rather than in healthy volunteers. Since these patients already have the target disease or condition, these studies may provide initial evidence of efficacy traditionally obtained in Phase 2 trials, and thus these trials are frequently referred to as Phase 1/2 clinical trials or Phase 1b trials. We cannot be certain that we will successfully complete Phase 1, Phase 2 or Phase 3 clinical trials of our pharmaceutical products in development within any specific time period, if at all. Furthermore, the FDA or the Institutional Review Board or the sponsor may suspend clinical trials at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk. During the clinical development of products, sponsors frequently meet and consult with the FDA in order to ensure that the design of their studies will likely provide data both sufficient and relevant for later regulatory review; however, no assurance of approvability can be given by the FDA.

The results of product development, preclinical studies and clinical studies are submitted to the FDA as part of a new drug application, or NDA, for approval of the marketing and commercial shipment of the product. Submission of an NDA may require the payment of a substantial user fee to the FDA, and although the agency has defined user fee goals for the time in which to respond to sponsor applications, there can be no assurance that the FDA will act in any particular timeframe. The FDA may deny a new drug application if the applicable regulatory criteria are not satisfied or may require additional clinical trials be conducted. Even if such data is submitted, the FDA may ultimately decide that the new drug application does not satisfy the criteria for approval. Once issued, the FDA may withdraw product approval if compliance with regulatory standards is not maintained or if safety problems occur after the product reaches the market. Requirements for additional Phase 4 studies (post approval marketing studies) to confirm safety and effectiveness in a broader commercial use population may be imposed as a condition of marketing approval. In addition, the FDA requires surveillance programs to monitor approved products which have been commercialized, and the agency has the power to require changes in labeling or to prevent further marketing of a product based on the results of these post-marketing programs. Any comparative claims comparing a product to other dosage forms or competitive products typically need to be supported by two adequate and well-controlled head-to-head clinical trials.

Satisfaction of FDA requirements or similar requirements of state, local and foreign regulatory agencies typically takes several years and the actual time required may vary substantially, based upon the type, complexity and novelty of the pharmaceutical product. Government regulation may delay or prevent marketing of potential products for a considerable period of time and impose costly procedures upon our activities. We cannot be certain that the FDA or any other regulatory agency will grant approval for any of our pharmaceutical products under development on a timely basis, if at all. Success in preclinical or early stage clinical trials does not assure success in later stage clinical trials. Data obtained from preclinical and clinical activities is not always conclusive and may be susceptible to varying interpretations which could delay, limit or prevent regulatory approval. Evolving safety concerns can result in the imposition of new requirements for expensive and time-consuming tests, such as for QT interval cardiotoxicity testing. Even if a product receives regulatory approval, the approval may be significantly limited to specific indications. Further, even after regulatory approval is obtained, any problems associated with a product may result in restrictions on the product or even complete withdrawal of the product from the market. Any pharmaceutical products that we may develop and obtain approval for would also be subject to adverse findings of the active drug ingredients being marketed in different dosage forms and formulations. Delays in obtaining, or failures to obtain regulatory approvals would have a material adverse effect on our business. Marketing our pharmaceutical products abroad will require similar regulatory approvals and is subject to similar risks. In addition, we cannot predict what adverse governmental regulations may arise from future U.S. or foreign governmental action.

Any pharmaceutical products manufactured or distributed by us pursuant to FDA approvals are subject to pervasive and continuing regulation by the FDA, including record-keeping requirements and reporting of adverse experiences with the product or the active pharmaceutical ingredient or other components of the product. Drug manufacturers and their subcontractors are required to register their establishments with the FDA and state agencies, and are subject to periodic unannounced inspections by the FDA and state agencies for compliance with good manufacturing practices, which impose procedural and documentation requirements upon us and our third party manufacturers. We cannot be certain that we or our present or future suppliers will be able to comply with the GMP regulations and other FDA regulatory requirements.

The Federal Food, Drug, and Cosmetic Act strictly regulates drug product marketing, prohibits manufacturers from marketing drug products for off-label use and regulates the distribution of drug samples. The FDA has actively enforced regulations prohibiting the marketing of products for unapproved uses, and federal and state authorities are also actively litigating against sponsors who promote their drugs for unapproved uses under various fraud and abuse and false claims act statutes. We and our products are also subject to a variety of state laws and regulations in those states or localities where our products are or will be marketed. Any applicable state or local regulations may hinder our ability to market our products in those states or localities. We are also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control, and disposal of hazardous or potentially hazardous substances. We may incur significant costs to comply with such laws and regulations now or in the future.

The FDA's policies may change and additional government regulations may be enacted which could prevent or delay regulatory approval of our product candidates. Moreover, increased attention to the containment of health care costs in the U.S. and in foreign markets could result in new government regulations that could have a material adverse effect on our business. We cannot predict the likelihood, nature or extent of adverse governmental regulation that might arise from future legislative or administrative action, either in the U.S. or abroad. *The Drug Enforcement Administration.* The Drug Enforcement Administration (DEA) regulates chemical compounds as Schedule I, II, III, IV or V substances, with Schedule I substances considered to present the highest risk of substance abuse and Schedule V substances the lowest risk. Certain active ingredients in ORADUR-Methylphenidate are listed by the DEA as Schedule II under the Controlled Substances Act of 1970. Consequently, their manufacture, research, shipment, storage, sale and use are subject to a high degree of oversight and regulation. For example, all Schedule II drug prescriptions must be signed by a physician, physically presented to a pharmacist and may not be refilled without a new prescription. Furthermore, the amount of Schedule II substances we can obtain for clinical trials and commercial distribution is limited by the DEA and our quota may not be sufficient to complete clinical trials or meet commercial demand. There is a risk that DEA regulations may interfere with the supply of the drugs used in our clinical trials, and, in the future, our ability to produce and distribute our products in the volume needed to meet commercial demand, which could negatively impact us and our collaborators.

*Other Healthcare Laws.* In addition to FDA and DEA restrictions on the marketing of pharmaceutical products, other foreign, federal and state healthcare regulatory laws restrict business practices in the pharmaceutical industry. These laws include, but are not limited to, federal and state anti-kickback, false claims, data privacy and security, and physician payment and drug pricing transparency laws.

The U.S. federal Anti-Kickback Statute prohibits, among other things, any person or entity from knowingly and willfully offering, paying, soliciting, receiving or providing any remuneration, directly or indirectly, overtly or covertly, to induce or in return for purchasing, leasing, ordering, or arranging for or recommending the purchase, lease, or order of any good, facility, item or service reimbursable, in whole or in part, under Medicare, Medicaid or other federal healthcare programs. The term "remuneration" has been broadly interpreted to include anything of value. The Anti-Kickback Statute has been interpreted to apply to arrangements between pharmaceutical and medical device manufacturers on the one hand and prescribers, purchasers, formulary managers and beneficiaries on the other hand. Although there are a number of statutory exceptions and regulatory safe harbors protecting some common activities from prosecution, the exceptions and safe harbors are drawn narrowly. Practices that involve remuneration that may be alleged to be intended to induce prescribing, purchases, or recommendations may be subject to scrutiny if they do not meet the requirements of a statutory or regulatory exception or safe harbor. Failure to meet all of the requirements of a particular applicable statutory exception or regulatory safe harbor does not make the conduct per se illegal under the U.S. federal Anti-Kickback Statute. Instead, the legality of the arrangement will be evaluated on a case-by-case basis based on a cumulative review of all its facts and circumstances. Several courts have interpreted the statute's intent requirement to mean that if any one purpose of an arrangement involving remuneration is to induce referrals of federal healthcare covered business, the statute has been violated. In addition,

a person or entity does not need to have actual knowledge of the statute or specific intent to violate it in order to have committed a violation. Moreover, a claim including items or services resulting from a violation of the U.S. federal Anti-Kickback Statute constitutes a false or fraudulent claim for purposes of the federal civil False Claims Act. The majority of states also have anti-kickback laws, which establish similar prohibitions and in some cases may apply to items or services reimbursed by any third-party payor, including commercial insurers.

In addition, there has been a recent trend of increased federal and state regulation of payments made to physicians and certain other healthcare providers. The Affordable Care Act imposed, among other things, new annual reporting requirements through the Physician Payments Sunshine Act for covered manufacturers for certain payments and “transfers of value” provided to physicians and teaching hospitals, as well as ownership and investment interests held by physicians and their immediate family members. Failure to submit timely, accurately and completely the required information for all payments, transfers of value and ownership or investment interests may result in civil monetary penalties. Covered manufacturers must submit reports by the 90th day of each subsequent calendar year and the reported information is publicly made available on a searchable website. In addition, certain states require implementation of compliance programs and compliance with the pharmaceutical industry’s voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government, impose restrictions on marketing practices and/or require the tracking and reporting of marketing expenditures and pricing information as well as gifts, compensation and other remuneration or items of value provided to physicians and other healthcare professionals and entities. Finally, the Physician Self-Referral (Stark) Law prohibits physicians from referring Medicare or Medicaid patients to providers of “designated health services” with whom the physician or a member of the physician’s immediate family has an ownership interest or compensation arrangement, unless a statutory or regulatory exception applies.

## **Competition**

We may face competition from other companies in numerous industries including pharmaceuticals, medical devices and drug delivery.

Competition for DUR-928, if approved, will depend on the specific indications for which DUR-928 is approved. Intercept, Gilead, Shire, Conatus Pharmaceuticals, Galectin Therapeutics, Genfit, Pfizer, Roche, Bristol Myers Squibb, Novartis, Terns Pharmaceuticals, Galmed Pharmaceuticals, Enanta Pharmaceuticals, Novo Nordisk, Takeda, Vital Therapies, Allergan, Akarna Therapeutics, Inventiva Pharma, Genkyotex, VBL Therapeutics, NGM Biopharmaceuticals, Gemphire Therapeutics, Albireo Pharma, CymaBay Therapeutics, Madrigal Pharmaceuticals, Viking Therapeutics, CohBar, FALK Pharma, Acorda, Akero, Generon, and others have development plans for products to treat NAFLD/NASH, AH or other liver diseases. AbbVie, Ischemix, Thrasos Therapeutics, AM-Pharma, Complexa, Quark Pharmaceuticals and others have development plans for products to treat acute kidney injury. Numerous companies are applying significant resources and expertise to the problems of drug delivery and several of these are focusing or may focus on delivery of drugs to the intended site of action, including Pacira, Heron Therapeutics, Alkermes, Immune Pharmaceuticals, Innocoll, Nektar, Kimberly-Clark, Acorda Therapeutics, Flamel, Alexza, Mallinckrodt, Hospira, Pfizer, Cumberland Pharmaceuticals, Zyla Life Sciences, Acura, Elite Pharmaceuticals, Phosphagenics, Intellipharmaeutics, Collegium Pharmaceutical, Charleston Laboratories, Daiichi Sankyo and others. Some of these competitors may be addressing the same therapeutic areas or indications as we are. Our current and potential competitors may succeed in obtaining patent protection or commercializing products before us. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. Acquisitions of, or investments in, competing pharmaceutical or biotechnology companies by large corporations could increase such competitors’ financial, marketing, manufacturing and other resources.

POSIMIR, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, implantable and external infusion pumps which can be used for infusion of opioids and local anesthetics. Products of these types are marketed by Pacira, Purdue Pharma, AbbVie, Janssen, Actavis, Medtronic, Endo, AstraZeneca, Pernix Therapeutics, Tricumed, Halyard Health, Cumberland Pharmaceuticals, Acorda Therapeutics, Mallinckrodt, Inspirion Delivery Technologies, Mylan, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis, Zyla Life Sciences, Teva Pharmaceuticals, Collegium Pharmaceutical and others. Additional competition for POSIMIR may come from Heron Therapeutics if their product, HTX-011, is approved. PERSERIS competes with currently marketed or approved products by Johnson & Johnson, Eli Lilly, Otsuka, Alkermes, Merck, Allergan, Novartis, and others. Our ORADUR-ADHD product candidates, if approved, will compete with currently marketed or approved products by Shire, Johnson & Johnson, UCB, Novartis, Noven, Eli Lilly, Pfizer and others.

Competition for our ALZET product line primarily consists of customers choosing to utilize delivery methods for their research projects other than an osmotic pump. Competition for our LACTEL product line comes from companies including Evonik, Corbion, FUJIFILM Wako Pure Chemical Corporation, PCAS and others. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. We may also face competition for our ALZET and LACTEL product lines from other companies including low cost foreign competitors.

Any pharmaceutical products we develop will compete in highly competitive markets. Many of our potential competitors in these markets have greater development, financial, manufacturing, marketing, and sales resources than we do and we cannot be certain that they will not succeed in developing products or technologies which will render our technologies and products obsolete or noncompetitive. In addition, many of those potential competitors have significantly greater experience than we do in their respective fields.

#### **Corporate History, Headquarters and Website Information**

We were incorporated in Delaware in February 1998. Our principal executive offices are located at 10260 Bubb Road, Cupertino, California 95014. Our telephone number is (408) 777-1417, and our website address is [www.durect.com](http://www.durect.com). We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports available free of charge on our website as soon as reasonably practicable after we file these reports with the Securities and Exchange Commission (SEC). The SEC maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The SEC's website to access all of this information is [www.sec.gov](http://www.sec.gov). Our Code of Ethics can be found on our website.

#### **Employees**

As of February 28, 2020, we had 90 employees, including 44 in research and development, 21 in manufacturing and 25 in selling, general and administrative. From time to time, we also employ independent contractors to support our research, development and administrative organizations. None of our employees are represented by a collective bargaining unit, and we have never experienced a work stoppage. We consider our relations with our employees to be good.

#### **Executive Officers of the Registrant**

Our executive officers and their ages as of February 28, 2020 are as follows:

<b>Name</b>	<b>Age</b>	<b>Position</b>
James E. Brown, D.V.M.	63	President, Chief Executive Officer and Director
Michael H. Arenberg, J.D., M.B.A.	50	Chief Financial Officer
Judy R. Joice	63	Senior Vice President, Operations and Corporate Quality Assurance

James E. Brown, D.V.M. co-founded DURECT in February 1998 and has served as our President, Chief Executive Officer and a Director since June 1998. He previously worked at ALZA Corporation as Vice President of Biopharmaceutical and Implant Research and Development from June 1995 to June 1998. Prior to that, Dr. Brown held various positions at Syntex Corporation, a pharmaceutical company, including Director of Business Development from May 1994 to May 1995, Director of Joint Ventures for Discovery Research from April 1992 to May 1995, and held a number of positions including Program Director for Syntex Research and Development from October 1985 to March 1992. Dr. Brown holds a B.A. from San Jose State University and a D.V.M. (Doctor of Veterinary Medicine) from the University of California, Davis where he also conducted post-graduate work in pharmacology and toxicology.

Michael H. Arenberg was appointed Chief Financial Officer effective October 2018. Mr. Arenberg has been with DURECT since 1999, most recently serving as Senior Vice President, Corporate and Business Development, where he negotiated and closed over 50 collaborations, including several important in-licensing transactions. Mr. Arenberg earned his undergraduate degree from the University of Colorado, his law degree from the University of Denver, and his MBA from the Leavy School of Business at Santa Clara University.

Judy R. Joice has served as our Senior Vice President, Operations and Corporate Quality Assurance since March 2014 and as our Vice President, Operations and Corporate Quality Assurance since April 2011. Previously, Ms. Joice served as our Vice President, Corporate Quality Assurance since July 2008 and as our Executive Director, Quality Assurance from July 2007 to July 2008. She has over 25 years' experience in the pharmaceutical industry with such companies as Nektar Therapeutics, Oread, Roche Pharmaceuticals, and Syntex Research. During her career, Ms. Joice has gained broad experience in CMC development activities including novel excipients, new chemical entities, devices, and combination products. She has developed, implemented and managed all aspects of company-wide quality systems and compliance functions, ranging from drug development through commercial manufacturing. Ms. Joice has a B.S. in Chemistry from California State University, Hayward.

**Item 1A. Risk Factors.**

In addition to the other information in this Form 10-K, a number of factors may affect our business and prospects. These factors include but are not limited to the following, which you should consider carefully in evaluating our business and prospects. If any of the following risks actually occur, our business, financial condition, results of operations and growth prospects may be materially and adversely affected.

**Risks Related To Our Business**

*We are dependent on the success of DUR-928 and we cannot be certain that it will receive regulatory approval or be commercialized*

Our business depends substantially on the successful development of DUR-928, which is currently in Phase 1 and Phase 2 clinical development for two different indications, NASH and AH. Current clinical trials related to the NASH indication are designed to evaluate safety, pharmacokinetics and various pharmacodynamic signals. Future clinical trials will need to establish clinically and statistically significant proof of efficacy, and/or sufficient evidence of safety to support additional clinical trials and ultimately regulatory approval. DUR-928 will require additional development, including more clinical trials as well as further preclinical studies, including those designed to evaluate its toxicology, carcinogenicity and pharmacokinetics, and regulatory clearances before it can be commercialized. Positive results obtained during early development do not necessarily mean later development will succeed or that regulatory clearances will be obtained. Our drug development efforts may not lead to commercial drugs, either because DUR-928 fails to be safe and effective or because we have inadequate financial or other resources to advance DUR-928 through the pre-clinical and clinical development and approval processes. We consider DUR-928 to be our lead and most important asset. If DUR-928 fails to demonstrate safety or efficacy at any time or during any phase of development, we would experience potentially significant delays in, or be required to abandon, development of DUR-928, any of which would materially harm our business.

We do not anticipate that DUR-928 will be eligible to receive regulatory approval from the FDA or comparable foreign authorities and begin commercialization for a number of years, if ever. Even if we ultimately receive regulatory approval for DUR-928, we or our potential future partners, if any, may be unable to commercialize it successfully for a variety of reasons. These include, for example, the availability of alternative, potentially superior or less expensive treatments, lack of cost-effectiveness, the lack of favorable access and/or commercial pricing, the cost or technical challenges of manufacturing the product on a commercial scale and competition with other drugs. The success of DUR-928 may also be limited by the prevalence and severity of any adverse side effects. If we fail to commercialize DUR-928, we may be unable to generate sufficient revenues to attain or maintain profitability, and our financial condition and stock price may decline.

*Early indications of activity from Phase 1 and 2 clinical trials of DUR-928 may not predict therapeutic efficacy*

Although Phase 1 and Phase 2 clinical trials of DUR-928 have shown positive initial data in AH patients including reductions in bilirubin and MELD scores from baseline and promising Lille scores, and demonstrated that DUR-928 can lead to the reduction of certain biomarkers, such as statistically significant reductions from baseline in the levels of both full-length and cleaved cytokeratin-18 (CK-18), bilirubin, high sensitivity C-Reactive Protein (hsCRP) and IL-18 in NASH patients, and non-statistically significant reductions in CK-18 and bilirubin in CKD patients, such initial results, indications of activity and biomarker changes may ultimately not be correlated with treatment or improvement in the associated disease, and there is a risk that DUR-928 may not demonstrate therapeutic efficacy in larger controlled trials, despite encouraging initial data and improvements in biomarker levels. The failure of DUR-928 to show efficacy in one indication may negatively affect its perceived value in other indications, or the emergence of safety signals in ongoing or future clinical trials, would significantly harm our business.

### *Open-label trials of DUR-928 in NASH and AH have inherent limitations*

The ongoing NASH and recently completed AH trials of DUR-928, are open-label trials with no control groups. Open label trials have inherent risk of bias given that the patients and physicians know that they received active study drug, which can lead to placebo effects. Trials without control groups have an inherent risk in that the comparisons used to determine the study drug's effect and side effect profile are based on comparisons with baseline (pre-treatment) levels (for blood chemistry and biomarker endpoints) and/or with historical controls, which may not have been conducted under similar enough conditions to make accurate comparisons and/or draw accurate conclusions from those comparisons. Any initial data collected from these open-label trials also cannot be meaningfully analyzed or relied upon until after the completion of the trials due to the limited number of patients involved, open-label nature and lack of control groups. Additionally, larger controlled clinical trials will be required to evaluate the safety and efficacy of DUR-928 to treat any indication, including AH, NASH, AKI, psoriasis and CKD. There can be no assurance that ongoing or future studies will demonstrate the safety or efficacy of DUR-928 in a statistically significant manner.

### *Ongoing and planned clinical trials for DUR-928 may be delayed and may not demonstrate efficacy or safety in the indications tested*

A clinical trial of DUR-928 in NASH patients is ongoing, with top line data expected in mid-2020. There can be no assurance that this trial will enroll at a rate and that data will be available and analyzed in time to meet this time frame. We are planning a double blind, multi-center Phase 2b clinical trial to evaluate intravenously infused DUR-928 in patients with severe AH and anticipate initiating that trial in mid-2020. Assuming reasonable enrollment rates, we anticipate that top-line data would be available from this trial in 2022. There can be no assurance that the trial will commence or enroll as anticipated, and delays in commencement or enrollment could add to the costs and expenses of this trial and harm our business. With respect to the above ongoing and contemplated clinical trials, there can be no assurance that biological activity demonstrated in previous animal disease models or earlier clinical trials will also be seen in these additional patients in ongoing trials or future clinical trials, or that any clinically relevant biological activity will be observed, or that enrollment rates will be favorable or that these additional trials or additional patients in ongoing trials will not identify safety issues. Failure of these trials to achieve desired results in their anticipated timeframes would negatively impact our business and ability to raise additional capital.

### *The path to regulatory approval of DUR-928 is uncertain*

We are currently developing DUR-928 in several indications, including AH and NASH. In these indications, there are no currently approved drugs. Accordingly, we will have to interact with the FDA and other regulatory agencies regarding important aspects of the clinical development program, including the size of clinical trials, the specific primary and secondary endpoints for the clinical trials, inclusion and exclusion criteria, stopping rules, duration of follow up, size of the safety databases and other matters. This uncertainty may make it difficult to predict the timing or expense required to obtain regulatory approval for DUR-928. We also may need to revise our clinical development plans after trials have commenced or been completed, which could add to the time and expense associated with the clinical development of DUR-928. If we are unable to reach agreement with the FDA or other regulatory agencies regarding clinical development plans for DUR-928, we may curtail or limit our development activities for this product candidate.

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

Our Epigenetic Regulator Program is in the early stages of development, involves a novel therapeutic approach and new chemical entities, requires significant further research and development and regulatory approvals and is subject to the risks of failure inherent in the development of products based on innovative approaches. New chemical entities derived from our Epigenetic Regulator Program are molecules that have not previously been approved and marketed as therapeutics, unlike product candidates in our drug delivery programs, in which we apply our formulation expertise and technologies largely to active pharmaceutical ingredients whose safety and efficacy have previously been established but which we aim to improve in some manner through a new formulation. As a result, the product candidates from our Epigenetic Regulator Program may face greater risk of unanticipated safety issues or other side-effects, or may not demonstrate efficacy. Further, the regulatory pathway for our new chemical entities may be more demanding than that for product candidates under our drug delivery programs, for which we may be able to leverage existing data under Section 505(b)(2) of the Act to reduce development risk, time and cost. For example, we have yet to define the therapeutic dose or dosing regimen in any indication for DUR-928, the first drug candidate in our Epigenetic Regulator Program.



*Prospects for POSIMIR are uncertain following the failure of the PERSIST trial to achieve its primary efficacy endpoint and the termination of our agreement with Sandoz*

The failure of the PERSIST trial for POSIMIR to achieve its primary efficacy endpoint may reduce the prospects of obtaining FDA approval for POSIMIR. In January 2019, Sandoz elected to terminate our licensing agreement for POSIMIR, as a result of which we will not receive any milestone or royalty payments from Sandoz and we or a potential future partner will be responsible for commercialization of POSIMIR in the United States, if approved. We intend to seek a new collaboration partner for POSIMIR in the United States, but there is no assurance we will be successful in that effort or that any terms offered will be attractive to the Company. We may elect to terminate development of POSIMIR at any time. If we elect to continue to develop POSIMIR, we may be required to make a larger investment than previously planned, which would limit the funds available for other product development activities or require us to raise additional capital.

*The FDA may not agree with our response to its Complete Response Letter (CRL) to the NDA submission for POSIMIR*

After carefully reviewing the existing POSIMIR data and evaluating the feedback we have received from the FDA, including the CRL and other correspondence, we submitted to FDA a response to the CRL. The submission seeks FDA approval of POSIMIR. In July 2019, we announced that the FDA agreed to file the submitted response to the CRL as a complete Class 2 Resubmission and assigned a user fee goal date for FDA response of December 27, 2019. The FDA subsequently notified the Company that its resubmission for POSIMIR would be discussed at a meeting of the Anesthetic and Analgesic Drug Products Advisory Committee (AADPAC). The meeting was held on January 16, 2020; a new user fee goal date has not been assigned. At the AADPAC meeting, six advisory committee members voted to recommend that the efficacy, safety, and overall risk-benefit profile of POSIMIR support approval, while six did not support approval based on the information presented. Although the FDA considers the recommendations of the AADPAC, the recommendations by the panel are non-binding. The final decision regarding pending regulatory actions for a product is made by the FDA. There can be no assurance that the FDA will complete their review in a timely manner, or will assign a new user fee goal date, or will agree with our response to the CRL, or will approve POSIMIR for marketing. The FDA may require additional studies or additional information regarding POSIMIR. We would need to review any such requests to determine whether we believe that a viable path for regulatory approval of POSIMIR and the commercial opportunity remains available.

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

Successful and timely completion of clinical trials will require that we enroll a sufficient number of subjects and/or patients. Enrollment, a significant factor in the timing of clinical trials, is affected by many factors including the size and nature of the patient population and the ability of clinical sites to successfully recruit subjects to participate in clinical trials. Trials may be subject to delays as a result of patient enrollment taking longer than anticipated or patient withdrawal. We may not be able to initiate or continue clinical trials for DUR-928 if we are unable to locate and enroll a sufficient number of eligible patients to participate in these trials as required by the FDA or similar regulatory authorities outside the United States. It is possible that the specific requirements by the FDA for our patients to be included in these trials may make the trials more difficult to conduct or may significantly extend the time required for enrollment of these trials.

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

- the eligibility criteria for the trial in question;
- the prevalence and incidence of the conditions being studied in the clinical trials;
- the perceived risks and benefits of our product candidates;
- clinicians' and patients' perceptions as to the potential advantages of the product candidate being studied in relation to other available therapies, including any new drugs or therapeutic biologics that may be approved for the indications we are investigating;

- the efforts to facilitate timely enrollment in clinical trials;
- competition for patients from other clinical trials;
- the willingness of potential clinical trial patients to provide informed consent to participate in the trial;
- the patient referral practices of physicians;
- the ability to monitor patients adequately during and after treatment; and
- the proximity and availability of clinical trial sites for prospective patients.

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

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

The failure to adequately demonstrate the safety and effectiveness of a pharmaceutical product candidate under development to the satisfaction of FDA and other regulatory agencies will result in delays to the regulatory approval or non-approvability of our product candidates, and could materially harm our business. Clinical trials may not demonstrate the sufficient levels of safety and efficacy necessary to obtain the requisite regulatory approvals for our product candidates, or may require such significant numbers of patients or additional costs to make it impractical to satisfy the FDA's requirements, and thus our product candidates may not be approved for marketing. For example, the Phase 3 PERSIST trial for POSIMIR did not meet its primary efficacy endpoint. In addition, during the review process, the FDA may request more information regarding the safety of our product candidates, as they have in their Complete Response Letter for POSIMIR, and answering such questions could require significant additional work and expense, and take a significant amount of time, resulting in a material delay of approval or the failure to obtain approval or lead the company to abandon the development of that product candidate. During the review process, the FDA may also request more information regarding the chemistry, manufacturing or controls related to our product candidates, 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 or abandonment of the product candidate. Additionally, even if our product candidates receive FDA approval, the FDA may require that we conduct additional clinical studies after such approval, place limitations on our products in applicable labels, require marketing under a REMS program, delay approval to market our products or limit the use of our products, which may harm our business and results of operations.

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

In July 2016, we entered into a Loan and Security Agreement (the Loan Agreement) with Oxford Finance LLC (Oxford Finance), pursuant to which Oxford Finance provided a \$20 million secured single-draw term loan to us with an initial maturity date of August 1, 2020. The term loan was fully drawn at close and the proceeds may be used for working capital and general business requirements. The term loan repayment schedule provided initially for interest only payments for the first 18 months, followed by consecutive monthly payments of principal and interest in arrears starting on March 1, 2018 and continuing through the maturity date of August 1, 2020. Following three amendments, we make interest only payments under the amended Loan Agreement until December 1, 2021 and the final maturity date of the loan is May 1, 2024. The Loan Agreement provides for a floating interest rate (7.95% initially and 9.07% as of December 31, 2019) based on an index rate plus a spread and an additional payment equal to 10% of the principal amount of the term loan, which is due when the term loan becomes due or upon the prepayment of the facility. If we elect to prepay the loan, there is also a prepayment fee between 0.75% and 2.5% of the principal amount of the term loan depending on the timing of prepayment. Our debt repayment obligations under the Loan Agreement, as amended, may prove a burden to the Company as they become due, particularly following the expiration of the interest-only period.

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

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

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

Our business currently does not generate sufficient revenues to meet our capital requirements and we do not expect that it will do so in the near future. We have expended and will continue to expend substantial funds to complete the research, development and clinical testing of our 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, and such availability will depend on a number of factors, some of which are outside of our control, including general capital markets conditions and investors' view of our prospects and valuation. 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 and anticipated revenues will be adequate to satisfy our capital needs for at least the next 12 months from the date the financial statements are filed. However, our independent auditors may not agree with this assessment, and our actual capital requirements will depend on many factors, including:

- success in entering into collaboration agreements and achieving milestones under such agreements;
- the continuation of our collaborative agreements that provide financial funding for our activities;
- regulatory actions with respect to our and our collaborators' product candidates;
- continued progress and cost of our research and development programs;
- progress with preclinical studies and clinical trials;
- the time and costs involved in obtaining regulatory clearance;
- costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims;
- costs of developing sales, marketing and distribution channels and our ability and that of our collaborators to sell our products, products we have a financial interest in and eventually, product candidates;
- costs involved in establishing manufacturing capabilities for pre-clinical, non-clinical, clinical and commercial quantities of our product candidates;
- competing technological and market developments;

- market acceptance of our products, products we have a financial interest in and eventually, product candidates;
- any failure to comply with the covenants in our debt instruments that results in acceleration of repayment obligations;
- costs for recruiting and retaining employees and consultants; and
- unexpected legal, accounting and other costs and liabilities related to our business.

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

*We do not control the commercialization of PERSERIS or Methydur Sustained Release Capsules*

We rely on Indivior for the commercialization of PERSERIS. Indivior has stated that it launched PERSERIS in February 2019 in the U.S. with a sales force consisting of approximately 50 representatives and expects 2020 sales of between \$15 million and \$25 million. There can be no assurance that Indivior will obtain market acceptance and meaningful sales. If Indivior does not successfully commercialize PERSERIS, the earn-out payments we receive under our agreement with them may be limited. We rely on Orient Pharma for the commercialization of Methydur Sustained Release Capsules in the territories licensed to Orient Pharma. If Orient Pharma does not successfully commercialize Methydur Sustained Release Capsules throughout their territory, the royalty payments we receive under our agreement with them may be limited.

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

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

- with respect to each product candidate based on a new chemical entity, determining appropriate indication(s);
- with respect to our Proprietary Pharmaceutical Programs based on our drug delivery technologies, selecting and developing a drug delivery technology to deliver the proper dose of drug over the desired period of time;
- determining the appropriate route of administration and drug dosage for each product candidate in each indication;
- developing product candidates that will be tolerated, safe and effective and that will be compatible with the active pharmaceutical agent;
- demonstrating each product candidate will be chemically and physically stable for commercially reasonable time periods;
- demonstrating through clinical trials that each product candidate is safe and effective in patients for the intended indication at an achievable dose and that the product candidate's benefits outweigh its risks; and
- completing the manufacturing development and scale-up to permit manufacture of the product candidate in commercial quantities and at acceptable cost.

The time frame necessary to achieve these developmental milestones for any individual product candidate is long and uncertain, and we may not successfully complete these milestones for any of our product candidates in development. Except for marketing authorization for PERSERIS by Indivior in the U.S. and for Orient Pharma's distribution of Methydrur Sustained Release Capsules in Taiwan, development is incomplete for all product candidates in our development programs, including DUR-928 and the investigational HIV product being developed with Gilead. We may not be able to finalize the design or formulation of any of these product candidates. Further, although we believe our design and formulation of POSIMIR to be substantially complete, there can be no assurance that additional development will not be required prior to regulatory approval of this product. 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, stability and performance. We or our collaborators may not be able to complete development of any product candidates that will be safe and effective and that will have a commercially reasonable treatment and storage period. If we or our third-party collaborators are unable to complete development of DUR-928, POSIMIR, the investigational HIV product being developed with Gilead, or other product candidates, we will not be able to earn revenue from them, which would materially harm our business.

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

*Cancellation of collaborations regarding our product candidates may adversely affect potential economic benefits*

Third-party collaboration agreements typically allow the third party to terminate the agreement (or a specific program within an agreement) by providing notice. Termination can result from failure of the collaboration to achieve anticipated milestones, for changes in strategy of the other party or for other reasons. For example, in January 2019, Sandoz notified us that they were terminating our agreement with respect to POSIMIR, and in March 2019, Cassava Sciences notified us that they were terminating our agreement with respect to REMOXY ER. In these cases, the product rights revert to us. 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 Gilead, Santen or Orient Pharma could have similar negative effects.

*A significant component of our revenues depend on collaboration agreements with other companies. If we are unable to enter into new agreements or meet our obligations or manage our relationships with our collaborators under these agreements our revenues may decrease. Acquisitions of our collaborators can be disruptive*

Our revenues are based to a significant extent on collaborative arrangements with third parties, pursuant to which we receive payments based on our performance of research and development activities set forth in these agreements. In particular, for 2019, approximately 58% of our total revenues were from our collaboration agreement with Gilead. There can be no assurance that we will be successful in reformulating the lead product in our Gilead collaboration, that Gilead will continue to fund this program, and that Gilead will not terminate the collaboration. In addition, we have seen periodic declines in revenues associated with our existing collaboration agreements, which reflect the current development stage of the product candidates subject to those agreements, and our collaborator's decreased needs for our services. Long-term growth of our collaboration revenues requires us to enter into new collaboration agreements, and there can be no assurance that we will do so. Even if we enter into new collaboration agreements, we may not be able to fulfill our obligations or attain milestones set forth in any specific agreement, which could cause our revenues and/or cash flows 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 Gilead with respect to an investigational long-acting HIV product, Orient Pharma with respect to Methydur Sustained Release Capsules, and Santen with respect to an investigational ophthalmic product may be terminated by the other party at will or upon specified conditions including, for example, if we fail to satisfy specified performance milestones or if we breach the terms of the agreement. Acquisitions of our collaborators or strategic changes or re-organizations or re-prioritizations of our collaborators can lead to turnover of program staff, a review of development programs and strategies by the acquirer, and other events that can disrupt a program, resulting in program delays or discontinuations.

If we do not enter into new collaboration agreements, and if any of our collaborative agreements are terminated or delayed, our anticipated revenues and/or cash flows may be reduced or not materialize, and our investigational products in development related to those agreements may not be commercialized.

*We have an ongoing dispute with Sandoz AG related to a disputed termination fee*

The Company and Sandoz are in dispute with regard to Sandoz's obligation to pay a termination fee to DURECT. DURECT has initiated a formal dispute resolution process related to the termination fee. The Company's management may devote significant time and resources to this dispute resolution process, which may detract from time our management would otherwise devote to managing our operations and could have a material adverse effect on our business.

*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 over the period of our performance obligations with the third-party collaborator pursuant to the applicable agreement. The period of performance obligations may also be revised on a prospective basis. As of December 31, 2019, we had \$23.5 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, including clinical and regulatory milestones, or sales accomplishments. While our involvement is generally necessary to the achievement of development-based milestones, the performance of our third-party collaborators is also generally required or sometimes solely required for us to achieve those milestones. Under our third-party collaborative agreements, our third-party collaborators will take the lead in commercialization

activities and we do not expect to be 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 could cause us to defer or cut-back development activities or forego the exploitation of opportunities in certain geographic territories, any of which could have a material adverse effect on our business.

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

Our current business strategy includes the entry into additional collaborative agreements for the development and commercialization of our product candidates, including, but not limited to DUR-928, POSIMIR and others. The negotiation and consummation of these types of agreements typically involve simultaneous discussions with multiple potential collaborators and require significant time and resources from our officers, business development, legal, and research and development staff. In addition, in attracting the attention of pharmaceutical and biotechnology company collaborators, we compete with numerous other third parties with product opportunities as well as the collaborators' own internal product opportunities. We may not be able to consummate additional collaborative agreements, or we may not be able to negotiate commercially acceptable terms for these agreements. If we do not consummate additional collaborative agreements, we may have to consume money more rapidly on our product development efforts, defer development activities or forego the exploitation of certain geographic territories, abandon development of certain product candidates or indications for certain product candidates, any of which could have a material adverse effect on our business.

*We and our third-party collaborators may not be able to manufacture sufficient quantities of our pharmaceutical product candidates and components to support the non-clinical, 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 product candidates, and components (including active ingredients and excipients) in non-clinical, clinical and commercial quantities, either directly or through third parties, in compliance with regulatory requirements and at an acceptable cost. The manufacturing processes associated with our product candidates are complex. We and our third-party collaborators, where relevant, have not yet completed development of the manufacturing process for any product candidates or components, including DUR-928 and POSIMIR. If we and our third-party collaborators, where relevant, fail to timely complete the development of the manufacturing process for our product candidates, we and our third-party collaborators, where relevant, will not be able to timely produce supplies for non-clinical, 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 quality and cost, then we and our third-party collaborators may not be able to develop or 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 product candidates, including DUR-928 and POSIMIR. If we experience delays or technical difficulties in developing acceptable manufacturing processes or 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 at our Cupertino facility. 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/or 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 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 non-clinical and clinical trials and the commercial sale of our product candidates and those of our third-party collaborators could be delayed or never occur. 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 non-clinical trials, clinical trials, chemistry, manufacturing and controls (CMC) and commercial launch of our product candidates and those of our third-party collaborators.

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*

Developing, manufacturing, 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 meet GMP, GLP and/or other governmental requirements for drug development;
- failure to obtain approvals for clinically intended uses of our pharmaceutical product candidates under development; or
- FDA required product withdrawals or warnings arising from identification of serious and unanticipated adverse side effects in our product candidates.

Manufacturers of drugs must comply with the applicable FDA good manufacturing practice regulations, which include production design controls, testing, quality control and quality assurance requirements as well as the corresponding maintenance of records and documentation. Compliance with current good manufacturing practices regulations is difficult and costly. Manufacturing facilities are subject to ongoing periodic inspection by the FDA and corresponding state and in some cases, foreign 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 and/or foreign regulatory requirements. We have not been subject to a good manufacturing practice 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 or foreign equivalents may refuse or withdraw marketing clearance, put our or our partner's clinical trial on hold, withdraw or reject an investigational new drug (IND) application or require product recall, which may cause interruptions or delays in the development, 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 December 31, 2019, had an accumulated deficit of approximately \$489.2 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 and/or intellectual property rights for use in our product candidates. The license fees for these technologies or rights would increase the costs of our product candidates.



To date, we have not generated significant revenue from the commercial sale of our pharmaceutical product candidates and do not expect to do so in the near future. Our current revenues are from the ALZET product line, from the LACTEL product line, from certain excipient sales, from earn-out payments from Indivior related to sales of PERSERIS, 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 in the near future. We do not anticipate meaningful revenues to derive from the commercialization and marketing of our product candidates in development in the near future, and therefore do not expect to generate sufficient revenues to cover expenses or achieve profitability in the near future.

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

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

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

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

- fail to satisfy financial or contractual obligations to us;
- fail to adequately market our product candidates;
- cease operations with little or no notice to us;
- offer, design, manufacture or promote competing product lines;
- fail to maintain adequate inventory and thereby restrict use of our product candidates; or
- build up inventory in excess of demand thereby limiting future purchases of our product candidates resulting in significant quarter-to-quarter variability in our sales.

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

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

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

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

Certain components and drug substances used in our and our collaborators' product candidates, including DUR-928, POSIMIR, Methydrur Sustained Release Capsules, and PERSERIS, are currently purchased from a single or a limited number of outside sources. In particular, Eastman Chemical is the sole supplier of our requirements of sucrose acetate isobutyrate, a necessary component of POSIMIR and certain other pharmaceutical product candidates we have under development. A third party manufacturer is our sole supplier for future clinical and commercial supplies of POSIMIR. Another third party manufacturer is our sole supplier for future non-clinical, clinical and commercial supplies of DUR-928. The reliance on a sole or limited number of suppliers could result in:

- delays associated with redesigning a pharmaceutical product candidate due to a failure to obtain a single source component;
- delays associated with finding and contracting with a new supplier (if we can find one capable of replacing the old supplier and negotiate commercially reasonable terms) and then transferring the technology to the new supplier;
- an inability to obtain an adequate supply of required product candidate, active pharmaceutical ingredient or excipients or other components; and
- reduced control over pricing, quality and delivery time.

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

While we have entered into contract manufacturing agreements with multiple vendors for DUR-928, we currently have a third party sole supplier for GMP supplies of DUR-928. This third party is our sole source for the drug product required for development and commercialization of this drug candidate. There can be no assurance that we will receive sufficient quantities of DUR-928 to commence and conduct the non-clinical trials, clinical trials and CMC activities we are planning, and delays in supply could delay development of DUR-928.

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

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

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

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

We may incur significant non-cash charges related to impairment write-downs of our long-lived assets, including goodwill. We are required to perform periodic impairment reviews of our goodwill at least annually. The carrying value of goodwill on our balance sheet was \$6.4 million at December 31, 2019. To the extent these reviews conclude that the expected future cash flows generated from our business activities are not sufficient to recover the cost of our long-lived assets, we will be required to measure and record an impairment charge to write-down these assets to their realizable values. We completed our last review during the fourth quarter of 2019 and determined that goodwill was not impaired as of December 31, 2019. However, there can be no assurance that upon completion of subsequent reviews a material impairment charge will not be recorded. If future periodic reviews determine that our assets are impaired and a write-down is required, it will adversely impact or delay our profitability.

Inventories, in part, include certain excipients that are sold to customers and included in product candidates in development. These inventories are capitalized based on management's judgment of probable sale prior to their expiration date which in turn is primarily based on management's internal estimates. The valuation of inventory requires us to estimate the value of inventory that may become expired prior to use. We may be required to expense previously capitalized inventory costs upon a change in our judgment, due to, among other potential factors, a denial or delay of approval of a product by the necessary regulatory bodies, changes in product development timelines, or other information that suggests that the inventory will not be saleable. In addition, these circumstances may cause us to record a liability related to minimum purchase agreements that we have in place for raw materials. For example, during the year ended December 31, 2017, we recorded charges to cost of goods sold of approximately \$2.0 million, of which approximately \$503,000 related to the write-down of the cost basis of inventory on hand, \$500,000 related to the prepaid inventory for the minimum purchase commitment for the excipient, and \$1.0 million related to the recognition of our remaining minimum purchase commitment at that time for the same excipient after we announced that PERSIST, the Phase 3 clinical trial for POSIMIR, did not meet its primary efficacy endpoint.

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

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. Our short-term investments consist primarily of readily marketable debt securities with original maturities of greater than 90 days from the date of purchase but remaining maturities of less than one year from the balance sheet date. Our long-term investments consist primarily of readily marketable debt securities with maturities in one year or beyond from the balance sheet date. While, as of the date of this filing, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash

equivalents, short-term investments or long-term investments since December 31, 2019, no assurance can be given that deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents, short-term investments or long-term investments or our ability to meet our financing objectives.

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

Our success will depend to a significant degree upon the continued services of key management, technical and scientific personnel. In addition, our success will depend on our ability to attract and retain other highly skilled personnel, particularly as we develop and expand our Epigenetic Regulator Program. Competition for qualified personnel is intense, and the process of hiring and integrating such qualified personnel is often lengthy. We may be unable to recruit such personnel on a timely basis, if at all. Our management and other employees may voluntarily terminate their employment with us at any time. The loss of the services of key personnel, or the inability to attract and retain additional qualified personnel, could result in delays to product development or approval, loss of sales and diversion of management resources as well as difficulties or inability to raise sufficient capital to fund the Company's operations.

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

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

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

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

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

We utilize information technology, systems and networks to process, transmit and store electronic information in connection with our business activities. As use of digital technologies has increased, cyber incidents, including deliberate attacks and attempts to gain unauthorized access to computer systems and networks, have increased in frequency and sophistication. These threats pose a risk to the security of our systems and networks and the confidentiality, availability and integrity of our data, and may cause a disruption in our operations, harm our reputation, cause us to pay to retrieve our data if it becomes infected or otherwise subject to ransomware and increase our stock trading risk. There can be no assurance that we will be successful in preventing cyber-attacks or successfully mitigating their effects. Similarly, there can be no assurance that our third-party collaborators, distributors and other contractors and consultants will be successful in protecting our clinical and other data that is

stored on their systems. Any cyber-attack or destruction or loss of data could have a material adverse effect on our business and prospects. In addition, we may suffer reputational harm or face litigation or adverse regulatory action as a result of cyber-attacks or other data security breaches and may incur significant additional expense to implement further data protection measures.

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

Our corporate headquarters, certain manufacturing facilities and personnel are located in a geographical area that is known to be seismically active and prone to earthquakes, as well as wildfires and related power outages or power shortages. Should such a natural disaster occur or power outage or power shortage, our ability to conduct our business could be severely restricted, and our business and assets, including the results of our research, development and manufacturing efforts, could be harmed or destroyed.

*We may face risks related to health epidemics that could impact our results of operations*

Our business could be adversely affected by the effects of a widespread outbreak of contagious disease, including the recent outbreak of respiratory illness caused by a novel coronavirus first identified in Wuhan, Hubei Province, China. Any outbreak of contagious diseases and other adverse public health developments could have a material and adverse effect on our business operations. Although we do not currently expect the coronavirus outbreak to impact our research and development plans, product sales or operating results, it is possible. In addition, a significant outbreak of contagious diseases in the human population could result in a widespread health crisis that could adversely affect the economies and financial markets of many countries, resulting in an economic downturn that could materially harm our business.

### **Risks Related to Our Intellectual Property**

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

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

As of February 28, 2020, we owned or exclusively in-licensed over 40 unexpired issued U.S. patents and over 185 unexpired issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have over 40 pending U.S. patent applications and over 145 foreign applications pending in Europe, Australia, Japan, Canada and other countries.

The patent status of our most advanced drug candidates is as follows:

Our Epigenetic Regulator Program includes eight in-licensed patent families and three patent families solely owned by us. Three patent families each include at least one granted patent providing protection until at least 2026, 2032, and 2034, respectively. The other patent families include pending patent applications, which if granted, could result in patents expiring in 2033, 2035, 2037, 2037, 2037, 2040, 2040, and 2041, respectively, plus any eligible patent term adjustments and extensions. Of the eleven patent families covering DUR-928 and/or other molecules in the Epigenetic Regulator Program, two were only filed in the United States, and the other nine have been filed or likely will be filed both in the U.S. and internationally. Since DUR-928 is an endogenous, orally bioavailable, small molecule, patent claims directed to DUR-928 composition of matter may be more difficult to maintain or enforce in the United States under Myriad Genetics and other recent court decisions. One of the U.S. patents issued before Myriad Genetics, and five of the DUR-928 U.S. patents issued after Myriad Genetics. The granted claims in the U.S. include both composition of matter and method of treatment claims. There can be no assurance that the pending patent applications will be granted. Further, there can be no assurance that VCU will not attempt to terminate their license to us, which termination could result in the loss of our rights to these patent families.

In the United States, POSIMIR is covered by three patent families. One patent family includes granted patents expiring in at least 2025. The other two patent families include pending patent applications, which if granted, could result in a patent expiring in 2026 and 2041, respectively, plus any eligible patent term adjustments and extensions. In Europe, POSIMIR is covered by four granted patents with two expiring in 2025 and two expiring in 2026, plus any eligible patent term extensions. The family providing protection until at least 2041 will likely be filed in Europe.

In the United States, our ORADUR-Methylphenidate ER patent portfolio includes five patent families. Two patent families include granted patents providing protection until at least 2023 and 2029, respectively. The other patent families include pending patent applications, which if granted, could result in patents expiring in 2026, 2028, and 2037, respectively, plus any eligible patent term adjustments and extensions. There can be no assurance that the pending patent applications will be granted.

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

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

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

*Our collaboration agreements may depend on our intellectual property*

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

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

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

collaborators with the right, under specified circumstances, to defend against any claims of infringement of the third party intellectual property rights, and such collaborators may not defend against such claims adequately or in the manner that we would do ourselves. Intellectual property litigation or claims could force us or our collaborators to do one or more of the following, any of which could harm our business or financial results:

- cease selling, incorporating or using any of our product candidates that incorporate the challenged intellectual property, which would adversely affect our revenue;
- obtain a license from the holder of the infringed intellectual property right, which license may be costly or may not be available on reasonable terms, if at all; or
- redesign our product candidates, which would be costly and time-consuming.

## **Risks Related To Our Industry**

*The markets for our pharmaceutical product candidates and for our ALZET and LACTEL product lines are rapidly changing and competitive, and new products or technologies developed by others could impair our ability to maintain or grow our business and remain competitive*

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

We may face competition from other companies in numerous industries including pharmaceuticals, biotechnology, medical devices and drug delivery. Competition for DUR-928, if approved, will depend on the specific indications for which DUR-928 is approved. Intercept, Gilead, Shire, Conatus Pharmaceuticals, Galectin Therapeutics, Genfit, Pfizer, Roche, Bristol Myers Squibb, Novartis, Terns Pharmaceuticals, Galmed Pharmaceuticals, Enanta Pharmaceuticals, Novo Nordisk, Takeda, Vital Therapies, Allergan, Akarna Therapeutics, Inventiva Pharma, Genkyotex, VBL Therapeutics, NGM Biopharmaceuticals, Gemphire Therapeutics, Albireo Pharma, CymaBay Therapeutics, Madrigal Pharmaceuticals, Viking Therapeutics, CohBar, FALK Pharma, Acorda, Akero, Generon, and others have development plans for products to treat NAFLD/NASH, AH or other liver diseases. AbbVie, Ischemix, Thrasos Therapeutics, AM-Pharma, Complexa, Quark Pharmaceuticals and others have development plans for products to treat acute kidney injury.

POSIMIR, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, implantable and external infusion pumps which can be used for infusion of opioids and local anesthetics. Products of these types are marketed by Pacira, Purdue Pharma, AbbVie, Janssen, Actavis, Medtronic, Endo, AstraZeneca, Pernix Therapeutics, Tricumed, Halyard Health, Cumberland Pharmaceuticals, Acorda Therapeutics, Mallinckrodt, Inspirion Delivery Technologies, Mylan, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis, Zyla Life Sciences, Teva Pharmaceuticals, Collegium Pharmaceutical and others. Additional competition for POSIMIR may come from Heron Therapeutics if their product, HTX-011, is approved. PERSERIS competes with currently marketed or approved products by Johnson & Johnson, Eli Lilly, Otsuka, Alkermes, Merck, Allergan, Novartis, and others. Our ORADUR-ADHD product candidates, if approved, will compete with currently marketed or approved products by Shire, Johnson & Johnson, UCB, Novartis, Noven, Eli Lilly, Pfizer and others.

Numerous companies are applying significant resources and expertise to the problems of drug delivery and several of these are focusing or may focus on delivery of drugs to the intended site of action, including Pacira, Heron Therapeutics, Alkermes, Immune Pharmaceuticals, Innocoll, Nektar, Kimberly-Clark, Acorda Therapeutics, Flamel, Alexza, Mallinckrodt, Hospira, Pfizer, Cumberland Pharmaceuticals, Zyla Life Sciences, Acura, Elite Pharmaceuticals, Phosphagenics, Intellipharma, Collegium Pharmaceutical, Charleston Laboratories, Daiichi Sankyo and others. Some of these competitors may be addressing the same therapeutic areas or indications as we are. Our current and potential competitors may succeed in obtaining patent protection or commercializing products before us. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. Acquisitions of, or investments in, competing pharmaceutical or biotechnology companies by large corporations could increase such competitors' financial, marketing, manufacturing and other resources.

Competition for our ALZET product line primarily consists of customers choosing to utilize delivery methods for their research projects other than an osmotic pump. Competition for our LACTEL product line comes from companies including Evonik, Corbion, FUJIFILM Wako Pure Chemical Corporation, PCAS and others. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. We may also face competition for our ALZET and LACTEL product lines from other companies including low cost foreign competitors.

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

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

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

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

- the Federal Healthcare Anti-Kickback Statute, which prohibits, among other things, persons from knowingly and willfully soliciting, offering, receiving or providing remuneration, directly or indirectly, in cash or in kind, to induce or reward, or in return for, either the referral of an individual for, or the purchase, order or recommendation of, any good or service, for which payment may be made under a federal healthcare program such as Medicare and Medicaid, and which will constrain our marketing practices and the marketing practices of our licensees, educational programs, pricing policies, and relationships with healthcare providers or other entities;
- the federal physician self-referral prohibition, commonly known as the Stark Law, which prohibits physicians from referring Medicare or Medicaid patients to providers of "designated health services" with whom the physician or a member of the physician's immediate family has an ownership interest or compensation arrangement, unless a statutory or regulatory exception applies;
- federal false claims laws that prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, claims for payment from Medicare, Medicaid, or other government reimbursement programs that are false or fraudulent, and which may expose entities that provide coding and billing advice to customers to potential criminal and civil penalties, including through civil whistleblower or qui tam actions, and including as a result of claims presented in violation of the Federal Healthcare Anti-Kickback Statute, the Stark Law or other healthcare-related laws, including laws enforced by the FDA;



- the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which imposes criminal and civil liability for executing a scheme to defraud any healthcare benefit program and also created federal criminal laws that prohibit knowingly and willfully falsifying, concealing or covering up a material fact or making any materially false statements in connection with the delivery of or payment for healthcare benefits, items or services, and which as amended by the Health Information Technology for Economic and Clinical Health Act, or HITECH, also imposes obligations, including mandatory contractual terms, with respect to safeguarding the privacy, security and transmission of individually identifiable health information;
- federal physician sunshine requirements under the Affordable Care Act, which requires manufacturers of drugs, devices, biologics and medical supplies to report annually to HHS information related to payments and other transfers of value to physicians, other healthcare providers, and teaching hospitals, and ownership and investment interests held by physicians and other healthcare providers and their immediate family members and applicable group purchasing organizations;
- the Federal Food, Drug, and Cosmetic Act, which, among other things, strictly regulates drug product marketing, prohibits manufacturers from marketing drug products for off-label use and regulates the distribution of drug samples; and
- state and foreign law equivalents of each of the above federal laws, such as anti-kickback and false claims laws, which may apply to sales or marketing arrangements and claims involving healthcare items or services reimbursed by non- governmental third-party payers, including private insurers, state laws requiring pharmaceutical companies to comply with the pharmaceutical industry's voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government and which may require drug manufacturers to report information related to payments and other transfers of value to physicians and other healthcare providers or marketing expenditures, and state and foreign laws governing the privacy and security of health information in specified circumstances, many of which differ from each other in significant ways and often are not preempted by federal laws such as HIPAA, thus complicating compliance efforts.

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

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

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

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

The current U.S. presidential administration has signed two Executive Orders designed to delay the implementation of certain provisions of the Affordable Care Act or otherwise circumvent some of the requirements for health insurance mandated by the Affordable Care Act. Concurrently, Congress has considered legislation that would repeal or repeal and replace all or part of the Affordable Care Act. While Congress has not passed comprehensive repeal legislation, two bills affecting the implementation of certain taxes under the Affordable Care Act have been signed into law. The Tax Cuts and Jobs Act of 2017 includes a provision repealing, effective January 1, 2019, the tax-based shared responsibility payment imposed by the Affordable Care Act on certain individuals who fail to maintain qualifying health coverage for all or part of a year that is commonly referred to as the “individual mandate”. As legislative and regulatory developments are ongoing, we cannot predict the ultimate content, timing or effect of healthcare reform legislation or the impact of potential legislation on our business.

In addition, other legislative changes have been proposed and adopted since the Affordable Care Act was enacted. These changes include reductions to Medicare payments to providers of up to 2% per fiscal year that will remain in effect through 2027; the American Taxpayer Relief Act of 2012, which, among other things, further reduced Medicare payments to several types of providers and increased the statute of limitations period for the government to recover overpayments to providers from three to five years. More recently, there has been heightened governmental scrutiny over the manner in which manufacturers set prices for their marketed products, which has resulted in several Congressional inquiries and proposed bills designed to, among other things, bring more transparency to product pricing, review the relationship between pricing and manufacturer patient programs, and reform government program reimbursement methodologies for pharmaceutical products. For example, the marketing, pricing and sale of the Company’s products are subject to regulation, investigations and legal actions including under the Medicaid Drug Rebate Program under the Affordable Care Act, which has increased the statutory minimum rebates a manufacturer must pay under the program as well as a new methodology by which rebates are owed calculated for drugs that are inhaled, infused, instilled, implanted or injected. We are also subject to federal and state false claims acts, as well as federal and state antitrust and consumer protection laws. Increased scrutiny of health care industry business practices in recent years by government agencies and state attorneys general in the U.S., and any resulting investigations and prosecutions, carry risk of significant civil and criminal penalties including, but not limited to, debarment from participation in such government healthcare programs.

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

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

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

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

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

Our future financial performance will depend upon the successful introduction and customer acceptance of our product candidates in research and development, including DUR-928 and POSIMIR, if approved, and including Indivior's PERSERIS. Even if approved for marketing, our product candidates may not achieve market acceptance. The degree of market acceptance will depend upon a number of factors, including:

- the receipt of regulatory clearance of marketing claims for the uses that we are developing;
- the establishment and demonstration in the medical community of the safety and clinical efficacy of our products and their potential advantages over existing therapeutic products; and
- pricing and reimbursement policies of government and third-party payors such as insurance companies, health maintenance organizations, hospital formularies and other health plan administrators.

In addition, market adoption of POSIMIR and other products in development may depend on what is included in the approved product label, including which clinical data, warnings and precautions is included, and there can be no assurance as to what the final product labels will contain. Physicians, patients, payers or the medical community in general may be unwilling to accept, utilize or recommend any of our products. If we are unable to obtain regulatory approval, commercialize and market our future products when planned and achieve market acceptance, we will not achieve anticipated revenues.

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

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

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

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

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

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

Future changes in financial accounting standards may cause adverse, unexpected fluctuations in the timing of the recognition of revenues or expenses and may affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred with frequency and may occur in the future and we may make changes in our accounting policies in the future. Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses. Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, PCAOB pronouncements and NASDAQ rules, are creating uncertainty for companies such as ours and insurance, accounting and auditing costs are high as a result of this uncertainty and other factors. Compliance with evolving corporate governance and public disclosure standards may result in increased general and administrative expenses and a diversion of management time and attention from value-creating activities to compliance activities.

*Risks related to actions on trade by the U.S. and foreign governments could adversely affect the Company's results of operations and financial condition*

The U.S. government has indicated its intent to adopt a new approach to trade policy and in some cases to renegotiate, or potentially terminate, certain existing bilateral or multilateral trade agreements. It has also initiated or is considering the imposition of tariffs on certain foreign products. Changes in U.S. trade policy have resulted in, and could continue to result in, one or more U.S. trading partners adopting responsive trade policy making it more difficult or costly for us to export our products to those countries. These measures could also result in increased costs for goods imported into the United States. This in turn could require us to increase prices to our customers which may reduce demand, or, if we are unable to increase prices, result in lowering our margin on products sold.

There is also a concern that the imposition of additional tariffs by the United States could result in the adoption of tariffs by other countries. A potential resulting trade war could have a significant adverse effect on world trade and the world economy. We cannot predict future trade policy or the terms of any renegotiated trade agreements and their impact on our business. The adoption and expansion of trade restrictions, the occurrence of a trade war, or other governmental action related to tariffs or trade agreements or policies has the potential to adversely impact demand for our products, our costs, our customers, our suppliers, and the U.S. economy, which in turn could adversely impact our business, financial condition and results of operations.

**Risks Related To Our Common Stock**

*Our operating history makes evaluating our stock difficult*

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

*Investors may experience substantial dilution of their investment*

In order to raise capital and for other purposes, we may in the future offer and issue additional shares of our common stock or other securities convertible into or exchangeable for our common stock, and the price per share at which we sell additional shares of our common stock or other securities convertible into or exchangeable for our common stock in future transactions may be higher or lower than the price per share at which investors in our common stock bought their shares. In August 2018, we filed a shelf registration statement on Form S-3 with the SEC that allows us to offer up to \$175 million of securities from time to time in one or more public offerings, inclusive of up to \$75.0 million of additional shares of common stock which the Company may sell, subject to certain limitations, under the 2015 Sales Agreement through Cantor Fitzgerald, acting as agent. In 2019, we raised net proceeds (net of commissions) of approximately \$3.5 million from the sale of 2,349,820 shares of the Company's common stock in the open market at a weighted average price of \$1.55 per share pursuant to the October 2018 registration statement. On June 20, 2019, we entered into a privately negotiated transaction to sell 29,000,000 shares of our common stock to certain investors in a registered offering at a price of \$0.52 per share, raising total gross proceeds to DURECT of approximately \$15.1 million. This transaction closed on June 24, 2019. Total stock issuance costs related to this financing were approximately \$124,000. Any additional sales in the public market of our common stock, under our Controlled Equity Offering program with Cantor Fitzgerald, in other offerings under the shelf registration statement or otherwise, could adversely affect prevailing market prices for our common stock. In addition, as of December 31, 2019, 29,803,766 shares of our common stock were issuable upon exercise of stock options outstanding under our stock option plans at a weighted average exercise price of \$1.41 per share and 7,936,039 additional shares of common stock reserved for potential future issuance under our stock option plan, and an aggregate of 249,276 shares of common stock reserved for potential future issuance under our 2000 Employee Stock Purchase Plan. Investors will incur dilution from the sale of any additional shares or upon the issuance of any shares pursuant to such plans, or upon exercise of any outstanding options.

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

In several instances in the past, including as recently as December 2018, we received written notification from Nasdaq informing us that because the closing bid price of our common stock was below \$1.00 for 30 consecutive trading days, our shares no longer complied with the minimum closing bid price requirement for continued listing on Nasdaq under Nasdaq Marketplace Rules. Each time, we were given a period of 180 days from the date of the notification to regain compliance with Nasdaq's listing requirements by having the closing bid price of our common stock listed on Nasdaq be at least \$1.00 for at least 10 consecutive trading days.

While we have regained compliance within the applicable time periods in the past, if our shares again no longer comply with the minimum closing bid price requirement for continued listing on the Nasdaq Capital Market under Nasdaq Marketplace Rule 5550(a)(2) and we do not regain compliance within the applicable 180-day time period, Nasdaq will notify us that our securities will be subject to delisting. The Company may appeal Nasdaq's determination to delist its securities to a Hearings Panel. During any appeal process, shares of our common stock would continue to trade on the Nasdaq Capital Market.

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

*Our ability to use net operating losses and certain other tax attributes is uncertain and may be limited*

Our ability to use our federal and state net operating losses to offset potential future taxable income and related income taxes that would otherwise be due is dependent upon our generation of future taxable income before the expiration dates of the net operating losses, and we cannot predict with certainty when, or whether, we will generate sufficient taxable income to use all of our net operating losses. In addition, utilization of net operating

losses to offset potential future taxable income and related income taxes that would otherwise be due is subject to annual limitations under the “ownership change” provisions of Sections 382 and 383 of the Internal Revenue Code of 1986, as amended (Internal Revenue Code) and similar state provisions, which may result in the expiration of net operating losses before future utilization. In general, under the Code, if a corporation undergoes an “ownership change,” generally defined as a greater than 50% change (by value) in its equity ownership over a three-year period, the corporation’s ability to use its pre-change net operating losses and other pre-change tax attributes (such as research and development credit carryforwards) to offset its post-change taxable income or taxes may be limited. Our equity offerings and other changes in our stock ownership, some of which are outside of our control, may have resulted or could in the future result in an ownership change. If an ownership change limitation were to apply, utilization of our domestic net operating losses and tax credit carryforwards could be limited in future periods and a portion of the carryforwards could expire before being available to reduce future income tax liabilities.

*The price of our common stock may be volatile*

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

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

- adverse results (including adverse events or failure to demonstrate safety or efficacy) or delays in our clinical and non-clinical trials of DUR-928 or other product candidates;
- announcements of FDA non-approval of our product candidates, or delays in the FDA or other foreign regulatory agency review process;
- adverse actions taken by regulatory agencies or law enforcement agencies with respect to our product candidates, clinical trials, manufacturing processes or sales and marketing activities, or those of our third-party collaborators;
- announcements of technological innovations, patents, product approvals or new products by our competitors;
- failure of third-party collaborators to continue development of the respective product candidates they are developing;
- regulatory, judicial and patent developments in the United States and foreign countries;
- any lawsuit or arbitration involving us or our product candidates including intellectual property infringement or product liability suits;
- announcements concerning our competitors, or the biotechnology or pharmaceutical industries in general;
- developments concerning our strategic alliances or acquisitions or termination of such alliances;
- actual or anticipated variations in our operating results;
- changes in recommendations by securities analysts or lack of analyst coverage;
- negative press coverage or online misinformation about the Company or its partners or their respective products or personnel;
- deviations in our operating results from the estimates of analysts;
- sales of our common stock by our executive officers or directors or sales of substantial amounts of common stock by us or others;
- potential failure to meet continuing listing standards from The Nasdaq Capital Market;
- loss or disruption of facilities due to natural disasters;
- acceleration of our debt obligations due to a determination by our lender that a material adverse change has occurred;

- changes in accounting principles; or
- loss of any of our key scientific or management personnel.

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

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

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

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

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

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

- the election of directors;
- the amendment of charter documents;
- the approval of certain mergers and other significant corporate transactions, including a sale of substantially all of our assets; or
- the defeat of any non-negotiated takeover attempt that might otherwise benefit the public stockholders.

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

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

- authorizing the issuance of "blank check" preferred stock without any need for action by stockholders;
- providing for a classified board of directors with staggered terms;
- requiring supermajority stockholder voting to effect certain amendments to our certificate of incorporation and bylaws;
- eliminating the ability of stockholders to call special meetings of stockholders;
- prohibiting stockholder action by written consent; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

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

Our bylaws provide that the Court of Chancery of the State of Delaware is the exclusive forum for any derivative action or proceeding brought on behalf of the Company, any action asserting a claim of breach of a

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

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

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

The following chart indicates the facilities that we lease, the location and size of each such facility and their designated use.

<u>Location</u>	<u>Approximate Square Feet</u>	<u>Operation</u>	<u>Expiration</u>
Cupertino, CA	30,149 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2024 (with an option to renew for an additional five years)
Cupertino, CA	20,100 sq. ft.	Office and Laboratory	Lease expires 2024 (with an option to renew for an additional five years)
Vacaville, CA	24,634 sq. ft.	Manufacturing	Lease expires 2023 (with an option to renew for an additional five years)
Birmingham, AL	21,540 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2021 (with two options to renew the lease term for an additional five years each after the current lease expires)

We believe that our existing facilities are adequate to meet our current and foreseeable requirements or that suitable additional or substitute space will be available as needed.

**Item 3. Legal Proceedings.**

We are not a party to any material legal proceedings.

**Item 4. Mine Safety Disclosures.**

Not applicable.



**Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is traded on the NASDAQ Capital Market under the symbol “DRRX”.

As of February 28, 2020, there were approximately 105 holders of record of the common stock. This does not include the number of persons whose stock is in nominee or “street name” accounts through brokers.

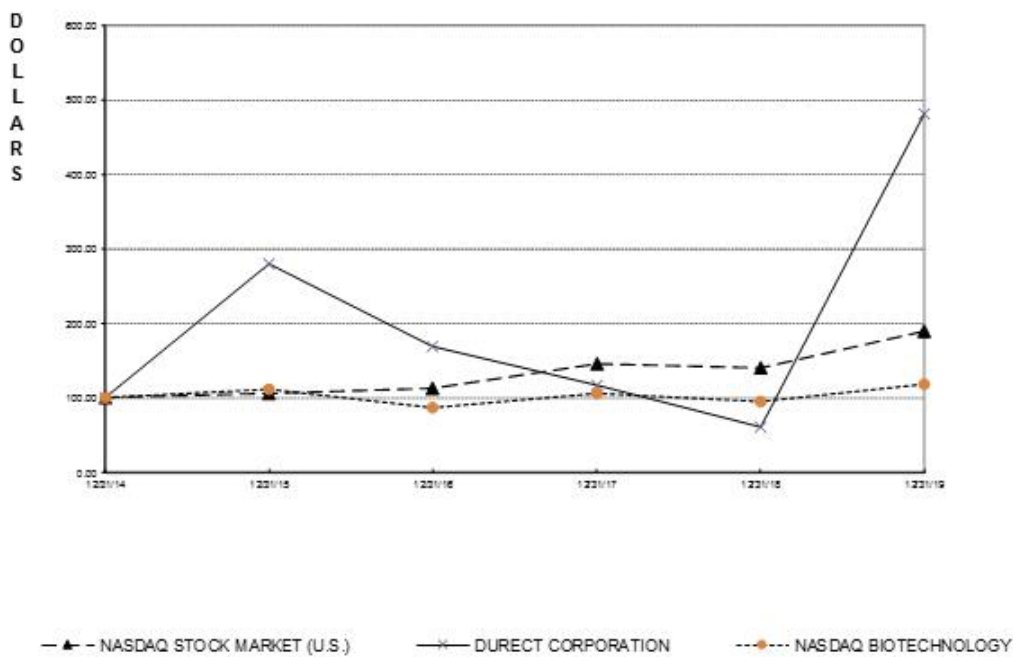
**Dividend Policy**

We have never paid cash dividends on our common stock. We currently intend to retain any future earnings to fund the development and growth of our business. Therefore, we do not currently anticipate paying any cash dividends in the foreseeable future.

## STOCK PERFORMANCE GRAPH

The following graph compares the cumulative total stockholder return data for our stock with the cumulative return of (i) The NASDAQ Stock Market (U.S.) Index and (ii) the NASDAQ Biotechnology Index since December 31, 2014. The graph assumes that \$100 was invested on December 31, 2014. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

### COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\* AMONG DURECT CORPORATION, THE NASDAQ STOCK MARKET (U.S.) INDEX, AND THE NASDAQ BIOTECHNOLOGY INDEX



\* \$100 Invested on 12/31/14 in stock or index—including reinvestment of dividends. Fiscal year ending December 31.

#### DURECT CORPORATION

	12/31/14	12/31/15	12/31/16	12/31/17	12/31/18	12/31/2019
DURECT CORPORATION	100.00	279.75	169.62	116.46	60.76	481.01
NASDAQ STOCK MARKET (U.S.)	100.00	105.73	113.66	145.76	140.10	189.45
NASDAQ BIOTECHNOLOGY	100.00	111.42	87.26	105.64	95.79	119.17

#### Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

**Item 6. Selected Financial Data.**

The following selected financial data should be read in conjunction with and are qualified by reference to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our financial statements and related notes, which are included in this Form 10-K. The statement of operations data for the years ended December 31, 2019, 2018 and 2017 and the balance sheet data at December 31, 2019 and 2018 are derived from, and are qualified by reference to, the audited financial statements included elsewhere in this Form 10-K. The statement of operations data for the years ended December 31, 2016 and 2015, and the balance sheet data at December 31, 2017, 2016 and 2015 are derived from our audited statements not included in this Form 10-K. Historical operating results are not necessarily indicative of results in the future. See Note 1 of notes to financial statements for an explanation of the determination of the shares used in computing net loss per share.

	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(in thousands, except per share data)				
<b>Statement of Operations Data:</b>					
Collaborative research and development and other revenue (1)	\$ 18,129	\$ 8,207	\$ 23,577	\$ 1,880	\$ 7,832
Product revenue, net	11,435	10,357	13,093	12,145	11,292
Revenue from sale of intellectual property rights	—	—	12,500	—	—
<b>Total revenue</b>	<b>29,564</b>	<b>18,564</b>	<b>49,170</b>	<b>14,025</b>	<b>19,124</b>
Operating expenses:					
Cost of revenue	4,143	4,263	6,633	5,290	3,905
Research and development	30,209	25,501	31,609	29,274	24,317
Selling, general and administrative	14,363	12,419	13,165	11,825	11,566
<b>Total operating expenses</b>	<b>48,715</b>	<b>42,183</b>	<b>51,407</b>	<b>46,389</b>	<b>39,788</b>
Loss from operations	(19,151)	(23,619)	(2,237)	(32,364)	(20,664)
Other income (expense):					
Interest and other income	1,074	870	967	143	237
Interest expense	(2,501)	(2,573)	(2,425)	(2,288)	(2,236)
<b>Net other expense</b>	<b>(1,427)</b>	<b>(1,703)</b>	<b>(1,458)</b>	<b>(2,145)</b>	<b>(1,999)</b>
<b>Net loss</b>	<b>\$ (20,578)</b>	<b>\$ (25,322)</b>	<b>\$ (3,695)</b>	<b>\$ (34,509)</b>	<b>\$ (22,663)</b>
Basic net loss per share	\$ (0.12)	\$ (0.16)	\$ (0.03)	\$ (0.26)	\$ (0.19)
Diluted net loss per share	\$ (0.12)	\$ (0.16)	\$ (0.03)	\$ (0.26)	\$ (0.19)
Shares used in computing basic net loss per share	178,042	159,834	145,273	133,163	118,523
Shares used in computing diluted net loss per share	178,042	159,834	145,273	133,163	118,523

	As of December 31,				
	2019	2018	2017	2016	2015
	(in thousands)				
<b>Balance Sheet Data:</b>					
Cash, cash equivalents and investments	\$ 64,824	\$ 34,465	\$ 36,909	\$ 25,154	\$ 29,290
Working capital	35,061	34,078	29,530	3,676	30,874
Total assets	86,020	49,999	53,113	40,508	46,772
Term loan, net	20,262	20,533	20,859	20,137	20,511
Other long-term liabilities	801	992	1,126	1,541	1,664
Stockholders’ equity	22,860	20,000	21,488	8,338	14,883

- (1) The 2017 figure includes the recognition of \$20.0 million in revenue associated with a nonrefundable upfront payment that we received in June 2017 under our license agreement with Sandoz. The 2018 figure includes the recognition of \$5.0 million in revenue associated with a nonrefundable milestone payment that we received in August 2018 under our agreement with Indivior. The 2019 figure includes the recognition of \$12.3 million in revenue associated with a nonrefundable \$25.0 million upfront payment and \$10.0 million milestone payment that we received in July and October 2019, respectively under our license agreement with Gilead.

**Item 7. 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 as of December 31, 2019, 2018, 2017 and 2016 should be read in conjunction with our Financial Statements, including the Notes thereto, and “Risk Factors” section included elsewhere in this Form 10-K. This Form 10-K 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 or elsewhere by management from time to time, the words “believe,” “anticipate,” “intend,” “plan,” “estimate,” “expect” and similar expressions are forward-looking statements. Such forward-looking statements contained herein are based on current expectations.*

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

- the clinical trial plans for DUR-928;
- potential uses and benefits of DUR-928 to treat alcoholic hepatitis, NASH or other conditions, including acute kidney injury, and nonalcoholic fatty liver disease;
- potential regulatory filings for or approval of DUR-928, POSIMIR, or any of our or any third parties’ other product candidates;
- the potential earn-out payments we may receive from Indivior related to the commercialization of PERSERIS and milestone and royalty payments we may receive from Gilead, Santen or Orient Pharma;
- 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 and technologies, including POSIMIR and our SABER and ORADUR technologies;
- responsibilities of our third-party collaborators, including the responsibility to make cost reimbursement, milestone, royalty and other payments to us, and our expectations regarding our collaborators’ plans with respect to our products and continued development of our products;
- our responsibilities to our third-party collaborators, including our responsibilities to conduct research and development, clinical trials and manufacture products;
- our ability to protect intellectual property, including intellectual property licensed to our collaborators;
- market opportunities for products in our product pipeline;
- the progress and results of our research and development programs and our evaluation of additional development programs;
- requirements for us to purchase supplies and raw materials from third parties, and the ability of third parties to provide us with required supplies and raw materials;
- the results and timing of clinical trials, the likelihood of future clinical trial results being similar to results from previous trials, including for DUR-928, the possible commencement of future clinical trials and announcements of the findings of our clinical trials;
- conditions for obtaining regulatory approval of our product candidates;
- submission and timing of applications for regulatory approval;
- the impact of FDA, DEA, EMEA and other government regulation on our business;
- uncertainties associated with obtaining, asserting 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 develop and/or license to third-party collaborators;

- the possibility we may commercialize our own products and build up our commercial, sales and marketing capabilities and other required infrastructure;
- the possibility that we may develop additional manufacturing capabilities;
- our employees, including the number of employees and the continued services of key management, technical and scientific personnel;
- our future performance, including our anticipation that we will not derive meaningful revenues from our products in development for at least the next twelve months, potential for future inventory write-offs and our expectations regarding our ability to achieve profitability;
- sufficiency of our cash resources, anticipated capital requirements and capital expenditures, our ability to comply with covenants of our term loan, and our need or desire 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.

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

## **Overview**

We are a biopharmaceutical company with research and development programs broadly falling into two categories: (i) new chemical entities derived from our Epigenetic Regulator Program, in which we attempt to discover and develop molecules which have not previously been approved and marketed as therapeutics, and (ii) proprietary pharmaceutical 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, 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.

Our product pipeline currently consists of multiple investigational drug candidates in development. DUR-928, a new chemical entity in Phase 1 and 2 development for different indications, is the lead candidate in DURECT’s Epigenetic Regulator Program. An endogenous, orally bioavailable, small molecule, DUR-928 has been shown in preclinical studies to play an important regulatory role in lipid homeostasis, inflammation, and cell survival. Human applications may include acute organ injury such as alcoholic hepatitis (AH) and acute kidney injury (AKI), chronic metabolic diseases such as nonalcoholic steatohepatitis (NASH), nonalcoholic fatty liver disease (NAFLD) and other liver diseases. DURECT’s proprietary oral and injectable delivery technologies are designed to enable new indications and enhanced attributes for small-molecule and biologic drugs. Important development programs in this category include POSIMIR® (bupivacaine extended-release solution), an investigational analgesic product intended to deliver bupivacaine to provide up to three days of pain relief after surgery and an investigational long-acting injectable HIV product being developed in collaboration with Gilead.

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 royalties on product sales. At the same time, we have retained the rights to other programs, which are the basis of future potential collaborations and which over time may provide a pathway for us to develop our own biopharmaceutical commercial, sales and marketing organization.

### ***Collaborative Research and Development and Other Revenues***

Collaborative research and development and other revenues consist of three broad categories: (a) the recognition of upfront license payments over the period of our continuing involvement with the third party, (b) the reimbursement of qualified research expenses by third parties and (c) milestone payments in connection with our collaborative agreements. During the last three years, we generated collaborative research and development revenues from collaborative agreements with Gilead, Sandoz, Zogenix, Santen and others.

### ***Product Revenues***

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

- ALZET® osmotic pumps which are used for animal research;
- LACTEL® biodegradable polymers which are used by our customers as raw materials in their pharmaceutical and medical products; and
- certain key excipients that are included in Methydrur Sustained Release Capsules 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 revenues 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.

### ***Revenues from Sale of Intellectual Property Rights***

From time-to-time, we also enter into arrangements in which we sell intellectual property rights and, in return, may receive upfront payments, contingent milestone payments and earn-outs from third party collaborators. Our deliverable under these arrangements typically consists of the sale of intellectual property rights, and does not include any substantive continuing obligations subsequent to the transfer of the related rights, title, and interest to the buyer. We recognize the upfront payment as revenue because such arrangement is part of our revenue-earning activities and is in line with our ordinary course of ongoing business operations. In September 2017, we entered into a patent purchase agreement with Indivior and received a non-refundable payment of \$12.5 million.

### ***Operating Results***

Since our inception in 1998, we have generally had a history of operating losses. At December 31, 2019, we had an accumulated deficit of \$489.2 million. Our net losses were \$20.6 million, \$25.3 million and \$3.7 million for the years ended December 31, 2019, 2018 and 2017, 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 2020 compared to 2019 as we experience higher research and development expenses related to DUR-928. We expect our selling, general and administrative expenses to decrease in 2020 compared to 2019 as a result of expected decreases in legal expenses and stock-based compensation expenses. We do not anticipate meaningful revenues from our products in development, should they be approved, for at least the next twelve months. Therefore, we expect to incur continuing losses and negative cash flows from operations for the foreseeable future.

### ***Critical Accounting Policies and Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to inventories and purchase commitments, revenue recognition, contract research liabilities, and stock-based compensation. Actual amounts could differ significantly from these estimates.

### *Inventories and Purchase Commitments*

Our inventories, in part, include certain excipients that are sold to a customer for a currently marketed animal health product and included in several products in development, awaiting regulatory approval or commercial launch. These inventories are capitalized based on management's judgment of probable sale prior to their expiration dates. The valuation of inventory requires management to estimate the value of inventory that may become expired prior to use. We 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 us to record a liability related to minimum purchase agreements that we have in place for raw materials. In October 2017, we announced that PERSIST, the Phase 3 clinical trial for POSIMIR, did not meet its primary efficacy endpoint of reduction in pain on movement over the first 48 hours after surgery as compared to standard bupivacaine HCl. As a result, during the year ended December 31, 2017, we recorded charges to cost of goods sold of approximately \$2.0 million, of which approximately \$503,000 related to the write-down of the cost basis of inventory on hand, \$500,000 related to the prepaid inventory for the minimum purchase commitment for the same excipient, and \$1.0 million related to the recognition of our remaining minimum purchase commitment for the same excipient. If we are able to subsequently sell products made with raw materials that were previously written down, we will report an unusually high gross profit as there will be no associated cost of goods for these materials.

### *Revenue Recognition*

We enter into license and collaboration agreements under which we may receive upfront license fees, research funding and contingent milestone payments and royalties. Prior to January 1, 2018, we evaluated the accounting treatment under these agreements including whether multiple deliverables existed, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. For our collaborations with multiple deliverables, we had concluded that the deliverables were not separable and the arrangements should be accounted for as a combined unit of accounting. As a combined unit of accounting, we recognized the consideration for the combined unit of accounting in the same manner as the revenue was recognized for the final deliverable, which was generally ratably over the longest period of involvement. For example, upfront payments received upon execution of collaborative agreements were recorded as deferred revenue and recognized as collaborative research and development revenue based on a straight-line basis over the period of our continuing involvement with the third-party collaborator pursuant to the applicable agreement. Such period generally represented the longer of the estimated research and development period or other continuing obligation period defined in the respective agreements between us and our third-party collaborators. If we determined that the expected timeline for a project and therefore our continuing involvement was materially different than we previously assumed, we adjusted the period over which we recognized the deferred revenue.

Effective January 1, 2018, we adopted FASB ASC Topic 606, Revenue from Contracts with Customers, or ASC 606. In accordance with ASC 606, we changed certain characteristics of our revenue recognition accounting policy as described below. ASC 606 was applied using the modified retrospective method, where the cumulative effect of the initial application was recognized as an adjustment to opening accumulated deficit at January 1, 2018. Therefore, comparative prior periods have not been adjusted and continue to be reported under FASB ASC Topic 605, Revenue Recognition, or ASC 605. We recorded a net decrease to opening accumulated deficit of \$470,000 with an offset entry to a contra liability account as of January 1, 2018 due to the cumulative impact of adopting ASC 606, with the impact relating to our deferred collaborative research and development revenues. There was no impact to reported total assets, revenues and operating expenses for the twelve months ended December 31, 2018 as a result of applying ASC 606.

### *Product Revenues, Net*

We 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.

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

*Trade Discounts and Allowances:* We provide certain customers with discounts that are explicitly stated in our contracts and are recorded as a reduction of revenues in the period the related product revenues are recognized.

*Product Returns:* Consistent with industry practice, we generally offer customers a limited right of return for products that have been purchased from us. We estimate the amount of our product sales that may be returned by our customers and record this estimate as a reduction of revenues in the period the related product revenues is recognized. We currently estimate product return liabilities using our own historical sales information. We expect product returns to be minimal.

#### *Collaborative Research and Development Revenues*

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

In determining the appropriate amount of revenue to be recognized as we fulfill our obligations under each of our agreements, we perform the following steps: (i) identification of the promised goods or services in the contract; (ii) determination of whether the promised goods or services are performance obligations, including whether they are distinct in the context of the contract; (iii) measurement of the transaction price, including the constraint on variable consideration; (iv) allocation of the transaction price to the performance obligations; and (v) recognition of revenue when (or as) we satisfy each performance obligation. As part of the accounting for these arrangements, we must develop assumptions that require judgment to determine the stand-alone selling price for each performance obligation identified in the contract. We use key assumptions to determine the stand-alone selling price, which may include forecasted revenues, development timelines, reimbursement rates for personnel costs, discount rates and probabilities of technical and regulatory success. We expect to recognize revenue for the variable consideration currently being constrained when it is probable that a significant revenue reversal will not occur.

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

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

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



*Royalties and Earn-outs:* For arrangements that include sales-based royalties or earn-outs, including milestone payments based on the level of sales, and the license is deemed to be the predominant item to which the royalties relate, we recognize revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied). To date, we have not recognized any material royalty revenue resulting from our collaborative arrangements or any material earn-out revenue from our patent purchase agreement with Indivior.

#### *Contract Research Liabilities*

We incur significant costs associated with third party consultants and organizations for pre-clinical studies, clinical trials, contract manufacturing, validation, testing, and other research and development-related services. We are required to estimate periodically the cost of services rendered but unbilled based on management's estimates of project status. If these good faith estimates are inaccurate, actual expenses incurred could materially differ from our estimates.

#### *Stock-Based Compensation*

Employee stock-based compensation is estimated at the date of grant based on the employee stock award's fair value using the Black-Scholes option-pricing model and is recognized as expense ratably over the requisite period.

We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock. We base the risk-free rate that we use in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms. We have never paid any cash dividends on our common stock and we do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model. We estimated forfeitures at the time of grant and revised those estimates in subsequent periods if actual forfeitures differ from those estimates. We used historical data to estimate pre-vesting option forfeitures and recorded stock-based compensation expense only for those awards that are expected to vest. Upon the adoption of ASU 2016-09, we account for forfeitures as they occur and record stock-based compensation expense only for those awards that vest. We amortize the fair value of options granted on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods. We may elect to use different assumptions under the Black-Scholes option valuation model in the future, which could materially affect our net income or loss and net income or loss per share.

### **Results of Operations**

#### *Comparison of years ended December 31, 2019, 2018 and 2017*

##### *Collaborative research and development and other revenues*

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

We expect our collaborative research and development and other revenues to fluctuate in future periods pending our efforts to enter into potential new collaborations, our existing third party collaborators' commitment to and progress in the research and development programs, and any royalty or earn-out revenue recognized from collaborators or counterparties. The collaborative research and development and other revenues associated with our major collaborators or counterparties are as follows (in thousands):

Collaborator/Counterparty	Year ended December 31,		
	2019	2018	2017
Gilead (1)	\$ 17,133	\$ 2,542	\$ 1,687
Sandoz AG (Sandoz) (2)	—	—	20,000
Other (3)	996	5,665	1,890
<b>Total collaborative research and development and other revenue</b>	<b>\$ 18,129</b>	<b>\$ 8,207</b>	<b>\$ 23,577</b>

- (1) We signed a license agreement with Gilead on July 19, 2019 and received an upfront license fee and a milestone payment totaling \$35.0 million in 2019. Amounts include partial recognition (\$12.3 million) of the upfront license fee and milestone payment in 2019, compared to zero for the corresponding periods in 2018 and 2017.
- (2) Amounts related to recognition of upfront fees were zero in 2019 and 2018, and \$20.0 million in 2017; the Company and Sandoz signed a license agreement effective June 2017. As of December 31, 2017, all of the \$20.0 million upfront fee had been recognized as revenue as the Company's contractual performance obligations had been fulfilled. In January 2019, the license agreement was terminated.
- (3) Includes: (a) amounts related to earn-out revenue from Indivior UK Limited (Indivior) with respect to PERSERIS net sales as well as a \$5.0 million milestone payment earned from Indivior in 2018; (b) feasibility program(s); (c) research and development activities funded by Santen. Note that in January 2018, we were notified by Santen that due to a shift in near term priorities, Santen has elected to reallocate research and development resources and put our program on pause until further notice. While the main program is on pause, the parties are working together on a limited set of research and development activities funded by Santen; and (d) research and development activities funded by Zogenix. Note that we and Zogenix signed a license agreement effective July 2011. In August 2017, we and Zogenix terminated the license agreement.

The increase in collaborative research and development revenues in 2019 compared with 2018 was primarily due to higher revenue recognized from our agreement with Gilead, partially offset by lower revenue recognized from our agreements with Indivior, Santen and feasibility agreements with other companies.

The decrease in collaborative research and development revenues in 2018 compared with 2017 was primarily due to lower revenue recognized from our agreements with Sandoz, partially offset by higher revenue recognized from feasibility agreements with other companies. In addition, we earned a \$5.0 million milestone payment from Indivior upon NDA approval of PERSERIS in the third quarter of 2018.

We received a \$25.0 million upfront fee in connection with the license agreement signed with Gilead in July 2019. In October 2019, we also received a \$10 million milestone payment from Gilead for further development of the product candidate. At December 31, 2019, \$12.3 million of the \$35.0 million upfront fee and milestone payment had been recognized as revenue based on the contractual performance obligations performed in 2019.

We received a \$20.0 million upfront fee in connection with a license agreement signed with Sandoz in June 2017. At December 31, 2017, all of the \$20.0 million upfront fee had been recognized as revenue as our contractual performance obligations had been fulfilled. In January 2019, the license agreement with Sandoz was terminated.

We received a \$2.0 million upfront fee in connection with the license agreement signed with Santen in December 2014. The \$2.0 million upfront fee was being recognized as collaborative research and development revenue over the term of our continuing involvement with Santen. At December 31, 2019, \$1.2 million of the \$2.0 million upfront fee had been recognized as revenue.

We received a \$2.25 million upfront fee in connection with the development and license agreement signed with Zogenix in July 2011 relating to Relday. The \$2.25 million upfront fee was being recognized as collaborative research and development revenue ratably over the term of our continuing involvement with Zogenix with respect to Relday. As a result of the termination of the Zogenix agreement in August 2017, we recognized revenue during the

third quarter of 2017 for the remaining \$750,000 of deferred revenue related to the upfront fee as we had no remaining performance obligations under the agreement; this recognition of revenue did not result in additional cash proceeds to us. At December 31, 2017, all of the \$2.25 million upfront fee had been recognized as revenue.

As of February 28, 2020, we had potential milestones of up to \$221.0 million that we may receive in the future under our collaborative arrangements, of which \$88.0 million are development-based milestones and \$133.0 million are sales-based milestones. Within the category of development-based milestones, \$2.0 million are related to early stage clinical testing (defined as Phase 1 or 2 activities), \$33.0 million are related to late stage clinical testing (defined as Phase 3 activities), \$3.0 million are related to regulatory filings, and \$50.0 million are related to regulatory approvals. No payments were received between December 31, 2019 and February 28, 2020.

#### *Product revenues*

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 Methydrur and in a currently marketed animal health product. Net product revenues were \$11.4 million, \$10.4 million, and \$13.1 million in 2019, 2018 and 2017, respectively.

The increase in product revenues in 2019 was primarily attributable to higher revenue from our LACTEL product line as a result of higher units sold, partially offset by slightly lower revenue from our ALZET mini pump product line as a result of lower units sold compared to 2018.

The decrease in product revenues in 2018 was primarily attributable to lower revenue from our LACTEL product line as a result of lower units sold, partially offset by slightly higher revenue from our ALZET mini pump product line as a result of higher units sold compared to 2017.

#### *Revenue from sale of intellectual property rights*

Revenue from the sale of intellectual property rights was zero in 2019 and 2018, and \$12.5 million in 2017. We entered into a patent purchase agreement with Indivior and received a non-refundable payment of \$12.5 million in September 2017. We recognized the \$12.5 million as revenue from sale of intellectual property rights in 2017 as we did not have any substantive continuing obligations under the purchase agreement.

#### *Cost of product revenues*

Cost of product revenues was \$4.1 million, \$4.3 million and \$6.6 million in 2019, 2018 and 2017, respectively. Cost of product revenues includes the cost of product revenue from our ALZET product line, our LACTEL product line and certain excipients that are included in several products in development, Methydrur Sustained Release Capsules and a currently marketed animal health product.

Excluding a one-time settlement credit of \$500,000 related to certain excipients that are included in Methydrur Sustained Release Capsules and in a currently marketed animal health product, cost of product revenue in 2019 increased primarily due to higher units sold related to our LACTEL product line and higher manufacturing costs for our ALZET product line compared to the corresponding period in 2018.

The decrease in the cost of product revenue in 2018 was primarily the result of charges of approximately \$2.0 million in 2017 associated with write-down of an excipient in light of PERSIST, the Phase 3 clinical trial of POSIMIR, not meeting its primary efficacy endpoint. Excluding the charges associated with the write-down of the excipient included in 2017, the decrease in the cost of product revenue in 2018 was primarily the result of lower cost of goods sold related to our LACTEL product line arising from lower units sold, partially offset by higher cost of goods sold related to our ALZET product line arising from higher units sold compared to 2017.

Stock-based compensation expense related to cost of product revenues was \$85,000, \$94,000, and \$109,000 in 2019, 2018, and 2017, respectively.

As of December 31, 2019, 2018, and 2017, we had 21 manufacturing employees at each date.

*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 \$30.2 million, \$25.5 million, and \$31.6 million in 2019, 2018, and 2017, respectively. Stock-based compensation expense recognized related to research and development personnel was \$755,000, \$1.5 million and \$1.4 million in 2019, 2018 and 2017, respectively. We expect our research and development expenses to increase in 2020 compared to 2019 as we experience higher research and development expenses related to DUR-928.

Research and development expenses increased by \$4.7 million in 2019 compared to 2018. The increase in 2019 was primarily attributable to higher research and development costs associated with DUR-928 and the Gilead program, partially offset by lower research and development costs associated with POSIMIR, depot injectable and other research programs compared to 2017, as more fully discussed below.

Research and development expenses decreased by \$6.1 million in 2018 compared to 2017. The decrease in 2018 was primarily attributable to lower research and development costs associated with POSIMIR, depot injectable and other research programs, partially offset by higher research and development costs associated with DUR-928, and Gilead program compared to 2017, as more fully discussed below.

Research and development expenses associated with our major development programs are as follows (in thousands):

	Year Ended December 31,		
	2019	2018	2017
DUR-928	\$ 20,474	\$ 15,106	\$ 13,279
POSIMIR	4,697	6,757	15,075
Gilead program (1)	3,918	2,283	1,265
Depot injectable programs	611	711	1,172
Other	509	644	818
Total research and development expenses	<u>\$ 30,209</u>	<u>\$ 25,501</u>	<u>\$ 31,609</u>

(1) See Note 2 Strategic Agreements in the financial statements for more details about our agreements with Gilead.

#### *DUR-928*

Our research and development expenses for DUR-928 increased to \$20.5 million in 2019 from \$15.1 million in 2018, primarily due to higher clinical trial expenses incurred.

Our research and development expenses for DUR-928 increased to \$15.1 million in 2018 from \$13.3 million in 2017, primarily due to higher contract manufacturing expenses and higher clinical trial and non-clinical study expenses incurred.

#### *POSIMIR*

Our research and development expenses for POSIMIR decreased to \$4.7 million in 2019 from \$6.8 million in 2018, primarily due to lower outside expenses as well as lower employee-related expenses for POSIMIR.

Our research and development expenses for POSIMIR decreased to \$6.8 million in 2018 from \$15.1 million in 2017, primarily due to lower clinical trial expenses, lower contract manufacturing expenses and lower employee-related expenses.

#### *Gilead Program*

Our research and development expenses for the Gilead program increased to \$3.9 million in 2019 from \$2.3 million in 2018, primarily due to higher employee-related costs and outside costs for the program.

Our research and development expenses for the Gilead program increased to \$2.3 million in 2018 from \$1.3 million in 2017, primarily due higher employee-related costs and outside costs for the program.

#### *Depot injectable programs*

Our research and development expenses for depot injectable programs decreased to \$611,000 in 2019 from \$711,000 in 2018 primarily due to lower employee-related costs and lower research supplies expenses for these programs.

Our research and development expenses for depot injectable programs decreased to \$711,000 in 2018 from \$1.2 million in 2017 primarily due to lower employee-related costs and lower research supplies expenses for these programs.

### *Other DURECT research programs*

Our research and development expenses for all other research activities decreased to \$509,000 in 2019 from \$644,000 in 2018, primarily due to lower employee-related costs incurred for these programs.

Our research and development expenses for all other research activities decreased to \$644,000 in 2018 from \$818,000 in 2017, primarily due to lower employee-related costs incurred for these programs.

As of December 31, 2019, 2018, and 2017, we had 45, 47, and 49 research and development employees, respectively.

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

*Selling, general and administrative.* Selling, general and administrative expenses are primarily comprised of salaries, benefits and stock-based compensation associated with finance, legal, business development, sales and marketing (including sales and marketing expenses for our ALZET and LACTEL product lines) and other administrative personnel, overhead and facility costs, and other general and administrative costs. Selling, general and administrative expenses were \$14.4 million, \$12.4 million, and \$13.2 million in 2019, 2018, and 2017, respectively. Stock-based compensation expense recognized related to selling, general and administrative personnel was \$1.3 million, \$1.4 million, and \$1.1 million in 2019, 2018 and 2017, respectively. We expect our selling, general and administrative expenses to decrease in 2020 compared to 2019 as a result of expected decreases in legal expenses and stock-based compensation expenses.

Selling, general and administrative expenses increased by approximately \$1.9 million in 2019 compared to 2018, primarily due to higher legal and patent expenses in 2019 compared with 2018. Selling, general and administrative expenses decreased by approximately \$746,000 in 2018 compared to 2017, primarily due to an advisory fee related to the execution of a license agreement which occurred in 2017.

As of December 31, 2019, 2018, and 2017, we had 22, 22, and 24 selling, general and administrative personnel, respectively.

*Other income (expense).* Interest and other income was \$1.1 million, \$870,000, and \$967,000 in 2019, 2018, and 2017, respectively. The increase in interest and other income in 2019 compared to 2018 was primarily the result of higher interest income generated as a result of higher average investment balances in 2019 compared with 2018. The decrease in interest and other income in 2018 compared to 2017 was primarily the result of a gain of \$500,000 from selling certain intellectual property rights in 2017 which was not part of our ordinary course of business, partially offset by higher interest income generated from our investments as a result of higher yields and higher average investment balances in 2018 compared with 2017.

Interest expense was \$2.5 million, \$2.6 million, and \$2.4 million in 2019, 2018, and 2017, respectively. The decrease in interest expense in 2019 compared to 2018 was primarily due to lower interest rates associated with the term loan in 2019 compared to 2018. The increase in interest expense in 2018 compared to 2017 was primarily due to higher interest rates associated with the term loan in 2018 compared to 2017.

*Income taxes.* As of December 31, 2019, we had net operating loss (NOL) carryforwards for federal income tax purposes of approximately \$358.6 million, of which \$320.4 million will expire in the years 2020 through 2037, and \$38.2 million will not expire. As of December 31, 2019, we had federal research and development tax credits of approximately \$14.5 million, which expire at various dates beginning in 2020 through 2039, if not utilized. As of December 31, 2019, we had NOL carryforwards for state income tax purposes of approximately \$219.2 million, which expire in the years 2020 through 2039, and state research and development tax credits of approximately \$15.8 million, which do not expire. Utilization of the net operating losses may be subject to a substantial annual limitation due to federal and state ownership change limitations. The annual limitation may result in the expiration of net operating losses and credits before utilization.

As of December 31, 2019 and 2018, we had net deferred tax assets of \$117.2 million and \$112.7 million, respectively. Deferred tax assets reflect the net tax effects of net operating loss and credit carryforwards and the temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance.

Because realization of such tax benefits is uncertain, we provided a 100% valuation allowance as of December 31, 2019 and 2018. Utilization of the NOL and R&D credits carryforwards may be subject to a substantial annual limitation due to ownership change limitations that have occurred previously or that could occur in the future provided by Sections 382 and 383 of the Internal Revenue Code of 1986, as well as similar state and foreign provisions. These ownership changes may limit the amount of NOL and R&D credits carryforwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an ownership change is defined as a greater than 50% change (by value) in its equity ownership over a three-year period, the corporation's ability to use its pre-change net operating losses and other pre-change tax attributes (such as research and development credit carryforwards) to offset its post-change taxable income or taxes may be limited. Since our formation, we have raised capital through the issuance of capital stock on several occasions which, combined with the purchasing shareholders' subsequent disposition of those shares, may have resulted in a change of control, as defined by Section 382, or could result in a change of control in the future upon subsequent disposition. We issued \$60.0 million of convertible notes in 2003 and subsequently all of these notes had been converted as of December 31, 2008 into approximately 19.0 million shares of our common stock. We also issued approximately 4.4 million shares of our common stock to an institutional investor in connection with an equity financing in September 2009. In December 2012, November 2013, April 2016 and June 2019, we completed underwritten public offerings in which we sold an aggregate of approximately 14.0 million, 8.2 million and 13.8 million shares and 29.0 million shares, respectively, of our common stock pursuant to effective registration statements. In 2016, 2017, 2018 and 2019, we issued approximately 5.2 million, 8.9 million, 9.6 million shares and 2.3 million shares, respectively, of our common stock in the open market through Controlled Equity Offering sales agreements with Cantor Fitzgerald pursuant to effective registration statements. These transactions may also have resulted in a change of control as defined by Section 382 or could result in a change of control in the future upon the subsequent disposition of the shares.

We have not currently completed a study to assess whether a change in control has occurred or whether there have been multiple changes of control since our formation due to the significant complexity and cost associated with such a study and the fact that there could be additional changes in the future. If we have experienced a change of control at any time since our formation, utilization of our NOL or R&D credits carryforwards would be subject to an annual limitation under Sections 382 and 383 which is determined by first multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate, and then could be subject to additional adjustments, as required. Any limitation may result in expiration of a portion of our NOL or R&D credits carryforwards before utilization. Tax years 1998 to 2019 remain subject to future examination by the major tax jurisdictions in which we are subject to tax.

### **Liquidity and Capital Resources**

We had cash, cash equivalents, and investments totaling \$64.8 million and \$34.5 million at December 31, 2019 and 2018, respectively. This includes \$150,000 of interest-bearing marketable securities classified as restricted investments on our balance sheet as of December 31, 2019 and 2018, which primarily serve as collateral for a letter of credit securing a leased facility in California. The letter of credit for our leased facility in California will expire in February 2024.

We generated \$11.1 million of cash in operating activities in the year ended December 31, 2019, and used \$19.8 million and \$1.3 million of cash in operating activities in the years ended December 31, 2018 and 2017, respectively. The cash provided by or used for operations was primarily to fund operations as well as working capital requirements. Our cash used in operating activities differs from our net loss in part due to the timing and recognition of up-front payments under collaborative agreements. Depending on the nature of the upfront payments received upon execution of collaborative agreements, which can either be recognized as revenue upfront in full or primarily recorded as deferred revenue and generally recognized over the period using a basis that best reflects the satisfaction of our performance obligations with the third-party collaborator pursuant to the applicable agreement. The generation of cash from operating activities in 2019 was primarily due to the receipt of \$35.0 million in payments from Gilead, partially offset by the changes in accounts receivable, inventories, prepaid expenses and

other assets, and accrued and other liabilities. The increase in cash used in operating activities in 2018 compared to 2017 was primarily due to decreased payments received from collaboration partners and customers as we received the \$20.0 million upfront fee from Sandoz in 2017, partially offset by changes in accounts receivable, prepaid expenses and other assets, and accrued and other liabilities in 2018.

We used \$27.3 million of cash in investing activities in the year ended December 31, 2019, and generated 4.5 million and \$12.7 million of cash from investing activities in the years ended December 31, 2018 and 2017, respectively. The decrease in cash received from investing activities in 2019 was primarily due to a decrease in proceeds from maturities of available-for-sale securities in 2019 compared to 2018. The decrease in cash received from investing activities in 2018 was primarily due to a decrease in proceeds from maturities of available-for-sale securities in 2018 compared to 2017. We anticipate incurring capital expenditures of approximately \$150,000 over the next 12 months. The amount and timing of these capital expenditures will depend on, among other things, our research and development activities and needs, and the need for equipment replacements.

We generated \$19.5 million, \$17.5 million and \$12.6 million of cash from financing activities in the years ended December 31, 2019, 2018 and 2017, respectively. The increase in cash received from financing activities in 2019 was primarily due to higher net proceeds received from issuances of common stock in 2019 compared to 2018. In June 2019, we entered into a privately negotiated transaction to sell 29,000,000 shares of our common stock to certain investors in a registered offering at a price of \$0.52 per share, raising total net proceeds to us of approximately \$15.0 million. In 2019, we also raised net proceeds (net of commission) of approximately \$3.5 million from the sale of 2.3 million shares of common stock at a weighted average price of \$1.55 per share in the open market through our Controlled Equity Offering sales agreement with Cantor Fitzgerald. The increase in cash received from financing activities in 2018 was primarily due to higher net proceeds received from issuances of common stock in 2018 compared to 2017. In 2018, we raised net proceeds (net of commission) of approximately \$16.8 million from the sale of 9.6 million shares of common stock at a weighted average price of \$1.80 per share in the open market through our Controlled Equity Offering sales agreement with Cantor Fitzgerald. In 2017, we raised net proceeds (net of commissions) of approximately \$12.0 million from the sale of approximately 8.9 million shares of our common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of \$1.39 per share.

In November 2015, we entered into the 2015 Sales Agreement with Cantor Fitzgerald, acting as agent. As of December 31, 2018, approximately 24.6 million registered shares of common stock were sold through the 2015 Sales Agreement for total net proceeds (net of commissions) of approximately \$38.3 million. In August 2018, we filed a shelf registration statement on Form S-3 with the SEC, which upon being declared effective in October 2018 and allowed us to offer up to \$175.0 million of securities from time to time in one or more public offerings, inclusive of up to \$75.0 million of additional shares of common stock which we may sell, subject to certain limitations, under the 2015 Sales Agreement through Cantor Fitzgerald, acting as agent. Any additional sales in the public market of our common stock, under the Controlled Equity Offering program with Cantor Fitzgerald or otherwise under the October 2018 shelf registration statement, could adversely affect prevailing market prices for our common stock. In 2019, we raised net proceeds (net of commissions) of approximately \$3.5 million from the sale of 2.3 million shares of the Company's common stock in the open market at a weighted average price of \$1.55 per share pursuant to the October 2018 registration statement. As of February 28, 2020, we had up to approximately \$71.4 million of common stock available for sale under the Controlled Equity Offering program and approximately \$84.9 million of common stock available for sale under our shelf registration statement.

In July 2016, we entered into a Loan and Security Agreement (the Loan Agreement) with Oxford Finance LLC (Oxford Finance), pursuant to which Oxford Finance provided a \$20.0 million secured single-draw term loan to us with an initial maturity date of August 1, 2020. The term loan was fully drawn at close and the proceeds may be used for working capital and general business requirements. The term loan repayment schedule provided initially for interest only payments for the first 18 months, followed by consecutive monthly payments of principal and interest in arrears starting on March 1, 2018 and continuing through the maturity date of August 1, 2020. Following three amendments, we make interest only payments under the amended Loan Agreement until December 1, 2021 and the final maturity date of the loan is May 1, 2024. The Loan Agreement provides for a floating interest rate (7.95% initially and 9.07% as of December 31, 2019) based on an index rate plus a spread and an additional payment equal to 10% of the principal amount of the term loan, which is due when the term loan becomes due or upon the prepayment of the facility. If we elect to prepay the loan, there is also a prepayment fee between 0.75% and 2.5% of the principal amount of the term loan depending on the timing of prepayment. Our debt repayment obligations under the Loan Agreement, as amended, may prove a burden to the Company as they become due, particularly following the expiration of the interest-only period.

The term loan is secured by substantially all of our assets, 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 us, which covenants limit our ability to convey, sell, lease, transfer, assign or otherwise dispose of certain assets; engage in any business other than the businesses currently engaged in by us or reasonably related thereto; liquidate or dissolve; make certain management changes; undergo certain change of control events; create, incur, assume, or be liable with respect to certain indebtedness; grant certain liens; pay dividends and make certain other restricted payments; make certain investments; 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 under the 2016 Loan Agreement and the occurrence of a material adverse change which is defined as a material adverse change in our business, operations, or condition (financial or otherwise), a material impairment of the prospect of repayment of any portion of the loan, or a material impairment in the perfection or priority of lender's lien in the collateral or in the value of such collateral. In the event of default by us under the 2016 Loan Agreement, the lender would be entitled to exercise its remedies thereunder, including the right to accelerate the debt, upon which we may be required to repay all amounts then outstanding under the Loan Agreement. As a result, that portion of the term loan that was due more than 12 months after December 31, 2017 was classified within non-current liabilities.

Cash used in our operating activities is heavily influenced by the timing and structure of new corporate collaborations. While one feature of our business strategy is seeking new corporate collaborations, assuming no new collaborations and no milestone payments, we anticipate that cash used in operating activities will increase in the near term as we received non-refundable upfront and milestone payments of \$35.0 million from Gilead in 2019.

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

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

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

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



In 2019, there were no significant changes in our commercial commitments and contractual obligations. In aggregate, we are required to make future payments pursuant to our existing contractual obligations as follows (in thousands):

<b>Contractual Obligations</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>Total</b>
Term loan (1)	\$ 1,848	\$ 3,172	\$ 9,381	\$ 8,644	\$ 4,718	\$ 27,763
Operating lease obligations	2,200	2,126	1,991	1,970	275	8,562
<b>Total contractual cash obligations</b>	<b>\$ 4,048</b>	<b>\$ 5,298</b>	<b>\$ 11,372</b>	<b>\$ 10,614</b>	<b>\$ 4,993</b>	<b>\$ 36,325</b>

(1) Includes principal, interest payments and final payments and assumes no acceleration of obligations.

### Recent Accounting Pronouncements

In November 2018, the Financial Accounting Standards Board (the FASB) issued ASU No. 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606 (ASU 2018-18)*. ASU 2018-18 clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue under Topic 606 when the counterparty is a customer for a distinct good or service (i.e. a unit of account). For units of account that are in the scope of Topic 606, all of the guidance in Topic 606 should be applied, including the guidance on recognition, measurement, presentation and disclosure. ASU 2018-18 also adds a reference in Topic 808 to the unit of account guidance in ASC 606 and requires that it be applied only to assess whether transactions in a collaborative arrangement are in the scope of Topic 606. ASU 2018-18 will preclude entities from presenting amounts related to transactions with a counterparty in a collaborative arrangement that is not a customer as revenue from contracts with customers. ASU 2018-18 is effective for the Company for all interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

In August 2018, the FASB issued Accounting Standards Update (“ASU”) No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which eliminates certain disclosure requirements for fair value measurements for all entities, requires public entities to disclose certain new information and modifies some disclosure requirements. This standard is effective for fiscal years beginning after December 15, 2019, including interim reporting periods within those years, with early adoption permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, (ASU 2017-04)*. ASU 2017-04 eliminated Step 2 from the goodwill impairment test. Instead, under the amendments in ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. ASU 2017-04 is effective for all interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 (ASU 2016-13) “Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires measurement and recognition of expected credit losses for financial assets. This standard is effective for fiscal years beginning after December 15, 2019, including interim reporting periods within those years and must be adopted using a modified retrospective approach, with certain exceptions. Early adoption is permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

### Off-Balance Sheet Arrangements

We have not utilized “off-balance sheet” arrangements to fund our operations or otherwise manage our financial position.

**Interest Rate Risk**

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and to our term loan. Fixed rate securities and borrowings may have their fair market value adversely impacted due to fluctuations in interest rates, while floating rate securities may produce less income than expected if interest rates fall and floating rate borrowings may lead to additional interest expense if interest rates increase. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates. Our interest expense on the term loan may rise if the interest rates increase.

Our primary investment objective is to preserve principal while at the same time maximizing yields without significantly increasing risk. Our portfolio includes money markets funds, certificates of deposit, commercial paper, corporate debt, and U.S. government agencies. The diversity of our portfolio helps us to achieve our investment objectives. As of December 31, 2019, all of our investment portfolio was composed of investments with original maturities of one year or less and approximately 52.0% of our investment portfolio matures less than 90 days from the date of purchase.

The following table presents the amounts of our cash equivalents and investments that may be subject to interest rate risk and the average interest rates as of December 31, 2019 by year of maturity (dollars in thousands):

	<u>2020</u>
Cash equivalents:	
Fixed rate	\$ 524
Average fixed rate	1.53%
Variable rate	\$ 31,837
Average variable rate	1.97%
Short-term investments:	
Fixed rate	\$ 29,750
Average fixed rate	1.97%
Restricted investments:	
Fixed rate	\$ 150
Average fixed rate	1.39%
Total investment securities	<u>\$ 62,261</u>
Average rate	1.93%

The following table presents the amounts of our cash equivalents and investments that may be subject to interest rate risk and the average interest rates as of December 31, 2018 by year of maturity (dollars in thousands):

	<u>2019</u>
Cash equivalents:	
Fixed rate	\$ 502
Average fixed rate	2.27%
Variable rate	\$ 29,553
Average variable rate	2.82%
Short-term investments:	
Fixed rate	\$ 2,671
Average fixed rate	2.80%
Restricted investments:	
Fixed rate	\$ 150
Average fixed rate	2.09%
Total investment securities	<u>\$ 32,876</u>
Average rate	2.77%

As of December 31, 2019, the fair value of our term loan was estimated to be \$20.3 million. The term loan repayment schedule provides for interest only payments until December 1, 2021, followed by consecutive monthly payments of principal and interest in arrears continuing through the maturity date of the term loan of May 1, 2024. The term loan also provides for a floating interest rate (9.07% as of December 31, 2019) based on an index rate plus a spread and an additional payment equal to 9.25% of the principal amount of the term loan, which has been accrued over the life of the term loan and 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 0.75% and 2.5% of the principal amount of the term loan depending on the timing of prepayment. The obligation under the term loan is subject to interest rate risk because the interest rates under the obligation may exceed current interest rates.

DURECT CORPORATION  
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To the Stockholders and the Board of Directors of DURECT Corporation

**Opinion on the Financial Statements**

We have audited the accompanying balance sheets of DURECT Corporation (the Company) as of December 31, 2019 and 2018, and the related statements of operations and comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and the financial statement schedule listed in the Index at Item 15(a)(2) (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and our report dated March 5, 2020 expressed an unqualified opinion thereon.

**Adoption of New Accounting Standard**

As discussed in Note 1 to the financial statements, the Company changed its method of accounting for leases effective January 1, 2019 due to the adoption of Accounting Standards Update (ASU) 2016-02, Leases (Topic 842), and the related amendments.

**Basis for Opinion**

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company's auditor since 1998.

Redwood City, California

March 5, 2020

**DURECT CORPORATION**  
**BALANCE SHEETS**  
(in thousands, except per share amounts)

	December 31,	
	2019	2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 34,924	\$ 31,644
Short-term investments	29,750	2,671
Accounts receivable (net of allowances of \$34 at December 31, 2019 and \$102 at December 31, 2018)	2,313	1,757
Inventories, net	3,383	3,421
Prepaid expenses and other current assets	1,459	2,247
Total current assets	71,829	41,740
Property and equipment, net	469	605
Operating lease right-of-use assets	6,066	—
Goodwill	6,399	6,399
Long-term restricted investments	150	150
Other long-term assets	1,107	1,105
Total assets	\$ 86,020	\$ 49,999
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,109	\$ 1,589
Accrued liabilities	6,284	4,668
Contract research liabilities	3,653	1,405
Deferred revenue, current portion	22,679	—
Operating lease liabilities, current portion	2,043	—
Total current liabilities	36,768	7,662
Deferred revenue, non-current portion	812	812
Operating lease liabilities, non-current portion	4,517	—
Term loan, non-current portion, net	20,262	20,533
Other long-term liabilities	801	992
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.0001 par value: 10,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.0001 par value: 350,000 shares authorized; 195,257 and 162,060 shares issued and outstanding at December 31, 2019 and 2018, respectively	19	16
Additional paid-in capital	512,046	488,608
Accumulated other comprehensive loss	(3)	—
Accumulated deficit	(489,202)	(468,624)
Stockholders' equity	22,860	20,000
Total liabilities and stockholders' equity	\$ 86,020	\$ 49,999

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

**DURECT CORPORATION**

**STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
(in thousands, except per share amounts)

	Year ended December 31,		
	2019	2018	2017
Collaborative research and development and other revenue	\$ 18,129	\$ 8,207	\$ 23,577
Product revenue, net	11,435	10,357	13,093
Revenue from sale of intellectual property rights	—	—	12,500
Total revenues	<u>29,564</u>	<u>18,564</u>	<u>49,170</u>
Operating expenses:			
Cost of product revenues	4,143	4,263	6,633
Research and development	30,209	25,501	31,609
Selling, general and administrative	14,363	12,419	13,165
Total operating expenses	<u>48,715</u>	<u>42,183</u>	<u>51,407</u>
Loss from operations	(19,151)	(23,619)	(2,237)
Other income (expense):			
Interest and other income	1,074	870	967
Interest expense	(2,501)	(2,573)	(2,425)
Net other expense	<u>(1,427)</u>	<u>(1,703)</u>	<u>(1,458)</u>
Net loss	(20,578)	(25,322)	(3,695)
Net change in unrealized gain on available-for-sale securities, net of tax	(3)	1	2
Total comprehensive loss	<u>\$ (20,581)</u>	<u>\$ (25,321)</u>	<u>\$ (3,693)</u>
Net loss per share			
Basic	<u>\$ (0.12)</u>	<u>\$ (0.16)</u>	<u>\$ (0.03)</u>
Diluted	<u>\$ (0.12)</u>	<u>\$ (0.16)</u>	<u>\$ (0.03)</u>
Weighted-average shares used in computing net loss per share			
Basic	<u>178,042</u>	<u>159,834</u>	<u>145,273</u>
Diluted	<u>178,042</u>	<u>159,834</u>	<u>145,273</u>

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

**DURECT CORPORATION**  
**STATEMENT OF STOCKHOLDERS' EQUITY**  
(in thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (loss)	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount				
Balance at December 31, 2016	141,297	\$ 14	\$ 448,404	\$ (3)	\$ (440,077)	\$ 8,338
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	667	—	649	—	—	649
Issuance of common stock upon equity financings, net of issuance costs of \$374	8,873	1	11,988	—	—	11,989
Issuance of fully vested options to settle accrued liabilities	—	—	1,600	—	—	1,600
Stock-based compensation expense from stock options and ESPP shares	—	—	2,605	—	—	2,605
Net loss	—	—	—	—	(3,695)	(3,695)
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	2	—	2
Balance at December 31, 2017	150,837	\$ 15	\$ 465,246	\$ (1)	\$ (443,772)	\$ 21,488
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	1,594	—	1,725	—	—	1,725
Issuance of common stock upon equity financings, net of issuance costs of \$566	9,629	1	16,779	—	—	16,780
Issuance of fully vested options to settle accrued liabilities	—	—	1,860	—	—	1,860
Stock-based compensation expense from stock options and ESPP shares	—	—	2,998	—	—	2,998
Net loss	—	—	—	—	(25,322)	(25,322)
Change in unrealized gain on available-for-sale securities, net of tax	—	—	—	1	—	1
Adjustment due to changes in accounting policies	—	—	—	—	470	470
Balance at December 31, 2018	162,060	\$ 16	\$ 488,608	\$ —	\$ (468,624)	\$ 20,000
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	1,847	—	1,979	—	—	1,979
Issuance of common stock upon equity financings, net of issuance costs of \$356	31,350	3	18,357	—	—	18,360
Issuance of fully vested options to settle accrued liabilities	—	—	994	—	—	994
Stock-based compensation expense from stock options and ESPP shares	—	—	2,108	—	—	2,108
Net loss	—	—	—	—	(20,578)	(20,578)
Change in unrealized loss on available-for-sale securities, net of tax	—	—	—	(3)	—	(3)
Balance at December 31, 2019	195,257	\$ 19	\$ 512,046	\$ (3)	\$ (489,202)	\$ 22,860

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



**DURECT CORPORATION**  
**STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities</b>			
Net loss	\$ (20,578)	\$ (25,322)	\$ (3,695)
Adjustments to reconcile net loss to net cash used in operating activities:			
Sale of intellectual property rights for non-operating purposes	—	—	(500)
Depreciation and amortization	291	254	437
Stock-based compensation	2,108	2,998	2,605
Inventory write-down	255	291	2,259
Amortization of debt issuance cost	369	149	62
Net accretion/amortization on investments	87	84	(41)
Changes in operating lease liabilities	215	—	—
Changes in assets and liabilities:			
Accounts receivable	(556)	619	(1,222)
Inventories	(217)	(549)	(140)
Prepaid expenses and other assets	786	(15)	(1,115)
Accounts payable	520	69	(566)
Accrued liabilities	2,894	1,594	1,594
Contract research liability	2,248	571	51
Deferred revenue	22,679	(493)	(1,072)
Total adjustments	31,679	5,572	2,352
Net cash provided by (used in) operating activities	11,101	(19,750)	(1,343)
<b>Cash flows from investing activities</b>			
Sale of intellectual property rights for non-operating purposes	—	—	500
Purchases of property and equipment	(155)	(93)	(69)
Purchases of available-for-sale securities	(31,866)	(9,588)	(8,373)
Proceeds from maturities of available-for-sale securities	4,697	14,218	20,632
Net cash (used in) provided by investing activities	(27,324)	4,537	12,690
<b>Cash flows from financing activities</b>			
Payments on equipment financing obligations	(7)	(9)	(14)
Net proceeds from issuances of common stock upon exercise of stock options, and purchases of ESPP shares	1,979	1,725	649
Net proceeds from issuances of common stock in connection with equity financings	18,360	16,780	11,989
Term loan amendment cost	(829)	(1,014)	—
Net cash provided by financing activities	19,503	17,482	12,624
Net increase in cash and cash equivalents	3,280	2,269	23,971
Cash, cash equivalents, and restricted cash, beginning of the period (1)	31,794	29,525	5,554
Cash, cash equivalents, and restricted cash, end of the period (1)	\$ 35,074	\$ 31,794	\$ 29,525
<b>Supplemental disclosure of cash flow information</b>			
Cash paid for interest	\$ 1,942	\$ 1,886	\$ 1,703
<b>Supplementary disclosure of non-cash financing information</b>			
Fully vested options issued to settle accrued liabilities	\$ 994	\$ 1,860	\$ 1,600
Operating lease right-of-use assets obtained in exchange for operating lease obligations (2)	\$ 7,329	\$ —	\$ —

(1) Includes restricted cash of \$150,000 (presented as long-term restricted investments) on the balance sheets at each of December 31, 2019, 2018 and 2017.

(2) Amounts for the twelve months ended December 31, 2019 include the transition adjustment for the adoption of Accounting Standards Update ("ASU" No. 2016-02, Leases ("Topic 842")).

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

**DURECT CORPORATION**  
**NOTES TO FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

***Nature of Operations***

DURECT Corporation (the Company) was incorporated in the state of Delaware on February 6, 1998. The Company is a biopharmaceutical company with research and development programs broadly falling into two categories: (i) new chemical entities derived from our Epigenetics Regulator Program, in which the Company attempts to discover and develop molecules which have not previously been approved and marketed as therapeutics, and (ii) Proprietary Pharmaceutical Programs, in which the Company applies its formulation expertise and technologies largely to active pharmaceutical ingredients whose safety and efficacy have previously been established but which the Company aims 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 and Use of Estimates***

The Company's financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of the accompanying Financial Statements conforms to accounting principles generally accepted in the U.S. which requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, equity, revenues and expenses, and related disclosures. On an ongoing basis, management evaluates its estimates including, but not limited to, those related to revenue recognition, the period of performance, identification of deliverables and evaluation of milestones with respect to our collaborations, the amounts of revenues, recoverability of inventory, certain accrued liabilities including accrued clinical trial liability, and stock-based compensation. The Company bases its estimates on historical experience and on various other market-specific and other relevant assumptions that the Company believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates.

***Liquidity and Need to Raise Additional Capital***

As of December 31, 2019, the Company has an accumulated deficit of \$489.2 million as well as negative cash flows from operating activities.

The Company generally has had negative cash flows from operating activities and expects its negative cash flows to continue. The Company will continue to require substantial funds to continue research and development, including clinical trials of its product candidates. Management's plans in order to meet its operating cash flow requirements beyond the next 12 months from the date the financial statements are filed, include seeking additional collaborative agreements for certain of its programs and achieving milestone and other payments under its collaboration and licensing agreements as well as financing activities such as public offerings and private placements of its common stock, preferred stock offerings, issuances of debt and convertible debt instruments.

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

### **Cash, Cash Equivalents and Investments**

The Company considers all highly liquid investments with maturities of 90 days or less from the date of purchase to be cash equivalents. Investments with original maturities of greater than 90 days from the date of purchase but less than one year from the balance sheet date are classified as short-term investments, while investments with maturities in one year or beyond one year from the balance sheet date are classified as long-term investments. Management determines the appropriate classification of its cash equivalents and investment securities at the time of purchase and re-evaluates such determination as of each balance sheet date. Management has classified the Company's cash equivalents and investments as available-for-sale securities in the accompanying financial statements. Available-for-sale securities are carried at fair value, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. Realized gains and losses are included in interest income. There were no material realized gains or losses in the periods presented. The cost of securities sold is based on the specific identification method.

The Company invests in debt instruments of government agencies, corporations, and money market funds with high credit ratings. The Company has established guidelines regarding diversification of its investments and their maturities with the objectives of maintaining safety and liquidity, while maximizing yield.

### **Concentrations of Credit Risk**

Financial instruments that potentially subject the Company to credit risk consist principally of interest-bearing investments and trade receivables. The Company maintains cash, cash equivalents and investments with various major financial institutions. The Company performs periodic evaluations of the relative credit standing of these financial institutions. In addition, the Company performs periodic evaluations of the relative credit quality of its investments.

Pharmaceutical companies and academic institutions account for a substantial portion of the Company's trade receivables. The Company provides credit in the normal course of business to its customers and collateral for these receivables is generally not required. The risk associated with this concentration is limited to a certain extent due to the large number of accounts and their geographic dispersion. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. The Company maintains reserves for estimated credit losses and, to date, such losses have been immaterial in all periods presented.

### **Customer and Product Line Concentrations**

A portion of the Company's revenue is derived from its ALZET mini pump product line, LACTEL biodegradable polymer product line and the sale of certain excipients for Methydrur Sustained Release Capsules and one excipient that is included in a currently marketed animal health product.

In 2019, revenue from the sale of products from the ALZET product line and the LACTEL product line accounted for 23% and 15% of total revenue, respectively. In 2018, revenue from the ALZET product line and the LACTEL product line accounted for 38% and 18% of total revenue, respectively. In 2017, revenue from the ALZET product line and the LACTEL product line accounted for 14% and 12% of total revenue, respectively.

In 2019, Gilead accounted for 58% of the Company's total revenue. In 2018, Indivior and Gilead accounted for 27% and 14% of the Company's total revenues, respectively. In 2017, Sandoz and Indivior accounted for 41% and 25% of the Company's total revenues, respectively.

Total revenue by geographic region for the years 2019, 2018 and 2017 are as follows (in thousands):

	Year ended December 31,		
	2019	2018	2017
United States	\$ 22,825	\$ 7,990	\$ 11,323
Europe	3,132	8,118	34,261
Japan	1,476	978	1,395
Others	2,131	1,478	2,191
Total	<u>\$ 29,564</u>	<u>\$ 18,564</u>	<u>\$ 49,170</u>

Revenue by geography is determined by the location of the customer.

### **Inventories**

Inventories are stated at the lower of cost or net realizable value, with cost determined on a first-in, first-out basis. 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. If the Company is able to subsequently sell products made with raw materials that were previously written down, the Company will report an unusually high gross profit as there will be no associated cost of goods for these materials. In October 2017, the Company announced that PERSIST, the Phase 3 clinical trial for POSIMIR, did not meet its primary efficacy endpoint. As a result, the Company determined that certain lots of inventory were no longer considered to be probable for use prior to expiration. The Company recorded charges to cost of goods sold of approximately \$2.0 million, of which approximately \$503,000 related to the write-down of the cost basis of inventory on hand, \$500,000 related to the prepaid inventory for the minimum purchase commitment for this excipient, and \$1.0 million related to the accrual of a liability for the remaining minimum purchase commitment for the same excipient. If the Company is able to subsequently sell products made with raw materials that were previously written down, the Company will report an unusually high gross profit as there will be no associated cost of goods for these materials.

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

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
Raw materials	\$ 282	\$ 223
Work in-process	1,537	1,486
Finished goods	1,564	1,712
Total inventories	<u>\$ 3,383</u>	<u>\$ 3,421</u>

### **Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation, which is computed using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the assets, or the terms of the related leases, whichever are shorter.

## **Goodwill**

Goodwill is periodically assessed and evaluated for impairment at the reporting unit level. The Company operates in one operating segment and also has only one reporting unit, which is the research, development and manufacturing of pharmaceutical products. The Company assesses the impairment of goodwill at least annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors the Company considers important which could trigger an impairment review include the following:

- significant decline in our stock price for a prolonged period;
- our market capitalization relative to net book value;
- new information affecting the commercial value of the asset;
- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for the Company's overall business; and
- significant negative industry or economic trends.

As of December 31, 2019, the carrying value of goodwill was approximately \$6.4 million and no impairment of goodwill has been recorded for any of the periods presented. The Company evaluates goodwill for impairment at least annually. In 2019, 2018 and 2017, goodwill was evaluated and no indicators of impairment were identified. To date, the Company has not recorded any impairment charge related to goodwill.

### **Impairment of Long-Lived Assets**

The Company reviews long-lived assets, including property and equipment, intangible assets, and other long-term assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable.

An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Impairment, if any, is calculated as the amount by which an asset's carrying value exceeds its fair value, typically using discounted cash flows to determine fair value. Through December 31, 2019, there have been no material impairment losses.

### **Leases**

The Company leases administrative, manufacturing and laboratory facilities under operating leases. Lease agreements may include rent holidays, rent escalation clauses and tenant improvement allowances. Prior to the adoption of Accounting Standards Update ("ASU" No. 2016-02, Leases, and the related amendments ("Topic 842"), the Company recognized scheduled rent increases on a straight-line basis over the lease term beginning with the date the Company took possession of the leased space. The Company recorded tenant improvement allowances as deferred rent liabilities and amortized the deferred rent over the terms of the lease to rent expense on the statements of operations and comprehensive loss.

Effective January 1, 2019, the Company adopted Topic 842 using the modified retrospective transition method approach with a cumulative-effect adjustment as of January 1, 2019. Other prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under previous lease guidance, ASC Topic 840: Leases (Topic 840). The Company elected the package of practical expedients permitted under the transition guidance within the new standard, which among other things, allowed the Company to carry forward the historical lease classification of those leases in place as of January 1, 2019.

The adjustments due to the adoption of Topic 842 primarily related to the recognition of an operating lease right-of-use asset and corresponding operating lease liability for the Company's leased properties. The Company's operating lease right-of-use asset and liability were recognized at the adoption date of ASC 842 based on the present value of lease payments over the remaining lease term at the adoption date. In determining the net present value of lease payments, we used our incremental borrowing rate of 13.8% based on the information available, including remaining lease term, at the adoption date of ASC 842. As of December 31, 2019, the weighted-average remaining lease term was 3.4 years for the Company's leased properties.

The impact of the adoption of Topic 842 on the accompanying Balance Sheet as of January 1, 2019 was as follows (in thousands):

	As of January 1, 2019		
	December 31, 2018	Adjustments Due to the Adoption of Topic 842	January 1, 2019
<b>Balance Sheet</b>			
Operating lease right-of-use assets	\$ —	\$ 7,329	\$ 7,329
Operating lease liabilities:			
Accrued liabilities (1)	\$ (92)	\$ 92	\$ —
Other long-term liabilities (1)	(270)	270	—
Lease liabilities, current portion	—	(1,972)	(1,972)
Lease liabilities, non-current portion	—	(5,719)	(5,719)
	<u>\$ (362)</u>	<u>\$ (7,329)</u>	<u>\$ (7,691)</u>

Includes deferred rent, current and long-term portions of operating lease liabilities which were recorded against the operating lease right-of-use asset upon adoption of Topic 842

There was no effect from the adoption of Topic 842 on the Company's Statement of cash flows.

#### **Stock-Based Compensation**

The Company accounts for share-based payments using a fair-value based method for costs related to all share-based payments, including stock options and stock issued under the Company's employee stock purchase plan (ESPP). The Company estimates the fair value of share-based payment awards on the date of grant using an option-pricing model. See Note 8 for further information regarding stock-based compensation.

#### **Revenue Recognition**

The Company enters into license and collaboration agreements under which the Company may receive upfront license fees, research funding and contingent milestone payments and royalties. Effective January 1, 2018, the Company adopted FASB ASC Topic 606, Revenue from Contracts with Customers, or ASC 606. In accordance with ASC 606, the Company changed certain characteristics of its revenue recognition accounting policy as described below. ASC 606 was applied using the modified retrospective method, where the cumulative effect of the initial application was recognized as an adjustment to opening retained earnings at January 1, 2018. The Company recorded a net decrease to opening accumulated deficit of \$470,000 with an offset entry to reduce deferred revenue as of January 1, 2018 due to the cumulative impact of adopting Topic 606, with the impact relating to the Company's deferred collaborative research and development revenues.

##### *Product Revenue, Net*

The Company sells osmotic pumps used in laboratory research, and designs, develops and manufactures a wide range of standard and custom biodegradable polymers and excipients for pharmaceutical and medical device clients for use as raw materials in their products.

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

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

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

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

In determining the appropriate amount of revenue to be recognized as it fulfills its obligations under each of its agreements, the Company performs the following steps: (i) identification of the promised goods or services in the contract; (ii) determination of whether the promised goods or services are performance obligations including whether they are distinct in the context of the contract; (iii) measurement of the transaction price, including the constraint on variable consideration; (iv) allocation of the transaction price to the performance obligations; and (v) recognition of revenue when (or as) the Company satisfies each performance obligation. As part of the accounting for these arrangements, the Company must develop assumptions that require judgment to determine the stand-alone selling price for each performance obligation identified in the contract. The Company uses key assumptions to determine the standalone selling price, which may include forecasted revenues, development timelines, reimbursement rates for personnel costs, discount rates and probabilities of technical and regulatory success. The Company expects to recognize revenue for the variable consideration currently being constrained when it is probable that a significant revenue reversal will not occur.

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

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

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

**Royalties and Earn-outs:** For arrangements that include sales-based royalties or earn-outs, including milestone payments based on the level of sales, and the license is deemed to be the predominant item to which the royalties relate, the Company recognizes revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied). To date, the Company has not recognized any material royalty revenue resulting from the Company's collaborative arrangements or material earn-out revenue from the Company's patent purchase agreement with Indivior.

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

***Research and Development Expenses***

Research and development expenses are primarily comprised of salaries and benefits 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 costs are expensed as incurred. Research and development costs paid to third parties under sponsored research agreements are recognized as the related services are performed. In addition, reimbursements of research and development expenses incurred by the Company's partners are recorded as collaborative research and development revenue.

***Comprehensive Loss***

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

***Segment Reporting***

The Company operates in one operating segment, which is the research, development and manufacturing of pharmaceutical products.



## Net Loss Per Share

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

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

	Year Ended December 31,		
	2019	2018	2017
<b>Numerators:</b>			
Net loss	\$ (20,578)	\$ (25,322)	\$ (3,695)
<b>Denominators:</b>			
Weighted average shares used to compute basic net loss per share	178,042	159,834	145,273
<b>Effect of dilutive securities:</b>			
Dilution from stock options	—	—	—
Dilution from ESPP	—	—	—
Dilutive common shares	—	—	—
Weighted average shares used to compute diluted net loss per share	<u>178,042</u>	<u>159,834</u>	<u>145,273</u>
<b>Net loss per share:</b>			
Basic	<u>\$ (0.12)</u>	<u>\$ (0.16)</u>	<u>\$ (0.03)</u>
Diluted	<u>\$ (0.12)</u>	<u>\$ (0.16)</u>	<u>\$ (0.03)</u>

The computation of diluted net loss per share for the years ended 2019, 2018 and 2017 excludes the impact of options to purchase 21.4 million, 16.6 million and 20.1 million shares of common stock outstanding, respectively, at December 31, 2019, 2018 and 2017, as such impact would be antidilutive.

## Shipping and Handling

Costs related to shipping and handling are included in cost of revenues for all periods presented.

## Recent Accounting Pronouncements

In November 2018, the Financial Accounting Standards Board (the FASB) issued ASU No. 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606 (ASU 2018-18)*. ASU 2018-18 clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue under Topic 606 when the counterparty is a customer for a distinct good or service (i.e. a unit of account). For units of account that are in the scope of Topic 606, all of the guidance in Topic 606 should be applied, including the guidance on recognition, measurement, presentation and disclosure. ASU 2018-18 also adds a reference in Topic 808 to the unit of account guidance in ASC 606 and requires that it be applied only to assess whether transactions in a collaborative arrangement are in the scope of Topic 606. ASU 2018-18 will preclude entities from presenting amounts related to transactions with a counterparty in a collaborative arrangement that is not a customer as revenue from contracts with customers. ASU 2018-18 is effective for the Company for all interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

In August 2018, the FASB issued Accounting Standards Update (“ASU”) No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*, which eliminates certain disclosure requirements for fair value measurements for all entities, requires public entities to disclose certain new information and modifies some disclosure requirements. This standard is effective for fiscal years beginning after December 15, 2019, including interim reporting periods within those years, with early adoption permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, (ASU 2017-04)*. ASU 2017-04 eliminated Step 2 from the goodwill impairment test. Instead, under the amendments in ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. ASU 2017-04 is effective for all interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its financial statements.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 (ASU 2016-13) “Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 requires measurement and recognition of expected credit losses for financial assets. This standard is effective for fiscal years beginning after December 15, 2019, including interim reporting periods within those years and must be adopted using a modified retrospective approach, with certain exceptions. Early adoption is permitted. The Company does not expect the adoption of this standard to have a material effect on its financial statements.

## 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):

Collaborator/Counterparty	Year ended December 31,		
	2019	2018	2017
Gilead (1)	\$ 17,133	\$ 2,542	\$ 1,687
Sandoz AG (Sandoz) (2)	—	—	20,000
Other (3)	996	5,665	1,890
Total collaborative research and development and other revenue	<u>\$ 18,129</u>	<u>\$ 8,207</u>	<u>\$ 23,577</u>

- (1) The Company signed a license agreement with Gilead on July 19, 2019 and received nonrefundable upfront license fee and milestone payment of \$35.0 million in 2019. Amounts include partial recognition (\$12.3 million) of the upfront license fee and milestone payment in 2019, compared to zero for the corresponding periods in 2018 and 2017.
- (2) Amounts related to recognition of upfront fees were zero in 2019 and 2018, and \$20.0 million in 2017; the Company and Sandoz signed a license agreement effective June 2017. As of December 31, 2017, all of the \$20.0 million upfront fee had been recognized as revenue as the Company’s contractual performance obligations had been fulfilled. In January 2019, the license agreement was terminated.
- (3) Includes: (a) amounts related to earn-out revenue from Indivior UK Limited (Indivior) with respect to PERSERIS net sales as well as a \$5.0 million milestone payment earned from Indivior in 2018; (b) feasibility program(s); (c) research and development activities funded by Santen pharmaceutical Co. Ltd. (Santen). Note that in January 2018, the Company was notified by Santen that due to a shift in near term priorities, Santen has elected to reallocate research and development resources and put our program on pause until further notice. While the main program is on pause, the parties are working together on a limited set of research and development activities funded by Santen; and (d) research and development activities funded by Zogenix. Note that the Company and Zogenix signed a license agreement effective July 2011. In August 2017, the Company and Zogenix terminated the license agreement.

As of February 28, 2020, the Company had potential milestones of up to \$221.0 million that the Company may receive in the future under its collaborative arrangements, of which \$88.0 million are development-based milestones and \$133.0 million are sales-based milestones. Within the category of development-based milestones, \$2.0 million are related to early stage clinical testing (defined as Phase 1 or 2 activities), \$33.0 million are related to late stage clinical testing (defined as Phase 3 activities), \$3.0 million are related to regulatory filings, and \$50.0 million are related to regulatory approvals. No payments were received between December 31, 2019 and February 28, 2020.

### ***Agreement with Gilead Sciences, Inc.***

On July 19, 2019, the Company entered into a license agreement (the “Gilead Agreement”) with Gilead Sciences, Inc. (“Gilead”). Pursuant to the Gilead Agreement, the Company has granted Gilead the exclusive worldwide rights to develop and commercialize a long-acting injectable HIV product utilizing DURECT’s SABER® technology. Gilead also received exclusive access to the SABER platform for HIV and Hepatitis B Virus (HBV) and the exclusive option to license additional SABER-based products directed to HIV and HBV.

Under the terms of the Gilead Agreement, Gilead made an upfront payment to DURECT of \$25 million, with the potential for up to an additional \$75 million in development and regulatory milestones, up to an additional \$70 million in sales-based milestones, as well as tiered single-digit royalties on product sales for a defined period. In September 2019, the Company also earned the right to receive a \$10 million milestone payment from Gilead for further development of the product candidate which was received in October 2019. Gilead has the exclusive option to license additional SABER-based products directed to HIV and HBV for up to an additional \$150 million per product in upfront, development, regulatory and sales-based milestones as well as tiered single-digit royalties on sales. The Company will perform specified development activities with Gilead funding certain portions of the development programs. The lead formulation is currently being re-formulated and will undergo additional pre-clinical development work. The Gilead Agreement contains customary representations, warranties and indemnification provision. The term of the Gilead Agreement is for the duration of Gilead’s obligation to pay royalties for product sales under the Gilead Agreement. The Gilead Agreement provides each party with specified termination rights, including the right of Gilead to terminate at will with advance notice to DURECT and each party to terminate the Gilead Agreement upon material breach of the Gilead Agreement by the other party.

The Company assessed the Gilead Agreement and concluded that Gilead is a customer. The Company evaluated the promised goods and services in the contract and concluded that it had two performance obligations. The first performance obligation, expected to be completed and delivered by December 31, 2020, consists of a bundle of the exclusive licenses to the HIV product candidate and exclusive access to the SABER platform for use in the fields of HIV and HBV, the research, development and manufacturing services through completion of technology transfer (“the Primary Services”), participation in the joint development committee and initial supply of the related materials. The Company obtains additional consideration related to the ongoing research, development and manufacturing services associated with the Primary Services, which approximates the estimated fair value of these services, based upon an estimated workplan between the two parties, which can be subject to change depending on a variety of factors. None of these goods and services were distinct as they are highly interdependent and each represents an input into the process through which Gilead will be able to derive the full benefits from the licensed intellectual property. The additional research and development services after technology transfer will be accounted for as the second performance obligation as these services are distinct, as these services are not essential for Gilead. The Company will also obtain additional consideration related to these research and development services, if and when they are performed, which will approximate the estimated fair value of these services.

The Company also evaluated Gilead’s rights to license additional SABER-based products and concluded that these are option rights, are at market rates, and do not constitute a material right performance obligation. As such, these options have been excluded from the initial allocation of transaction price and the Company will account for them as separate contracts when and if Gilead elects to exercise each option right.

During the twelve months ended December 31, 2019, the upfront and milestone consideration of \$35 million received in 2019 associated with the Primary Services is being recognized as revenue when the first performance obligation is being satisfied using the cost-to-cost input method, which the Company believes best depicts the transfer of control to the customer. Under the cost-to-cost input method, the extent of progress towards completion is measured based on the ratio of actual costs incurred to the total estimated costs. Revenue is recorded as a percentage of the transaction price based on the extent of progress towards completion. The estimate of the Company’s measure of progress, which can include additional Primary Services, if any, and the estimate of any additional consideration for those additional Primary Services, are included in the transaction price which is updated at each reporting date, and revenue is recognized on a cumulative catchup basis. As such, management applies a certain amount of judgment in estimating both the Primary Services and the corresponding timeline to through completion of the first performance obligation, which are key inputs when using the cost-to-cost input method.

During the twelve months ended December 31, 2019, the Company recognized \$12.3 million of the deferred revenue within collaborative research and development and other revenues. The Company also recognized \$4.8 million from Gilead during the twelve months ended December 31, 2019 from feasibility related collaborative research and development services. As of December 31, 2019, the Company intends to recognize the remaining \$22.7 million in deferred revenue associated with the upfront and milestone consideration within the next 12 months, which is when the Primary Services are estimated to be completed by. Given the estimate of the Company's measure of progress are updated at each reporting date, and revenue is recognized on a cumulative catchup basis, a significant change in the remaining estimated costs to complete the Primary Services could have a material impact on revenues recognized (including reversal of previously recognized revenue) at each reporting date, as well as the classification between the current and non-current portions of the associated deferred revenue should the development timeline for technology transfer also be significantly extended out.

The following table presents changes in the Company's contract assets and liabilities for the twelve months ended December 31, 2019 (in thousands):

	Balance at January 1, 2019	Additions	Deletions	Balance at December 31, 2019
<b>Balance Sheet</b>				
<b>Assets</b>				
Accounts receivable	\$ —	\$ 39,812	\$ (39,318)	\$ 494
Total contract asset	<u>\$ —</u>	<u>\$ 39,812</u>	<u>\$ (39,318)</u>	<u>\$ 494</u>
<b>Liabilities</b>				
Deferred revenue, current portion	\$ —	\$ 35,000	\$ (12,321)	\$ 22,679
Deferred revenue, non-current portion	—	—	—	—
Total contract liabilities	<u>\$ —</u>	<u>\$ 35,000</u>	<u>\$ (12,321)</u>	<u>\$ 22,679</u>

#### ***Patent Purchase Agreement with Indivior***

On September 26, 2017, the Company entered into a Patent Purchase Agreement (the "Indivior Agreement") with Indivior. Pursuant to the Indivior Agreement, the Company assigned to Indivior certain patents that may provide further intellectual property protection for PERSERIS™ (risperidone), Indivior's extended-release injectable suspension for the treatment of schizophrenia in adults. In consideration for such assignment, Indivior made an upfront non-refundable payment to the Company of \$12.5 million. Indivior also agreed to make an additional \$5.0 million payment to the Company contingent upon NDA approval of PERSERIS, as well as quarterly earn-out payments that are based on a single digit percentage of U.S. net sales for certain products covered by the assigned patent rights, including PERSERIS. The assigned patent rights include granted patents extending through at least 2026. The Company also receives a non-exclusive right under the assigned patents to develop and commercialize certain risperidone-containing products and products that do not contain risperidone or buprenorphine. The Indivior Agreement contains customary representations, warranties and indemnities of the parties. The Company received the payment of \$12.5 million from Indivior in September 2017 and recognized the \$12.5 million as revenue from sale of intellectual property rights in 2017 as the Company did not have any continuing obligations under the purchase agreement. In July 2018, Indivior announced that the FDA had approved the NDA for PERSERIS thereby triggering the \$5.0 million payment to the Company; this payment was received by the Company in August 2018. The Company recognized the \$5.0 million as milestone revenue during the twelve months ended December 31, 2018 as there is no further performance obligation associated with this milestone payment. Amounts recognized to date related to earn-out revenues from PERSERIS have been immaterial.

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

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

In connection with the Santen agreement, Santen agreed to pay the Company an upfront fee of \$2.0 million in cash and to make contingent cash payments to the Company of up to \$76.0 million upon the achievement of certain milestones, of which \$13.0 million are development-based milestones and \$63.0 million are commercialization-based milestones including milestones requiring the achievement of certain product sales targets (none of which has been achieved as of December 31, 2019). 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. In January 2018, the Company was notified by Santen that due to a shift in near term priorities, Santen elected to reallocate research and development resources and put the Company's program on pause until further notice. While the main program is on pause, the parties are working together on a limited set of research and development activities funded by Santen. As of December 31, 2019, the cumulative aggregate payments received by the Company under this agreement were \$3.3 million.

#### **Agreement with Sandoz AG.**

In May 2017, the Company and Sandoz AG ("Sandoz") entered into a license agreement to develop and market POSIMIR (bupivacaine extended release solution) in the United States. Following expiration of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR), the agreement became effective in June 2017.

On January 2, 2019, the Company received written notice from Sandoz that Sandoz terminated this agreement effective January 27, 2019. As a result of this termination, Sandoz returned its exclusive commercialization rights to develop and market POSIMIR in the United States. The parties are in dispute with regard to Sandoz's obligation to pay a termination fee to the Company. The Company has initiated a formal dispute resolution process related to the termination fee.

The cumulative aggregate payments received by the Company from Sandoz as of December 31, 2019 were \$20.0 million under this agreement.

### **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. The following table sets forth the fair value of the Company's financial assets that were measured at fair value on a recurring basis as of December 31, 2019 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 524	\$ —	\$ —	\$ 524
Certificates of deposit	—	150	—	150
Commercial paper	—	47,218	—	47,218
U.S. Government agencies	—	4,501	—	4,501
Corporate debt	—	9,868	—	9,868
Total	<u>\$ 524</u>	<u>\$ 61,737</u>	<u>\$ —</u>	<u>\$ 62,261</u>

The following table sets forth the fair value of our financial assets that were measured at fair value on a recurring basis as of December 31, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	\$ 502	\$ —	\$ —	\$ 502
Certificates of deposit	—	150	—	150
Commercial paper	—	32,224	—	32,224
Total	\$ 502	\$ 32,374	\$ —	\$ 32,876

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 December 31, 2019 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 December 31, 2019 and 2018 (in thousands):

	December 31, 2019			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	\$ 524	\$ —	\$ —	\$ 524
Certificates of deposit	150	—	—	150
Commercial paper	47,221	1	(4)	47,218
U.S. Government agencies	4,500	1	—	4,501
Corporate debt	9,869	1	(2)	9,868
	<u>\$ 62,264</u>	<u>\$ 3</u>	<u>\$ (6)</u>	<u>\$ 62,261</u>
Reported as:				
Cash and cash equivalents	\$ 32,364	\$ —	\$ (3)	\$ 32,361
Short-term investments	29,750	3	(3)	29,750
Long-term restricted investments	150	—	—	150
	<u>\$ 62,264</u>	<u>\$ 3</u>	<u>\$ (6)</u>	<u>\$ 62,261</u>
	December 31, 2018			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	\$ 502	\$ —	\$ —	\$ 502
Certificates of deposit	150	—	—	150
Commercial paper	32,224	—	—	32,224
	<u>\$ 32,876</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 32,876</u>
Reported as:				
Cash and cash equivalents	\$ 30,055	\$ —	\$ —	\$ 30,055
Short-term investments	2,671	—	—	2,671
Long-term restricted investments	150	—	—	150
	<u>\$ 32,876</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 32,876</u>

The following is a summary of the cost and estimated fair value of available-for-sale securities at December 31, 2019, by contractual maturity (in thousands):

	December 31, 2019	
	Amortized Cost	Estimated Fair Value
Mature in one year or less	\$ 61,740	\$ 61,737
	<u>\$ 61,740</u>	<u>\$ 61,737</u>

There were no securities that have had an unrealized loss for more than 12 months as of December 31, 2019.

As of December 31, 2019, 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.

#### 4. Property and Equipment

Property and equipment consist of the following (in thousands):

	December 31,	
	2019	2018
Equipment	\$ 12,862	\$ 12,785
Leasehold improvements	9,849	9,828
Construction-in-progress	90	33
	<u>22,801</u>	<u>22,646</u>
Less accumulated depreciation and amortization	(22,332)	(22,041)
Property and equipment, net	<u>\$ 469</u>	<u>\$ 605</u>

Depreciation expense was \$291,000, \$254,000 and \$437,000 in 2019, 2018 and 2017, respectively. Amortization expense was zero in 2019, 2018 and 2017 for assets held under capital leases.

As of December 31, 2019, the Company has recorded \$553,000 as a liability which was included in other long-term liabilities on its balance sheet for asset retirement obligations associated with the estimated restoration cost for its leased buildings.

#### 5. Restricted Investments

As of December 31, 2019 and 2018, the Company had \$150,000 recorded as restricted investments, which primarily served as collateral for letters of credit securing a leased facility in California.

## 6. Commitments

### Operating Leases

The Company has lease arrangements for its facilities in California and Alabama as follows.

<u>Location</u>	<u>Approximate Square Feet</u>	<u>Operation</u>	<u>Expiration</u>
Cupertino, CA	30,149 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2024 (with an option to renew for an additional five years)
Cupertino, CA	20,100 sq. ft.	Office and Laboratory	Lease expires 2024 (with an option to renew for an additional five years)
Vacaville, CA	24,634 sq. ft.	Manufacturing	Lease expires 2023 (with an option to renew for an additional five years)
Birmingham, AL	21,540 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2021 (with two options to renew the lease term for an additional five years each after the current lease expires)

Under these leases, the Company is required to pay certain maintenance expenses in addition to monthly rent. Rent expense is recognized on a straight-line basis over the lease term for leases that have scheduled rental payment increases. Rent expense under all operating leases was \$2.3 million, \$1.9 million and \$1.9 million for the years ended December 31, 2019, 2018 and 2017, respectively.

Future minimum payments under these noncancelable leases are as follows (in thousands):

<u>Year ending December 31,</u>	<u>Operating Leases</u>
2020	\$ 2,200
2021	2,126
2022	1,991
2023	1,970
2024	275
	<u>\$ 8,562</u>

### Other Purchase Commitments

In 2005, the Company entered into a supply agreement with a vendor. The remaining minimum purchase commitment under this agreement was \$500,000 in 2018, which had been recorded as an accrued liability on the Company's Balance Sheet at December 31, 2018, and which was charged to cost of goods sold in the Company's Statements of Operations and Comprehensive Loss in 2017. In 2019, the Company recorded a one-time settlement credit of \$500,000 as a reduction to cost of goods sold upon signing a settlement and release agreement with this vendor, and forgave the contractual right to receive inventory for the same amount that was previously reserved for.



## 7. Term Loan

In July 2016, the Company entered into a \$20.0 million secured single-draw term loan with Oxford Finance LLC (Oxford Finance). The Company and Oxford Finance entered into three subsequent amendments to the Loan Agreement in February 2018, November of 2018 and December 2019, for which the Company paid Oxford Finance loan modification fees of \$100,000, \$900,000 and \$825,000 respectively. As amended, the Loan Agreement provides for interest only payments for the first 18 months, followed by consecutive monthly payments of principal and interest in arrears starting on December 1, 2021 and continuing through the maturity date of the term loan of May 1, 2024. The Loan Agreement provides for a floating interest rate (7.95% initially and 9.07% as of December 31, 2019) based on an index rate plus a spread. In addition, a payment equal to 10% of the principal amount of the term loan 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 of between 0.75% and 2.5% of the principal amount of the term loan depending on the timing of prepayment. The \$150,000 facility fee that was paid at the original closing, the loan modification fees and other debt offering/issuance costs have been recorded as debt discount on the Company's balance sheet and together with the final \$2.0 million payment are being amortized to interest expense using the effective interest method over the revised term of the loan.

The term loan is secured by substantially all of the assets of the Company, except that the collateral does not include any intellectual property (including licensing, collaboration and similar agreements relating thereto), and certain other excluded assets. The 2016 Loan Agreement contains customary representations, warranties and covenants by the Company, which covenants limit the Company's ability to convey, sell, lease, transfer, assign or otherwise dispose of certain assets of the Company; engage in any business other than the businesses currently engaged in by the Company or reasonably related thereto; liquidate or dissolve; make certain management changes; undergo certain change of control events; create, incur, assume, or be liable with respect to certain indebtedness; grant certain liens; pay dividends and make certain other restricted payments; make certain investments; and make payments on any subordinated debt.

The Loan Agreement also contains customary indemnification obligations and customary events of default, including, among other things, the Company's failure to fulfill certain obligations of the Company under the 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.

The fair value of the term loan approximates the carrying value. Future maturities and interest payments under the term loan as of December 31, 2019, are as follows (in thousands):

2020	\$	1,848
2021		3,172
2022		9,381
2023 and after		13,361
Total minimum payments		27,762
Less amount representing interest		(6,090)
Gross balance of term loan		21,672
Less unamortized debt discount		(1,410)
Carrying value of term loan		20,262
Less term loan, current portion, net		—
Term loan, non-current portion, net	\$	20,262

## 8. Stockholders' Equity

### *Common Stock*

In November 2015, the Company filed a shelf registration statement on Form S-3 with the SEC, which allowed the Company to offer up to \$125.0 million of securities from time to time in one or more public offerings of its common stock. In addition, the Company entered into a Controlled Equity Offering sales agreement with Cantor Fitzgerald, under which the Company may sell, subject to certain limitations, up to \$40 million of common stock through Cantor Fitzgerald, acting as agent. In August 2018, the Company filed a new shelf registration statement on Form S-3 with the SEC, which upon being declared effective in October 2018, terminated the November 2015 registration statement and allowed the Company to offer up to \$175.0 million of securities from time to time in one or more public offerings, inclusive of up to \$75.0 million of additional shares of common stock which the Company may sell, subject to certain limitations, under the 2015 Sales Agreement through Cantor Fitzgerald, acting as agent.

In 2017, the Company raised net proceeds of approximately \$12.0 million from the sale of approximately 8.9 million shares of common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of \$1.39 per share. In 2018, the Company raised net proceeds of approximately \$16.8 million from the sale of approximately 9.6 million shares of common stock in the open market through the Controlled Equity Offering program with Cantor Fitzgerald at a weighted average price of \$1.80 per share. In 2019, the Company raised net proceeds of approximately \$3.5 million from the sale of 2,349,820 shares of the Company's common stock in the open market at a weighted average price of \$1.55 per share pursuant to the October 2018 registration statement. On June 20, 2019, the Company entered into a privately negotiated transaction to sell 29,000,000 shares of our common stock to certain investors in a registered offering at a price of \$0.52 per share, raising total gross proceeds to the Company of approximately \$15.1 million.

### *Description of Stock-Based Compensation Plans*

#### **2000 Stock Plan (Incentive Stock Plan)**

In January 2000, the Company's Board of Directors and stockholders adopted the DURECT Corporation 2000 Stock Plan, under which incentive stock options and non-statutory stock options and stock purchase rights may be granted to employees, consultants and non-employee directors. The 2000 Stock Plan was amended by written consent of the Board of Directors in March 2000 and written consent of the stockholders in August 2000.

In April 2005, the Board of Directors approved certain amendments to the 2000 Stock Plan. At the Company's annual stockholders meeting in June 2005, the stockholders approved the amendments of the 2000 Stock Plan to: (i) expand the types of awards that the Company may grant to eligible service providers under the Stock Plan to include restricted stock units, stock appreciation rights and other similar types of awards (including other awards under which recipients are not required to pay any purchase or exercise price) as well as cash awards; and (ii) include certain performance criteria that may be applied to awards granted under the Stock Plan.

At the Company's annual stockholders meeting in June 2010, the stockholders approved amendments of the 2000 Stock Plan to: (i) provide that the number of shares that remain available for issuance will be reduced by two shares for each share issued pursuant to an award (other than an option or stock appreciation right) granted on or after the date of the 2010 Annual Meeting; (ii) expand the types of transactions that might be considered repricings and option exchanges for which stockholder approval is required; (iii) provide that shares tendered or withheld in payment of the exercise price of an option or withheld to satisfy a withholding obligation, and all shares with respect to which a stock appreciation right is exercised, will not again be available for issuance under the Stock Plan; (iv) require that options and stock appreciation rights have an exercise price or base appreciation amount that is at least fair market value on the grant date, except in connection with certain corporate transactions, and that stock appreciation rights may not have longer than a 10-year term; (v) add new performance goals that may be used to provide "performance-based compensation" under the 2000 Stock Plan; (vi) extend the term of the 2000 Stock Plan to the date that is ten (10) years following the stockholders meeting; and (vii) expand the treatment of outstanding awards in connection with certain changes of control of the Company to cover mergers in which the consideration payable to stockholders is not solely securities of the successor corporation.

At the Company's annual stockholders meeting in June 2011, June 2014, June 2016 and June 2018, the stockholders approved amendments of the 2000 Stock Plan to increase the number of shares of the Company's common stock available for issuance by 5,500,000 shares, 4,000,000 shares, 5,000,000 shares and 7,500,000 shares, respectively, each of which had previously been approved by the Board of Directors.

At the Company's annual stockholders meeting in June 2019, the stockholders approved amendments of the 2000 Stock Plan to extend the term of the 2000 Stock Plan to the date that is ten (10) years following the stockholders meeting.

A total of 33,449,989 shares of common stock have been reserved for issuance under this plan. The plan expires in June 2029.

In April 2013, the Board of Directors approved certain amendments to the 2000 Stock Plan to: (i) increase the number of stock options granted to a non-employee director on the date which such person first becomes a director from 30,000 to 70,000 shares of common stock; each option shall have a ten-year term, become exercisable in installments of one-third of the total number of options granted on each anniversary of the grant and have a two-year period following termination of Director status in which the former director can exercise the option; (ii) modify the exercise period for future option grants to a non-employee director in which a former director can exercise the option following termination of Director status from a one year period to a two-year period.

Options granted under the 2000 Stock Plan expire no later than ten years from the date of grant. Options may be granted with different vesting terms from time to time not to exceed five years from the date of grant. The option price of an incentive stock option granted to an employee or of a nonstatutory stock option granted to any person who owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company (or any parent or subsidiary) shall be no less than 110% of the fair market value per share on the date of grant. The option price of an incentive stock option granted to any other employee shall be no less than 100% of the fair market value per share on the date of grant.

As of December 31, 2019, 7,936,039 shares of common stock were available for future grant and options to purchase 29,803,766 shares of common stock were outstanding under the 2000 Stock Plan.

#### **2000 Employee Stock Purchase Plan**

In August 2000, the Company adopted the 2000 Employee Stock Purchase Plan. This purchase plan is implemented by a series of overlapping offering periods of 24 months' duration, with new offering periods, other than the first offering period, beginning on May 1 and November 1 of each year and ending April 30 and October 31, respectively, two years later. The purchase plan allows eligible employees to purchase common stock through payroll deductions at a price equal to the lower of 85% of the fair market value of the Company's common stock at the beginning of each offering period or at the end of each purchase period. The initial offering period commenced on the effectiveness of the Company's initial public offering.

In April 2010, the Board of Directors approved certain amendments to the 2000 Employee Stock Purchase Plan. At the Company's annual stockholders meeting in June 2010, the stockholders approved the amendments of the 2000 Employee Stock Purchase Plan to: (i) increase the number of shares of our common stock authorized for issuance under the ESPP by 250,000 shares; (ii) extend the term of the ESPP to the date that is ten (10) years following the stockholders meeting; (iii) provide for six-month consecutive offering periods beginning on November 1, 2010; (iv) revise certain provisions to reflect the final regulations issued under Section 423 of the Code by the Internal Revenue Service; and (v) provide for the cash-out of options outstanding under an offering period in effect prior to the consummation of certain corporate transactions as an alternative to providing for a final purchase under such offering period.

In March 2015, the Board of Directors approved certain amendments to the 2000 Employee Stock Purchase Plan. At the Company's annual stockholders meeting in June 2015, the stockholders approved the amendments of the 2000 Employee Stock Purchase Plan to: (i) increase the number of shares of our common stock authorized for issuance under the ESPP by 350,000 shares; and (ii) extend the term of the ESPP to the date that is ten (10) years following the stockholders meeting. At the Company's annual stockholders meeting in June 2017, the stockholders approved amendments of the 2000 Employee Stock Purchase Plan to increase the number of shares our common stock authorized for issuance under the ESPP by 350,000 shares and to re-approve its material terms.

The plan expires in June 2025. A total of 2,900,000 shares of common stock have been reserved for issuance under this plan. As of December 31, 2019, 249,276 shares of common stock were available for future grant and 2,650,724 shares of common stock have been issued under the 2000 Employee Stock Purchase Plan.

As of December 31, 2019, shares of common stock reserved for future issuance consisted of the following:

	<u>December 31, 2019</u>
Stock options outstanding	29,803,766
Stock options available for grant	7,936,039
Employee Stock Purchase Plan	249,276
	<u>37,989,081</u>

A summary of stock option activity under all stock-based compensation plans is as follows:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price Per Share</u>	<u>Weighted Average Remaining Contractual Term (in Years)</u>	<u>Aggregate Intrinsic Value (in millions)</u>
Outstanding at December 31, 2018	30,317,615	\$ 1.63	5.02	\$ —
Options granted	4,484,650	\$ 0.61		
Options exercised	(1,735,743)	\$ 1.11		
Options forfeited	(116,472)	\$ 1.16		
Options expired	(3,146,284)	\$ 2.61		
Outstanding at December 31, 2019	<u>29,803,766</u>	\$ 1.41	5.17	\$ 71.3
Exercisable at December 31, 2019	<u>26,457,850</u>	\$ 1.47	4.78	\$ 61.7
Vested and expected to vest at December 31, 2019	29,803,766	\$ 1.41	5.17	\$ 71.3

The aggregate intrinsic value in the table above represents the total intrinsic value (i.e., the difference between the Company's closing stock price on the last trading day of 2019 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their in-the-money options on December 31, 2019. This amount changes based on the fair market value of the Company's common stock. The total intrinsic value of options exercised was \$1.7 million, \$1.6 million and \$328,000 for the years ended December 31, 2019, 2018 and 2017, respectively.

In lieu of providing cash bonuses to certain employees, in January 2019, 2018 and 2017, the Company granted its employees stock options to purchase 2.3 million, 1.9 million and 1.7 million shares, respectively, of the Company's common stock, which vested immediately on the grant date. The weighted-average grant-date fair value of all options granted with exercise prices equal to fair market value was \$0.43 in 2019, \$0.94 in 2018 and \$0.92 in 2017 determined by the Black-Scholes option valuation method. There were no options granted with exercise prices lower than fair market value in 2019, 2018 and 2017.

Expenses for non-employee stock options are recorded over the vesting period of the options, which closely approximates the non-employee's performance period, with the value determined by the Black-Scholes option valuation method and remeasured over the vesting term.

As of December 31, 2019, the Company had three stock-based equity compensation plans, which are described above. The employee stock-based compensation cost that has been included in the statements of operations and comprehensive loss is shown as below (in thousands):

	<u>Year ended December 31,</u>		
	<u>2019</u>	<u>2018</u>	<u>2017</u>
Cost of product revenues	\$ 85	\$ 94	\$ 109
Research and development	755	1,549	1,415
Selling, general and administrative	1,268	1,355	1,081
	<u>\$ 2,108</u>	<u>\$ 2,998</u>	<u>\$ 2,605</u>

Because the Company had a net operating loss carryforward as of December 31, 2019, no excess tax benefits for the tax deductions related to stock-based compensation expense were recognized in the statement of operations. Additionally, no incremental tax benefits were recognized from stock options exercised during 2019, which would have resulted in a reclassification to reduce net cash provided by operating activities with an offsetting increase in net cash provided by financing activities.

#### Determining Fair Value

**Valuation and Expense Recognition.** The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model. The Company recognizes the expense on a straight-line basis. The expense for options is recognized over the requisite service periods of the awards, which is generally the vesting period.

**Expected Term.** The expected term of options granted represents the period of time that the options are expected to be outstanding. The Company determines the expected life using historical options experience. This develops the expected life by taking the weighted average of the actual life of options exercised and cancelled and assumes that outstanding options are exercised uniformly from the current holding period through the end of the contractual life.

**Expected Volatility.** The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of the Company's common stock.

**Risk-Free Rate.** The Company bases the risk-free rate that it uses in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with substantially equivalent remaining terms.

**Dividends.** The Company has never paid any cash dividends on its common stock and the Company does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

The Company used the following assumptions to estimate the fair value of options granted (including fully vested options issued in January 2019, 2018 and 2017) and shares purchased under its stock plans and employee stock purchase plan for the years ended December 31, 2019, 2018 and 2017:

	Year ended December 31,		
	2019	2018	2017
<b>Stock Options</b>			
Risk-free rate	1.5-2.7%	2.7-3.1%	2.0-2.5%
Expected dividend yield	—	—	—
Expected term (in years)	7.5-10.0	7.0-10.0	6.8-10.0
Volatility	79-83%	78-86%	75-86%
Forfeiture rate (1)	0.0%	0.0%	0.0%

- (1) Effective January 1, 2017, the Company elected to account for forfeitures as they occur.

	Year ended December 31,		
	2019	2018	2017
<b>Employee Stock Purchase Plan</b>			
Risk-free rate	1.6-2.5%	1.3-2.5%	0.6-1.3%
Expected dividend yield	—	—	—
Expected term (in years)	0.5	0.5	0.5
Volatility	60-103%	60-146%	44-146%

There were 111,909, 119,097 and 122,033 shares purchased under the Company's employee stock purchase plan during the years ended December 31, 2019, 2018 and 2017, respectively. Included in the statement of operations and comprehensive loss for the year ended December 31, 2019, 2018 and 2017 was \$27,000, \$24,000 and \$34,000, respectively, in stock-based compensation expense related to the recognition of expenses related to shares purchased under the Company's employee stock purchase plan.

As of December 31, 2019, \$1.9 million of total unrecognized compensation costs related to nonvested stock options is expected to be recognized over the respective vesting terms of each award through 2022. The weighted average term of the unrecognized stock-based compensation expense is 2.2 years.

The following table summarizes information about stock options outstanding at December 31, 2019:

Range of Exercise Price	Options Outstanding		Options Exercisable			
	Number of Options Outstanding	Weighted-Average Remaining Contractual Life (In years)	Weighted-Average Exercise Price	Number of Options Exercisable	Weighted-Average Exercise Price	
\$0.51 - \$0.57	150,000	9.32	\$ 0.56	1,250	\$ 0.51	
\$0.58 - \$0.58	3,286,445	8.90	\$ 0.58	2,118,141	\$ 0.58	
\$0.58 - \$0.88	4,534,657	4.30	\$ 0.82	4,200,824	\$ 0.84	
\$0.93 - \$1.19	3,006,451	5.92	\$ 1.15	2,869,131	\$ 1.15	
\$1.20 - \$1.20	114,293	4.55	\$ 1.20	114,293	\$ 1.20	
\$1.21 - \$1.21	3,004,999	3.09	\$ 1.21	2,998,249	\$ 1.21	
\$1.24 - \$1.24	3,131,872	7.94	\$ 1.24	2,293,016	\$ 1.24	
\$1.26 - \$1.26	140,000	3.16	\$ 1.26	140,000	\$ 1.26	
\$1.31 - \$1.31	3,070,156	6.68	\$ 1.31	2,478,491	\$ 1.31	
\$1.33 - \$3.61	9,364,893	3.26	\$ 2.24	9,244,455	\$ 2.25	
<b>\$0.51 - \$3.61</b>	<b>29,803,766</b>	<b>5.17</b>	<b>\$ 1.41</b>	<b>26,457,850</b>	<b>\$ 1.47</b>	

The Company received \$1.9 million, \$1.6 million and \$562,000 in cash from option exercises under all stock-based compensation plans for the years ended December 31, 2019, 2018 and 2017, respectively.

## 9. Income Taxes

The Company accounts for income taxes using the liability method under ASC 740, *Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on temporary differences resulting from the different treatment of items for tax and financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. Additionally, the Company must assess the likelihood that deferred tax assets will be recovered as deductions from future taxable income. The Company has provided a full valuation allowance on the Company's deferred tax assets because the Company believes it is more likely than not that its deferred tax assets will not be realized. The Company evaluates the realizability of its deferred tax assets on a quarterly basis. The Company recorded a deferred tax liability of \$244,000 and \$244,000 on its balance sheet at both December 31, 2019 and 2018, that arose from tax amortization of an indefinite-lived intangible asset. The Company also recorded a deferred tax expense of zero, zero and a benefit of \$153,000 related to the deferred tax liability in the years ended December 31, 2019, 2018 and 2017, respectively. The Company recorded no tax expense in each of 2019 and 2018.

The reconciliation of income tax expenses (benefit) at the statutory federal income tax rate of 21% for 2019 and 2018, and 34% for 2017, to net income tax benefit included in the statements of operations and comprehensive loss for the years ended December 31, 2019, 2018 and 2017 is as follows (in thousands):

	Year Ended December 31,		
	2019	2018	2017
U.S. federal taxes benefit at statutory rate	\$ (4,321)	\$ (5,318)	\$ (1,307)
State taxes	—	—	3
Change in valuation allowance	4,394	5,143	(41,865)
Stock-based compensation	879	999	1,832
Research and development tax credits	(1,004)	(999)	(1,353)
Tax Reform change in tax rate and other	—	—	42,528
Other	52	175	12
Total income tax (benefit) provision	\$ —	\$ —	\$ (150)

In 2019, 2018 and 2017, total income tax provision (benefit) expense was zero, zero and \$(150,000), respectively. The Company has presented these amounts within interest and other income, net in the Statements of Operations and Comprehensive Loss. Deferred tax assets and liabilities reflect the net tax effects of net operating loss and research and other credit carryforwards and the temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	<b>December 31,</b>	
	<b>2019</b>	<b>2018</b>
<b>Deferred tax assets:</b>		
Net operating loss carryforwards	\$ 90,102	\$ 87,275
Research and other credits	18,860	17,524
Deferred revenue	248	277
Stock-based compensation	4,376	4,755
Other	5,288	2,823
<b>Total deferred tax assets</b>	<b>118,874</b>	<b>112,654</b>
Valuation allowance for deferred tax assets	(117,245)	(112,654)
<b>Deferred tax liabilities—Intangibles</b>	<b>(1,873)</b>	<b>(244)</b>
<b>Net deferred tax assets and liabilities</b>	<b>\$ (244)</b>	<b>\$ (244)</b>

The Company recognizes deferred tax assets to the extent that the Company believes that these assets are more likely than not to be realized. In making such a determination, all available positive and negative evidence is considered, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If it is determined that the Company would be able to realize deferred tax assets in the future in excess of their net recorded amount, the Company would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes. The recognition and measurement of tax benefits requires significant judgment. Judgments concerning the recognition and measurement of tax benefit might change as new information becomes available. Given the Company's history of operating losses, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by \$4.6 million during 2019, and \$6.3 million in 2018, and decreased \$43.1 million during 2017, respectively.

As of December 31, 2019, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$358.6 million, of which \$320.4 million will expire in the years 2020 through 2037, and \$38.2 million which do not expire, and federal research and development tax credits of approximately \$14.5 million, which expire at various dates beginning in 2020 through 2039, if not utilized.

As of December 31, 2019, the Company had net operating loss carryforwards for state income tax purposes of approximately \$219.2 million, which expire in the years 2020 through 2039, if not utilized, and state research and development tax credits of approximately \$15.8 million, which do not expire.

Utilization of the net operating losses may be subject to a substantial annual limitation due to federal and state ownership change limitations. The annual limitation may result in the expiration of net operating losses before utilization.

At December 31, 2019 and December 31, 2018, the Company had unrecognized tax benefits of approximately \$9.1 million and \$8.4 million, respectively (none of which, if recognized, would affect the Company's effective tax rate). The Company does not believe there will be any material changes in its unrecognized tax positions over the next twelve months.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	December 31,	
	2019	2018
Balance at beginning of the year	\$ 8,432	\$ 7,849
Decreased related to prior year tax positions	(73)	(7)
Increased related to current year tax positions	719	590
Balance at end of the year	<u>\$ 9,078</u>	<u>\$ 8,432</u>

Interest and penalty costs related to unrecognized tax benefits, if any, are classified as a component of interest and other income, net in the Statements of Operations and Comprehensive Loss. The Company did not recognize any interest and penalties expenses related to unrecognized tax benefits for the years ended December 31, 2019, 2018 and 2017.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company is subject to U.S. federal and state income tax examination for calendar tax years ending 1998 through 2018 due to unutilized net operating losses and research credits.

**10. Unaudited Selected Quarterly Financial Data (in thousands, except per share amounts)**

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2019	2018	2019	2018	2019	2018	2019	2018
Revenue (1)	\$ 4,131	\$ 3,488	\$ 3,985	\$ 3,413	\$ 10,763	\$ 8,036	\$ 10,685	\$ 3,627
Net loss	\$ (7,130)	\$ (8,297)	\$ (7,227)	\$ (7,011)	\$ (1,990)	\$ (2,715)	\$ (4,231)	\$ (7,299)
Basic net loss per share	\$ (0.04)	\$ (0.05)	\$ (0.04)	\$ (0.04)	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.05)
Diluted net loss per share	\$ (0.04)	\$ (0.05)	\$ (0.04)	\$ (0.04)	\$ (0.01)	\$ (0.02)	\$ (0.02)	\$ (0.05)

(1) The figures for the third and fourth quarters of 2019 include \$6.2 million, and \$6.1 million respectively, of revenue recognized under the July 2019 license agreement with Gilead (see note 2). The third quarter of 2018 figure includes the recognition of \$5.0 million in revenue associated with a nonrefundable milestone payment that the Company received in August 2018 under its agreement with Indivior (see note 2).



**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.**

Not applicable.

**Item 9A. Controls and Procedures.**

**Disclosure Controls and Procedures**

As required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15, DURECT's management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of DURECT's disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e) and 15d-15(e). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that DURECT's disclosure controls and procedures were effective as of the end of the period covered by this report.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision of our Chief Executive Officer and Chief Financial Officer and with the participation of our management, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2019 based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2019.

Our independent registered public accountants, Ernst & Young LLP, audited the financial statements included in this Annual Report on Form 10-K and have issued an audit report on our internal control over financial reporting which appears below.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

To the Stockholders and the Board of Directors of DURECT Corporation

**Opinion on Internal Control over Financial Reporting**

We have audited DURECT Corporation’s internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). In our opinion, DURECT Corporation (the Company) maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the balance sheets as of December 31, 2019 and 2018, and the related statements of operations and comprehensive loss, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes and the financial statement schedule listed in the Index at Item 15(a)(2) and our report dated March 5, 2020 expressed an unqualified opinion thereon.

**Basis for Opinion**

The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s Report on Internal Control Over Financing Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Definition and Limitations of Internal Control over Financial Reporting**

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Ernst & Young LLP

Redwood City, California  
March 5, 2020

**Item 9B. Other Information.**

None

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The names of the executive officers of the Company and their ages, titles and biographies as of the date hereof are incorporated by reference from Part I, Item 1, above.

Information required by this item will be contained in our definitive proxy statement to be filed with the Securities and Exchange Commission on Schedule 14A in connection with our 2020 Annual Meeting of Stockholders (the Proxy Statement), which is expected to be filed not later than 120 days after the end of our fiscal year ended December 31, 2019, under the headings “Election of Directors,” “The Board, Board Committees and Meetings,” “Code of Ethics,” and “Section 16(a) Beneficial Ownership Reporting Compliance,” and is incorporated herein by reference.

**Item 11. Executive Compensation**

Information required by this item will be contained in the Proxy Statement under the headings “Executive Compensation,” “Director Compensation,” and “Compensation Committee Report” and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information required by this item will be contained in the Proxy Statement under the headings “Common Stock Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information,” and is incorporated herein by reference.

**Item 13. Certain Relationships, Related Transactions and Director Independence**

Information required by this item will be contained in the Proxy Statement under the headings “Certain Relationships,” “Other Transactions,” and “The Board, Board Committees and Meetings,” and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Information required by this item will be contained in the Proxy Statement under the heading “Fees Billed for Services Rendered by Principal Accountant,” and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

(a) The following documents are filed as part of this report:

(1) *Financial Statements*

See Item 8 of this Form 10-K

(2) *Financial Statement Schedules*

See Schedule II—Valuation and Qualifying Accounts, immediately following Item 16 of this Form 10-K

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

(3) The list of exhibits filed as part of this report is set forth on the Exhibit Index immediately preceding the signature page of this report and is incorporated herein by reference in this Item 5(a)(3) or is filed in accordance with Item 601 of Regulation S-K.

<u>Number</u>	<u>Description</u>
2.1	<a href="#"><u>Agreement and Plan of Merger dated April 18, 2001, among the Company, Target and Magnolia Acquisition Corporation (incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K (File No. 000-31615) filed on May 15, 2001).</u></a>
2.2	<a href="#"><u>Agreement and Plan of Merger dated August 15, 2003, among the Company, Birmingham Polymers, Inc., Absorbable Polymer Technologies, Inc. and the Principal Shareholders of Absorbable Polymer Technologies, Inc. (incorporated by reference to Exhibit 2.2 to our Registration Statement on Form S-3, as amended (File No. 333-108396), initially filed on August 29, 2003).</u></a>
3.1	<a href="#"><u>Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.3 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
3.2	<a href="#"><u>Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.4 to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-3, filed on July 1, 2010).</u></a>
3.3	<a href="#"><u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation of DURECT Corporation (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, as filed with the SEC on June 20, 2018).</u></a>
3.4	<a href="#"><u>Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of DURECT Corporation (incorporated by reference to Exhibit 3.3 to our Registration Statement on Form S-3 (File No. 333-128979) initially filed on October 13, 2005).</u></a>
3.5	<a href="#"><u>Certificate of Amendment to Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of DURECT Corporation (incorporated by reference to Exhibit 3.7 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 5, 2010).</u></a>
3.6	<a href="#"><u>Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K (File No. 000-31615), filed on December 17, 2014).</u></a>
4.1	<a href="#"><u>Second Amended and Restated Investors' Rights Agreement (incorporated by reference to Exhibit 4.2 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
4.2*	<a href="#"><u>Description of Securities of the Registrant.</u></a>
10.1+	<a href="#"><u>Form of Indemnification Agreement between the Company and each of its Officers and Directors (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
10.2+*	<a href="#"><u>2000 Stock Plan, as amended.</u></a>
10.3+	<a href="#"><u>2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.4 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
10.4+	<a href="#"><u>2000 Directors' Stock Option Plan (incorporated by reference to Exhibit 10.5 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
10.5	<a href="#"><u>Modified Net Single Tenant Lease Agreement between the Company and DeAnza Enterprises, Ltd. dated as of February 18, 1999 (incorporated by reference to Exhibit 10.11 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>
10.6	<a href="#"><u>Common Stock Purchase Agreement between the Company and ALZA Corporation dated April 14, 2000 (incorporated by reference to Exhibit 10.17 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).</u></a>

<u>Number</u>	<u>Description</u>
10.7**	<a href="#"><u>License &amp; Option Agreement and Mutual Release between Southern BioSystems, Inc, an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and Thorn BioScience LLC dated as of July 26, 2002 (incorporated by reference to Exhibit 10.30 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 14, 2002).</u></a>
10.8**	<a href="#"><u>Development and License Agreement between the Company, Southern BioSystems, Inc., an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and Pain Therapeutics, Inc. dated as of December 19, 2002 (incorporated by reference to Exhibit 10.34 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 14, 2003).</u></a>
10.9	<a href="#"><u>Lease between the Company and Renault &amp; Handley Employee Investments Co. with commencement date of January 1, 2005 (incorporated by reference to Exhibit 10.36 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 11, 2004).</u></a>
10.10**	<a href="#"><u>Amendment dated December 21, 2005 to Development and License Agreement dated December 19, 2002 between the Company and Pain Therapeutics, Inc. (incorporated by reference to Exhibit 10.45 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 16, 2006).</u></a>
10.11**	<a href="#"><u>Sucrose Acetate Isobutyrate Pharmaceutical Grade Supply Agreement between the Company and Eastman Chemical Company dated as of December 30, 2005 (incorporated by reference to Exhibit 10.46 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 16, 2006).</u></a>
10.12	<a href="#"><u>First Lease Extension between the Company and Renault &amp; Handley Employee Investments Co. effective March 1, 2009 (incorporated by reference to Exhibit 10.54 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on May 7, 2009).</u></a>
10.13	<a href="#"><u>Second Amendment to Lease between De Anza Enterprises and the Company dated as of August 6, 2009 (incorporated by reference to Exhibit 10.56 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 2, 2009).</u></a>
10.14	<a href="#"><u>Lease between the Company and DRA/CLP Riverchase Center Birmingham, LLC dated as of October 19, 2010 (incorporated by reference to Exhibit 10.62 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on March 3, 2011).</u></a>
10.15	<a href="#"><u>Third Amendment to Lease between De Anza Enterprises and the Company dated as of December 21, 2010 (incorporated by reference to Exhibit 10.63 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on March 3, 2011).</u></a>
10.16	<a href="#"><u>Fourth Amendment to Lease between De Anza Enterprises and the Company dated as of August 20, 2013 (incorporated by reference to Exhibit 10.71 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 5, 2013).</u></a>
10.17	<a href="#"><u>Addendum II to Lease between the Company and Northwest Asset Management Company dated as of August 27, 2013 (incorporated by reference to Exhibit 10.72 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 5, 2013).</u></a>
10.18	<a href="#"><u>Second Amendment to Lease between Handley Management Corporation, as successor-by-merger to Renault &amp; Handley Employee Investments Co. and the Company dated November 11, 2013 (incorporated by reference to Exhibit 10.73 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on February 27, 2014).</u></a>
10.19	<a href="#"><u>Executive Change of Control Policy, as amended December 12, 2013 (incorporated by reference to Exhibit 10.74 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on February 27, 2014).</u></a>
10.20	<a href="#"><u>Loan and Security Agreement between the Company and Oxford Finance, LLC dated June 26, 2014 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on August 8, 2014).</u></a>

<u>Number</u>	<u>Description</u>
10.21**	<a href="#"><u>License Agreement between the Company and Santen Pharmaceutical Co., Ltd. dated December 11, 2014 (incorporated by reference to Exhibit 10.28 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on March 3, 2015).</u></a>
10.22**	<a href="#"><u>Exclusive License Agreement between the Company and Virginia Commonwealth University Intellectual Property Foundation dated December 5, 2012 (incorporated by reference to Exhibit 10.29 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on March 3, 2015).</u></a>
10.23	<a href="#"><u>First Amendment to Loan and Security Agreement and First Amendment to Disbursement Letter between the Company and Oxford Finance, LLC dated July 31, 2015 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 3, 2015).</u></a>
10.24	<a href="#"><u>Loan and Security Agreement between the Company and Oxford Finance LLC dated July 28, 2016. (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 1, 2016).</u></a>
10.25**	<a href="#"><u>Development and Commercialization Agreement between the Company and SANDOZ AG dated May 5, 2017. (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on August 9, 2017).</u></a>
10.26**	<a href="#"><u>Patent purchase agreement between the Company and Indivior UK Limited dated as of September 26, 2017. (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 2, 2017).</u></a>
10.27	<a href="#"><u>First Amendment to Loan and Security Agreement between the Company and Oxford Finance LLC dated February 28, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 5, 2018).</u></a>
10.28	<a href="#"><u>Second Amendment to Loan and Security Agreement between the Company and Oxford Finance LLC dated November 1, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed November 5, 2018).</u></a>
10.29	<a href="#"><u>Addendum III to Lease between the Company and Northwest Asset Management Company dated as of April 10, 2018 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on August 2, 2018).</u></a>
10.30**	<a href="#"><u>First Amendment to the Development and Commercialization Agreement between the Company and SANDOZ AG effective as of May 4, 2018 (incorporated by reference to Exhibit 10.2 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on August 2, 2018).</u></a>
10.31	<a href="#"><u>Fifth Amendment to Lease between De Anza Enterprises and the Company dated as of August 15, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the SEC on August 17, 2018).</u></a>
10.32	<a href="#"><u>Third Amendment to Lease between Handley Management Corporation, as successor-by-merger to Renault &amp; Handley Employee Investments Co. and the Company dated September 17, 2018 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the SEC on September 21, 2018).</u></a>
10.33	<a href="#"><u>Amendment No. 1 to Exclusive License Agreement between the Company and Virginia Commonwealth University Intellectual Property Foundation dated July 2, 2015 (incorporated by reference to Exhibit 10.4 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 8, 2018).</u></a>
10.34	<a href="#"><u>Amendment No. 2 to Exclusive License Agreement between the Company and Virginia Commonwealth University Intellectual Property Foundation dated March 6, 2018 (incorporated by reference to Exhibit 10.5 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 8, 2018).</u></a>

<u>Number</u>	<u>Description</u>
10.35++	<a href="#">License Agreement between the Company and Gilead Sciences, Inc. dated July 19, 2019 (incorporated by reference to Exhibit 10.1 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed with the SEC on November 5, 2019).</a>
10.36*	<a href="#">Third Amendment to Loan and Security Agreement between the Company and Oxford Finance LLC dated December 31, 2019 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, as filed with the SEC on January 6, 2020).</a>
23.1*	<a href="#">Consent of Independent Registered Public Accounting Firm.</a>
24.1*	<a href="#">Power of Attorney (see signature page of this Form 10-K).</a>
31.1*	<a href="#">Rule 13a-14(a) Section 302 Certification.</a>
31.2*	<a href="#">Rule 13a-14(a) Section 302 Certification.</a>
32.1***	<a href="#">Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>
32.2***	<a href="#">Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</a>
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

\*\* Confidential treatment granted with respect to certain portions of this Exhibit.

\*\*\* Furnished, not filed.

+ Indicates a management contract or compensatory plan or arrangement.

++ Certain portions of this exhibit (indicated by "[\*\*\*]") have been omitted in accordance with the rules of the Securities and Exchange Commission.

**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**

**Year Ended December 31, 2019, 2018 and 2017**  
**(in thousands)**

	<u>Balance at beginning of the year</u>	<u>Additions (Reductions) to allowances</u>	<u>Deductions</u>	<u>Balance at end of the year</u>
Allowance for doubtful accounts				
Year ended December 31, 2019	\$ 102	\$ (51)	\$ (17)	\$ 34
Year ended December 31, 2018	\$ 155	\$ (52)	\$ (1)	\$ 102
Year ended December 31, 2017	\$ 73	\$ 165	\$ (83)	\$ 155



## EXHIBIT INDEX

<u>Number</u>	<u>Description</u>
4.2*	<a href="#">Description of Securities of the Registrant.</a>
10.2+*	<a href="#">2000 Stock Plan, as amended.</a>
23.1*	<a href="#">Consent of Independent Registered Public Accounting Firm.</a>
24.1*	<a href="#">Power of Attorney (see signature page of this Form 10-K).</a>
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101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

\*\* Furnished, not filed.

+ Indicates a management contract or compensatory plan or arrangement.

**Item 16. Form 10-K Summary.**

The Company has elected not to include summary information.



**DESCRIPTION OF THE REGISTRANT'S SECURITIES  
REGISTERED PURSUANT TO SECTION 12 OF  
THE SECURITIES EXCHANGE ACT OF 1934**

*DURECT Corporation ("we," "our," "us," or the "Company") has one class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended: our common stock. The following summary of the terms of our common stock is based upon our Amended and Restated Certificate of Incorporation, as amended ("Restated Certificate of Incorporation") and our Amended and Restated Bylaws ("Restated Bylaws"). This summary does not purport to be complete and is subject to, and is qualified in its entirety by express reference to, the applicable provisions of our [Restated Certificate of Incorporation](#), as amended, and our [Restated Bylaws](#), which are filed as exhibits to our Annual Report on Form 10-K and are incorporated by reference herein. We encourage you to read our Restated Certificate of Incorporation, our Restated Bylaws and the applicable provisions of the Delaware General Corporation Law for more information.*

**DESCRIPTION OF COMMON STOCK**

**Authorized Capital Shares**

Our authorized capital stock consists of 350,000,000 shares of common stock, \$0.0001 par value per share, and 10,000,000 shares of preferred stock, \$0.0001 par value per share, of which 150,000 shares have been designated as Series A Participating Preferred Stock ("Series A Preferred Stock"). As of February 28, 2020, there were 150,000 shares of Series A Preferred Stock authorized and unissued, and there were no shares of Series A Preferred Stock outstanding.

**Common Stock**

**Dividend Rights**

Subject to preferences that may apply to any shares of preferred stock outstanding at the time, the holders of outstanding shares of our common stock are entitled to receive dividends out of funds legally available at the times and in the amounts that our board of directors may determine. In the event a dividend is paid in the form of shares of common stock or rights to acquire shares of common stock, the holders of common stock will receive common stock, or rights to acquire common stock, as the case may be.

**Voting Rights**

Holders of our common stock are entitled to one vote per share. We have not provided for cumulative voting for the election of directors in our Restated Certificate of Incorporation, which means that the holders of a majority of our shares of common stock can elect all of the directors then standing for election.

**No Preemptive or Similar Rights**

Our common stock is neither entitled to preemptive rights nor is it subject to redemption.

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## **Conversion**

Our common stock is not convertible into any other shares of our capital stock.

## **Right to Receive Liquidation Distributions**

Upon our liquidation, dissolution or winding-up, the assets legally available for distribution to our stockholders would be distributable ratably among the holders of our common stock and any participating preferred stock outstanding at that time after payment of liquidation preferences, if any, on any outstanding shares of preferred stock and payment of other claims of creditors.

## **Impact of Preferred Stock**

Our board of directors may authorize the issuance of preferred stock with voting or conversion rights that could adversely affect the voting power or other rights of the holders of our common stock. Our Restated Certificate of Incorporation specifies the following rights, preferences, and privileges for our Series A preferred stockholders:

- *Dividend Rights.* Holders of shares of our Series A Preferred Stock shall be entitled to receive when, as and if declared by the Board of Directors out of funds legally available for the purpose, quarterly dividends payable in cash on the last day of March, June, September and December in each year.
  - *Voting Rights.* Each share of Series A Preferred Stock is entitled to 1,000 votes on all matters submitted to a vote of the stockholders of the Corporation. Except as provided in our Restated Certificate of Incorporation or by law, the holders of shares of Series A Preferred Stock and the holder of common stock shall vote together as one class on all matters submitted to a vote of stockholders.
  - *Right to Receive Liquidation Distributions.* In the event of any liquidation, dissolution or winding-up of the affairs of the Company, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Preferred Stock unless, prior thereto, the holders of shares of Series A Preferred Stock shall have received an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, plus an amount equal to the greater of (1) \$1,000 per share, provided that in the event the Company does not have sufficient assets, after payment of its liabilities and distribution to holders of preferred stock ranking prior to the Series A Preferred Stock, available to permit payment in full of the \$1,000 per share amount, the amount required to be paid under Section 6(A)(1) of our Restated Certificate of Incorporation shall, subject to Section 6(B) thereof, equal the value of the amount of available assets divided by the number of outstanding shares of Series A Preferred Stock or (2) subject to the provisions for adjustment set forth therein, 1,000 times the aggregate per share amount to be distributed to the holders of common stock (the greater of (1) or (2), the "Series A Liquidation Preference"). In the event, however, that there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other series of preferred stock, if any, which rank on a parity with the Series A Preferred Stock, then such remaining assets shall be distributed ratably to the holders of such parity shares in proportion to their respective liquidation preferences.
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**Fully Paid and Non-Assessable**

All of the outstanding shares of our common stock are fully paid and non-assessable.

**Listing**

Our common stock is listed on the Nasdaq Global Market under the symbol "DRRX."

**Transfer Agent and Registrar**

The transfer agent and registrar for our common stock is Computershare Trust Company, N.A.

**Anti-takeover Provisions**

The provisions of Delaware law and the provisions of our Restated Certificate of Incorporation and our Restated Bylaws may have the effect of delaying, deferring or preventing a change in our control.

*Delaware Law.* We are governed by the provisions of Section 203 of the Delaware General Corporation Law ("Section 203"). In general, Section 203 prohibits a public Delaware corporation from engaging in a "business combination" with an "interested stockholder" for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. A "business combination" includes mergers, asset sales or other transactions resulting in a financial benefit to the stockholder. An "interested stockholder" is a person who, together with affiliates and associates, owns, or within the prior three years did own, 15% or more of the corporation's outstanding voting stock. These provisions may have the effect of delaying, deferring or preventing a change in our control.

*Restated Certificate of Incorporation and Restated Bylaw Provisions.* Our Restated Certificate of Incorporation and our Restated Bylaws include a number of other provisions that could deter hostile takeovers or delay or prevent a change in our control, including the following:

- *Advance Notice Requirements for Stockholder Proposals and Director Nominations.* Our Restated Bylaws provide advance notice procedures for stockholders seeking to bring business before our annual meeting of stockholders, or to nominate candidates for election as directors at our annual meeting of stockholders. Our Restated Bylaws also specify certain requirements regarding the form and content of a stockholder's notice. These provisions might preclude our stockholders from bringing matters before our annual meeting of stockholders or from making nominations for directors at our annual meeting of stockholders.
- *Issuance of Undesignated Preferred Stock.* Our board of directors has the authority, without further action by the stockholders, to issue up to 10,000,000 shares of undesignated preferred stock with rights and preferences, including voting rights, designated from time to time by our board of directors. The existence of authorized but unissued shares of preferred stock would enable our board of directors to render more difficult, or to discourage an attempt to obtain control of us by means of, a merger, tender offer, proxy contest or similar transaction.

These provisions may deter a hostile takeover or delay a change in control or management of the Company.

## DURECT CORPORATION

## 2000 STOCK PLAN

(as amended on March 13, 2000)

(as further amended on March 31, 2000)

(as further amended on March 15, 2001)

(as further amended April 14, 2005)

(as further amended June 23, 2010)

(as further amended June 23, 2011)

(as further amended June 16, 2014)

(as further amended June 22, 2016)

(as further amended June 19, 2018)

(as further amended June 19, 2019)

1. **Purposes of the Plan.** The purposes of this 2000 Stock Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to Employees and Consultants of the Company and its Subsidiaries and to promote the success of the Company's business. Options granted under the Plan may be Incentive Stock Options (as defined under Section 422 of the Code) or Nonstatutory Stock Options, as determined by the Administrator at the time of grant of an option and subject to the applicable provisions of Section 422 of the Code, as amended, and the regulations promulgated thereunder. Stock Grants, Stock Units, Stock Appreciation Rights, Stock Purchase Rights and Cash Awards may also be granted under the Plan.
2. **Definitions.** As used herein, the following definitions shall apply:
  - (a) "**Administrator**" means the Board or any of its Committees appointed pursuant to Section 4 of the Plan.
  - (b) "**Applicable Laws**" means the legal requirements relating to the administration of stock option and restricted stock purchase plans under applicable U.S. state corporate laws, U.S. federal and applicable state securities laws, the Code, any stock exchange rules or regulations and the applicable laws of any other country or jurisdiction where Options or Stock Purchase Rights are granted under the Plan, as such laws, rules, regulations and requirements shall be in place from time to time.
  - (c) "**Award**" means a Stock Award, a Cash Award or an Option granted in accordance with the terms of the Plan.
  - (d) "**Award Agreement**" means a Stock Award Agreement, Cash Award Agreement and/or Option Agreement, which may be in written or electronic format, in such form and with such terms and conditions as may be specified by the Administrator, evidencing the terms and conditions of an individual Award. Each Award Agreement is subject to the terms and conditions of the Plan.
  - (e) "**Board**" means the Board of Directors of the Company.
  - (f) "**Cash Award**" means a bonus opportunity awarded under Section 14 pursuant to which a Participant may become entitled to receive an amount based on the satisfaction of such performance criteria as are specified in the agreement or other documents evidencing the Award (the "**Cash Award Agreement**").
  - (g) "**Code**" means the Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code or regulation thereunder shall include such section or regulation, any valid regulation promulgated under such section, and any comparable provision of any future legislation or regulation amending, supplementing or superseding such section or regulation.
  - (h) "**Committee**" means the Committee appointed by the Board of Directors in accordance with Section 4(a) and (b) of the Plan.
  - (i) "**Common Stock**" means the Common Stock of the Company.

- (j) “**Company**” means Durect Corporation, a Delaware corporation.
- (k) “**Consultant**” means any person, including an advisor, who is engaged by the Company or any Parent or Subsidiary to render consulting or advisory services and is compensated for such services, and any Director of the Company whether compensated for services provided in his or her capacity as a Director or not.
- (l) “**Continuous Status as an Employee or Consultant**” means the absence of any interruption or termination of service as an Employee or Consultant. Continuous Status as an Employee or Consultant shall not be considered interrupted in the case of: (i) sick leave; (ii) military leave; (iii) any other leave of absence approved by the Administrator, provided that such leave is for a period of not more than three (3) months, unless reemployment upon the expiration of such leave is guaranteed by contract or statute, or unless provided otherwise pursuant to Company policy adopted from time to time; or (iv) in the case of transfers between locations of the Company or between the Company, its Subsidiaries or their respective successors. For purposes of this Plan, a change in status from an Employee to a Consultant or from a Consultant to an Employee will not constitute an interruption of Continuous Status as an Employee or Consultant.
- (m) “**Director**” means a member of the Board of Directors of the Company.
- (n) “**Employee**” means any person (including, if appropriate, Officers, Directors and Named Executives), employed by the Company or any Parent or Subsidiary of the Company, with the status of employment determined based upon such minimum number of hours or periods worked as shall be determined by the Administrator in its discretion, subject to any requirements of the Code. The payment by the Company of a director’s fee to a Director shall not be sufficient to constitute “employment” of such Director by the Company.
- (o) “**Exchange Act**” means the Securities Exchange Act of 1934, as amended.
- (p) “**Fair Market Value**” means, as of any date, the fair market value of Common Stock determined as follows:
- (i) If the Common Stock is listed on any established stock exchange or a national market system including without limitation The Nasdaq Global Select Market, The Nasdaq Global Market or The Nasdaq Capital Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported), as quoted on such system or exchange, or the exchange with the greatest volume of trading in Common Stock, on the date of grant or the date of determination, as applicable (or, if no closing sales price or closing bid was reported on that date, as applicable, on the last trading date such closing sales price or closing bid was reported), as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;
  - (ii) If the Common Stock is regularly quoted on an automated quotation system (including the OTC Bulletin Board) or by a recognized securities dealer, its Fair Market Value shall be the closing sales price for such stock as quoted on such system or by such securities dealer on the date of grant or the date of determination, as applicable, but if selling prices are not reported, the Fair Market Value of a share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the date of grant (or, if no such prices were reported on that date, on the last date such prices were reported), as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or
  - (iii) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Administrator.
- (q) “**Incentive Stock Option**” means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code, as designated in the applicable written Option Agreement.
- (r) “**Listed Security**” means any security of the Company that is listed or approved for listing on a national securities exchange or designated or approved for designation as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc.
- (s) “**Named Executive**” means an Employee who is a “covered employee” under Section 162(m)(3) of the Code.
- (t) “**Nonstatutory Stock Option**” means an Option not intended to qualify as an Incentive Stock Option, as designated in the applicable written Option Agreement.
- (u) “**Officer**” means a person who is an officer of the Company (or any Parent or Subsidiary) within the meaning of Section 16(a) of the Exchange Act and the rules and regulations promulgated thereunder.
- (v) “**Option**” means a stock option granted pursuant to the Plan.
- (w) “**Option Agreement**” means a written agreement between an Optionee and the Company reflecting the terms of an Option granted under the Plan and includes any documents attached to such Option Agreement, including, but not limited to, a notice of stock option grant and a form of exercise notice.
- (x) “**Optioned Stock**” means the Common Stock subject to an Option or a Stock Purchase Right.



- (y) “**Optionee**” means an Employee or Consultant who receives an Option.
- (z) “**Parent**” means a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code, or any successor provision.
- (aa) “**Participant**” means any holder of one or more Options or Stock Awards, or the Shares issuable or issued upon exercise of such Awards, under the Plan.
- (bb) “**Plan**” means this 2000 Stock Plan.
- (cc) “**Qualifying Performance Criteria**” means any one or more of the following performance criteria, either individually, alternatively or in any combination, applied to either the Company as a whole or to a business unit, Parent, Subsidiary or business segment, either individually, alternatively or in any combination, and measured either annually or cumulatively over a period of years, on an absolute basis or relative to a pre-established target, to previous years’ results or to a designated comparison group, and on a pre-tax or after-tax basis, in each case as specified by the Committee in the Award: (i) cash flow (including operating cash flow or free cash flow); (ii) earnings (including gross margin, earnings before interest and taxes, earnings before taxes, and net earnings); (iii) earnings per share; (iv) growth in earnings or earnings per share; (v) stock price; (vi) return on equity or average stockholders’ equity; (vii) total stockholder return; (viii) return on capital; (ix) return on assets or net assets; (x) return on investment; (xi) revenue; (xii) income or net income; (xiii) operating income or net operating income; (xiv) operating profit or net operating profit; (xv) operating margin; (xvi) return on operating revenue; (xvii) market share; (xviii) contract awards or backlog; (xix) overhead or other expense reduction; (xx) growth in stockholder value relative to the moving average of the S&P 500 Index or a peer group index; (xxi) credit rating; (xxii) strategic plan development and implementation (including individual performance objectives that relate to achievement of the Company’s or any business unit’s strategic plan); (xxiii) improvement in workforce diversity; (xxiv) expenses; (xxv) economic value added; (xxvi) product quality; (xxvii) number of customers; (xxviii) objective customer indicators; (xxix) customer satisfaction; (xxx) new product invention or innovation; (xxxi) profit after taxes; (xxxii) pre-tax profit; (xxxiii) working capital; (xxxiv) sales; (xxxv) advancement of the Company’s product pipeline; (xxxvi) consummation of strategic transactions; (xxxvii) reduction in cash utilization; and (xxxviii) addition of technologies and products. The Committee may appropriately adjust any evaluation of performance under a Qualifying Performance Criteria to exclude any of the following events that occurs during a performance period: (A) asset write-downs; (B) litigation or claim judgments or settlements; (C) the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results; (D) accruals for reorganization and restructuring programs; and (E) any gains or losses classified as extraordinary or as discontinued operations in the Company’s financial statements.
- (dd) “**Reporting Person**” means an Officer, Director, or greater than 10% stockholder of the Company within the meaning of Rule 16a-2 under the Exchange Act, who is required to file reports pursuant to Rule 16a-3 under the Exchange Act.
- (ee) “**Restatement Effective Date**” means the date of the Company’s 2019 Annual Meeting of Stockholders.
- (ff) “**Restricted Stock**” means shares of Common Stock acquired pursuant to a grant of a Stock Award under Sections 11, 12 or 13 below.
- (gg) “**Rule 16b-3**” means Rule 16b-3 promulgated under the Exchange Act, as the same may be amended from time to time, or any successor provision.
- (hh) “**Share**” means a share of the Common Stock, as adjusted in accordance with Section 17 of the Plan.
- (ii) “**Stock Appreciation Right**” means a right to receive cash and/or shares of Common Stock based on the appreciation in the Fair Market Value of a specific number of shares of Common Stock granted under Section 13.
- (jj) “**Stock Award**” means a Stock Grant, a Stock Unit, a Stock Appreciation Right or a Stock Purchase Right granted under Sections 11, 12 or 13.
- (kk) “**Stock Award Agreement**” means a written agreement, the form(s) of which shall be approved from time to time by the Administrator, between the Company and a holder of a Stock Award evidencing the terms and conditions of an individual Stock Award grant. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.
- (ll) “**Stock Exchange**” means any stock exchange or consolidated stock price reporting system on which prices for the Common Stock are quoted at any given time.
- (mm) “**Stock Grant**” means the award of a certain number of shares of Common Stock granted under Section 11 below.
- (nn) “**Stock Purchase Right**” means the right to purchase Common Stock pursuant to Section 12 below.
- (oo) “**Stock Unit**” means a bookkeeping entry representing an amount equivalent to the Fair Market Value of one Share, payable in cash, property or Shares. Stock Units represent an unfunded and unsecured obligation of the Company, except as otherwise provided for by the Administrator.

(pp) “**Subsidiary**” means a “subsidiary corporation,” whether now or hereafter existing, as defined in Section 424(f) of the Code, or any successor provision.

(qq) “**Ten Percent Holder**” means a person who owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary.

3. **Stock Subject to the Plan.** Subject to the provisions of Section 17 of the Plan, the maximum aggregate number of Shares that may be sold or issued under the Plan is 46,296,500 Shares; provided, however, that the maximum aggregate number of Shares that may be issued pursuant to Incentive Stock Option is 46,296,500 Shares. The Shares may be authorized, but unissued, or reacquired Common Stock. Notwithstanding the foregoing, any Shares issued in connection with Awards granted on or after June 23, 2010, other than Options and Stock Appreciation Rights, shall be counted against the limit set forth herein as two (2) Shares for every one (1) Share issued in connection with such Award (and shall be counted as two (2) Shares for every one (1) Share returned or deemed not have been issued from the Plan pursuant to this Section 3 in connection with Awards other than Options and Stock Appreciation Rights).

Any Shares covered by an Award (or portion of an Award) which is forfeited, canceled or expires (whether voluntarily or involuntarily) shall be deemed not to have been issued for purposes of determining the maximum aggregate number of Shares which may be issued under the Plan. Shares that actually have been issued under the Plan pursuant to an Award shall not be returned to the Plan and shall not become available for future issuance under the Plan, except that if unvested Shares are forfeited, or repurchased by the Company at the lower of their original purchase price or their Fair Market Value at the time of repurchase, such Shares shall become available for future grant under the Plan. Notwithstanding anything to the contrary contained herein: (i) Shares tendered or withheld in payment of an Option exercise price shall not be returned to the Plan and shall not become available for future issuance under the Plan; (ii) Shares withheld by the Company to satisfy any tax withholding obligation shall not be returned to the Plan and shall not become available for future issuance under the Plan; and (iii) all Shares covered by the portion of a Stock Appreciation Right that is exercised (whether or not Shares are actually issued to the Participant upon exercise of the Stock Appreciation Right) shall be considered issued pursuant to the Plan.

4. **Administration of the Plan.**

(a) **General.** The Plan shall be administered by the Board or a Committee, or a combination thereof, as determined by the Board. The Plan may be administered by different administrative bodies with respect to different classes of Optionees and, if permitted by the Applicable Laws, the Board may authorize one or more officers (who may (but need not) be Officers) to grant Options, Stock Awards and Cash Awards to Employees and Consultants.

(b) **Administration With Respect to Reporting Persons.** With respect to Options, Stock Awards and Cash Awards granted to Reporting Persons and Named Executives, the Plan may (but need not) be administered so as to permit such Options, Stock Awards and Cash Awards to qualify for the exemption set forth in Rule 16b-3 and to qualify as performance-based compensation under Section 162(m) of the Code.

(c) **Committee Composition.** If a Committee has been appointed pursuant to this Section 4, such Committee shall continue to serve in its designated capacity until otherwise directed by the Board. From time to time the Board may increase the size of any Committee and appoint additional members thereof, remove members (with or without cause) and appoint new members in substitution therefor, fill vacancies (however caused) and remove all members of a Committee and thereafter directly administer the Plan, all to the extent permitted by the Applicable Laws and, in the case of a Committee administering the Plan pursuant to Section 4(b) above, to the extent permitted or required by Rule 16b-3 and Section 162(m) of the Code.

(d) **Powers of the Administrator.** Subject to the provisions of the Plan and in the case of a Committee, the specific duties delegated by the Board to such Committee, and subject to the approval of any relevant authorities, including the approval, if required, of any Stock Exchange, the Administrator shall have the authority, in its discretion:

- (i) to determine the Fair Market Value of the Common Stock, in accordance with Section 2(p) of the Plan;
- (ii) to select the Consultants and Employees to whom Options, Stock Awards and Cash Awards or any combination thereof may from time to time be granted hereunder;
- (iii) to determine whether and to what extent Options, Stock Awards and Cash Awards or any combination thereof are granted hereunder;
- (iv) to determine the number of shares of Common Stock to be covered by each such Award granted hereunder;
- (v) to approve forms of agreement for use under the Plan;

- (vi) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise and/or purchase price (if applicable), the time or times when an Award may be exercised (which may or may not be based on performance criteria), the vesting schedule, any vesting and/or exercisability acceleration or waiver of forfeiture restrictions, the acceptable forms of consideration, the term, and any restriction or limitation regarding any Award or the Shares relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine and may be established at the time an Award is granted or thereafter;
  - (vii) to determine the terms and restrictions applicable to Stock Awards and the Restricted Stock purchased by exercising such Stock Awards; and
  - (viii) to construe and interpret the terms of the Plan and Awards granted pursuant to the Plan;
  - (ix) in order to fulfill the purposes of the Plan and without amending the Plan, to modify grants of Options, Stock Awards and Cash Awards to participants who are foreign nationals or employed outside of the United States in order to recognize differences in local law, tax policies or customs;
  - (x) to allow Participants to satisfy withholding tax amounts by electing to have the Company withhold from the Shares to be issued upon exercise of a Nonstatutory Stock Option or vesting of a Stock Award that number of Shares having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined in such manner and on such date that the Administrator shall determine or, in the absence of provision otherwise, on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares withheld for this purpose shall be made in such form and under such conditions as the Administrator may provide;
  - (xi) to correct administrative errors;
  - (xii) to modify or amend each Award, including, but not limited to, the acceleration of vesting and/or exercisability, provided, however, that any such amendment is subject to Section 20 of the Plan and except as set forth in that Section, may not impair any outstanding Award unless agreed to in writing by the Participant;
  - (xiii) to authorize conversion or substitution under the Plan of any or all options, stock appreciation rights or stock awards held by service providers of an entity acquired by the Company (the “**Conversion Awards**”). Any conversion or substitution shall be effective as of the close of the merger, acquisition or other transaction. The Conversion Awards may be Nonstatutory Stock Options or Incentive Stock Options, as determined by the Administrator, with respect to options granted by the acquired entity; provided, however, that with respect to the conversion of stock appreciation rights in the acquired entity, the Conversion Awards shall be Nonstatutory Stock Options. Unless otherwise determined by the Administrator at the time of conversion or substitution, all Conversion Awards shall have the same terms and conditions as Awards generally granted by the Company under the Plan;
  - (xiv) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;
  - (xv) to impose such restrictions, conditions or limitations as it determines appropriate as to the timing and manner of any resales by a Participant or other subsequent transfers by the Participant of any Shares issued as a result of or under an Award, including without limitation, (A) restrictions under an insider trading policy and (B) restrictions as to the use of a specified brokerage firm for such resales or other transfers;
  - (xvi) to provide, either at the time an Award is granted or by subsequent action, that an Award shall contain as a term thereof, a right, either in tandem with the other rights under the Award or as an alternative thereto, of the Participant to receive, without payment to the Company, a number of Shares, cash or a combination thereof, the amount of which is determined by reference to the value of the Award; and
  - (xvii) to make all other determinations deemed necessary or advisable for administering the Plan and any Award granted hereunder.
- (e) **Effect of Administrator’s Decision.** All decisions, determinations and interpretations of the Administrator shall be final and binding on all holders of Options, Stock Awards or Cash Awards.

5. **Eligibility.**

- (a) **Recipients of Grants.** Nonstatutory Stock Options, Stock Awards and Cash Awards may be granted to Employees and Consultants. Incentive Stock Options may be granted only to Employees. An Employee or Consultant who has been granted an Option, Stock Award or Cash Award may, if he or she is otherwise eligible, be granted additional Options, Stock Awards or Cash Awards.
- (b) **Type of Option.** Each Option shall be designated in the Option Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designations, to the extent that the aggregate Fair Market Value of Shares with respect to which Options designated as Incentive Stock Options are exercisable for the first time by any Optionee during any calendar year (under all plans of the Company or any Parent or Subsidiary) exceeds \$100,000, such excess Options shall be treated as Nonstatutory Stock Options. For purposes of this Section 5(b), Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of the Shares subject to an Incentive Stock Option shall be determined as of the date of the grant of such Option.

- (c) **Employment Relationship.** The Plan shall not confer upon the holder of any Option or Stock Award any right with respect to continuation of employment or consulting relationship with the Company, nor shall it interfere in any way with such holder's right or the Company's right to terminate his or her employment or consulting relationship at any time, with or without cause.
6. **Term of Plan.** The Plan became effective upon its initial approval by the stockholders of the Company in March 2000 and was amended and restated effective as of the Restatement Effective Date. It shall continue in effect for a term of ten (10) years from the Restatement Effective Date unless sooner terminated under Section 20 of the Plan.
7. **Term of Option.** The term of each Option shall be the term stated in the Option Agreement; provided, however, that the term shall be no more than ten years from the date of grant thereof or such shorter term as may be provided in the Option Agreement and provided further that, in the case of an Incentive Stock Option granted to an Optionee who, at the time the Option is granted, owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Option shall be five years from the date of grant thereof or such shorter term as may be provided in the Option Agreement.
8. **Limitation on Grants to Employees.** Subject to adjustment as provided in Section 17 below, the maximum number of Shares which may be subject to Options and Stock Awards granted to any one Employee under this Plan for any fiscal year of the Company shall be 1,500,000 Shares.
9. **Option Exercise Price and Consideration.**
- (a) **Exercise Price.** The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be such price as is determined by the Board and set forth in the applicable agreement, but shall be subject to the following:
- (i) In the case of an Incentive Stock Option that is:
- (A) granted to an Employee who, at the time of the grant of such Incentive Stock Option, is a Ten Percent Holder, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.
- (B) granted to any other Employee, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.
- (ii) In the case of a Nonstatutory Stock Option, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant; or
- (iii) Notwithstanding the foregoing, Options may be granted with a per Share exercise price other than as required above pursuant to a merger or other corporate transaction.
- (b) **No Option Repricings, Exchanges or Buyouts.** Other than in connection with a change in the Company's capitalization, merger or certain other transactions (as described in Section 17 of the Plan), the following actions will be subject to stockholder approval: (i) the reduction of the exercise price of any Option granted under the Plan or (ii) the cancellation of an Option at a time when its exercise price exceeds the Fair Market Value of the underlying Shares, in exchange for another Option, Stock Appreciation Right or other Award or for a cash payment. Notwithstanding the foregoing, canceling an Option in exchange for another Option, Stock Appreciation Right or other Award with an exercise price, purchase price or base appreciation amount that is equal to or greater than the exercise price of the original Option shall not be subject to stockholder approval.
- (c) **Permissible Consideration.** The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall be determined by the Administrator (and, in the case of an Incentive Stock Option, shall be determined at the time of grant) and may consist entirely of (1) cash, (2) check, (3) promissory note (subject to the provisions of Section 153 of the Delaware General Corporation Law), (4) other Shares that (x) in the case of Shares acquired upon exercise of an Option, have been owned by the Optionee for more than six months on the date of surrender or such other period as may be required to avoid a charge to the Company's earnings, and (y) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which such Option shall be exercised, (5) authorization for the Company to retain from the total number of Shares as to which the Option is exercised that number of Shares having a Fair Market Value on the date of exercise equal to the exercise price for the total number of Shares as to which the Option is exercised, (6) delivery of a properly executed exercise notice together with such other documentation as the Administrator and the broker, if applicable, shall require to effect an exercise of the Option and delivery to the Company of the sale or loan proceeds required to pay the exercise price and any applicable income or employment taxes, (7) any combination of the foregoing methods of payment, or (8) such other consideration and method of payment for the issuance of Shares to the extent permitted under the Applicable Laws. In making its determination as to the type of consideration to accept, the Administrator shall consider if acceptance of such consideration may be reasonably expected to benefit the Company.

10. **Exercise of Option.**

- (a) **Procedure for Exercise; Rights as a Stockholder.** Any Option granted hereunder shall be exercisable at such times and under such conditions as determined by the Administrator, including performance criteria with respect to the Company and/or the Optionee, and as shall be permissible under the terms of the Plan. The Administrator shall have the discretion to determine whether and to what extent the vesting of Options shall be tolled during any unpaid leave of absence; provided, however, that in the absence of such determination, vesting of Options shall be tolled during any leave that is not a leave required to be provided to the Optionee under Applicable Law. In the event of military leave, vesting shall toll during any unpaid portion of such leave, provided that, upon an Optionee's returning from military leave (under conditions that would entitle him or her to protection upon such return under the Uniform Services Employment and Reemployment Rights Act), he or she shall be given vesting credit with respect to Options to the same extent as would have applied had the Optionee continued to provide services to the Company throughout the leave on the same terms as he or she was providing services immediately prior to such leave.

An Option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written (including electronic) notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and the Company has received full payment for the Shares with respect to which the Option is exercised. Full payment may, as authorized by the Board, consist of any consideration and method of payment allowable under Section 9(c) of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such stock certificate promptly upon exercise of the Option. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 17 of the Plan.

Exercise of an Option in any manner shall result in a decrease in the number of Shares that thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

- (b) **Termination of Employment or Consulting Relationship.** Subject to Section 10(c) below, in the event of termination of an Optionee's Continuous Status as an Employee or Consultant with the Company, such Optionee may, but only within three months (or such other period of time not less than 30 days as is determined by the Administrator, with such determination in the case of an Incentive Stock Option being made at the time of grant of the Option and not exceeding three months) after the date of such termination (but in no event later than the expiration date of the term of such Option as set forth in the Option Agreement), exercise his or her Option to the extent that the Optionee was entitled to exercise it at the date of such termination. To the extent that the Optionee was not entitled to exercise the Option at the date of such termination, or if the Optionee does not exercise such Option to the extent so entitled within the time specified herein, the Option shall terminate. No termination shall be deemed to occur and this Section 10(b) shall not apply if (i) the Optionee is a Consultant who becomes an Employee, or (ii) the Optionee is an Employee who becomes a Consultant.

(c) **Disability of Optionee.**

- (i) Notwithstanding Section 10(b) above, in the event of termination of an Optionee's Continuous Status as an Employee or Consultant as a result of his or her total and permanent disability (within the meaning of Section 22(e)(3) of the Code), such Optionee may, but only within twelve months from the date of such termination (but in no event later than the expiration date of the term of such Option as set forth in the Option Agreement), exercise the Option to the extent otherwise entitled to exercise it at the date of such termination. To the extent that the Optionee was not entitled to exercise the Option at the date of termination, or if the Optionee does not exercise such Option to the extent so entitled within the time specified herein, the Option shall terminate.

- (ii) In the event of termination of an Optionee's Continuous Status as an Employee or Consultant as a result of a disability which does not fall within the meaning of total and permanent disability (as set forth in Section 22(e)(3) of the Code), such Optionee may, but only within six months from the date of such termination (but in no event later than the expiration date of the term of such Option as set forth in the Option Agreement), exercise the Option to the extent otherwise entitled to exercise it at the date of such termination. However, to the extent that such Optionee fails to exercise an Option which is an Incentive Stock Option ("**ISO**") (within the meaning of Section 422 of the Code) within three months of the date of such termination, the Option will not qualify for ISO treatment under the Code. To the extent that the Optionee was not entitled to exercise the Option at the date of termination, or if the Optionee does not exercise such Option to the extent so entitled within six months from the date of termination, the Option shall terminate.

- (d) **Death of Optionee.** In the event of the death of an Optionee during the period of Continuous Status as an Employee or Consultant since the date of grant of the Option, or within 30 days following termination of the Optionee's Continuous Status as an Employee or Consultant, the Option may be exercised, at any time within six months following the date of death (but in no event later than the expiration date of the term of such Option as set forth in the Option Agreement), by such Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right that had accrued at the date of death or, if earlier, the date of termination of the Optionee's Continuous Status as an Employee or Consultant. To the extent that the Optionee was not entitled to exercise the Option at the date of death or termination, as the case may be, or if the Optionee does not exercise such Option to the extent so entitled within the time specified herein, the Option shall terminate.
- (e) **Extension of Exercise Period.** The Administrator shall have full power and authority to extend the period of time for which an Option is to remain exercisable following termination of an Optionee's Continuous Status as an Employee or Consultant from the periods set forth in Sections 10(b), 10(c) and 10(d) above or in the Option Agreement to such greater time as the Board shall deem appropriate, provided that in no event shall such Option be exercisable later than the date of expiration of the term of such Option as set forth in the Option Agreement.
- (f) **Rule 16b-3.** Options granted to Reporting Persons shall comply with Rule 16b-3 and shall contain such additional conditions or restrictions as may be required thereunder to qualify for the maximum exemption for Plan transactions.
11. **Stock Grants and Stock Unit Awards.** Each Stock Award Agreement reflecting the issuance of a Stock Grant or Stock Unit shall be in such form and shall contain such terms and conditions as the Administrator shall deem appropriate. The terms and conditions of such agreements may change from time to time, and the terms and conditions of separate agreements need not be identical, but each such agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:
- (a) **Consideration.** A Stock Grant or Stock Unit may be awarded in consideration for such property or services as is permitted under Applicable Law, including for past services actually rendered to the Company or a Subsidiary for its benefit.
- (b) **Minimum Vesting.** Effective upon stockholder approval of the Plan in 2016, newly granted Stock Grants and Stock Units which vest based on the Participant's Continuous Service shall not provide for vesting which is any more rapid than vesting after one (1) year, and newly granted Stock Grants and Stock Units which vest upon the attainment of performance criteria shall provide for a performance period of at least one (1) year. Notwithstanding any contrary provision of the Plan, following the effectiveness of the minimum vesting requirements of this Section 11(b), Stock Grants and Stock Units covering a maximum of five percent (5%) of the Shares authorized for issuance under the Plan may be granted without regard to the limitations of this Section 11(b).
- (c) **Termination of Participant's Continuous Service.** In the event a Participant's Continuous Service terminates, the Company may reacquire any or all of the Shares held by the Participant which have not vested or which are otherwise subject to forfeiture or other conditions as of the date of termination under the terms of the agreement.
- (d) **Transferability.** Rights to acquire Shares under a Stock Grant or a Stock Unit agreement shall be transferable by the Participant only by will or by the laws of descent and distribution.
12. **Stock Purchase Rights.**
- (a) **Rights to Purchase.** Stock Purchase Rights may be issued either alone, in addition to, or in tandem with other awards granted under the Plan and/or cash awards made outside of the Plan. After the Administrator determines that it will offer Stock Purchase Rights under the Plan, it shall advise the offeree in writing of the terms, conditions and restrictions related to the offer, including the number of Shares that such person shall be entitled to purchase, the price to be paid, and the time within which such person must accept such offer, which shall in no event exceed 30 days from the date upon which the Administrator made the determination to grant the Stock Purchase Right. The purchase price of Shares subject to Stock Purchase Rights shall be as determined by the Administrator. The offer to purchase Shares subject to Stock Purchase Rights shall be accepted by execution of a Stock Award Agreement in the form determined by the Administrator.
- (b) **Repurchase Option.** Unless the Administrator determines otherwise, the Stock Award Agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's employment with the Company for any reason (including death or disability). The purchase price for Shares repurchased pursuant to the Restricted Stock Award Agreement shall be the original purchase price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company. The repurchase option shall lapse at such rate as the Administrator may determine.
- (c) **Other Provisions.** The Restricted Stock Purchase Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Administrator in its sole discretion. In addition, the provisions of Restricted Stock Purchase Agreements need not be the same with respect to each purchaser.

- (d) **Rights as a Stockholder.** Once the Stock Purchase Right is exercised, the purchaser shall have the rights equivalent to those of a stockholder, and shall be a stockholder when his or her purchase is entered upon the records of the duly authorized transfer agent of the Company. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 17 of the Plan.
13. **Stock Appreciation Rights.**
- (a) **General.** Stock Appreciation Rights may be granted either alone, in addition to, or in tandem with other Awards granted under the Plan. The Administrator may grant Stock Appreciation Rights to eligible Participants subject to terms and conditions not inconsistent with this Plan and determined by the Administrator. The specific terms and conditions applicable to the Participant shall be provided for in the Stock Award Agreement. Stock Appreciation Rights shall be exercisable, in whole or in part, at such times as the Administrator shall specify in the Stock Award Agreement.
- (b) **Exercise of Stock Appreciation Right.** Upon the exercise of a Stock Appreciation Right, in whole or in part, the Participant shall be entitled to a payment in an amount equal to the excess of the Fair Market Value on the date of exercise of a fixed number of Shares covered by the exercised portion of the Stock Appreciation Right, over the base appreciation amount of the Shares pursuant to the Stock Appreciation Right. The amount due to the Participant upon the exercise of a Stock Appreciation Right shall be paid in such form of consideration as determined by the Administrator and may be in cash, Shares or a combination thereof, over the period or periods, in each case as specified in the Stock Award Agreement. A Stock Award Agreement may place limits on the amount that may be paid over any specified period or periods upon the exercise of a Stock Appreciation Right, on an aggregate basis or as to any Participant. A Stock Appreciation Right shall be considered exercised when the Company receives written notice of exercise in accordance with the terms of the Stock Award Agreement from the person entitled to exercise the Stock Appreciation Right.
- (c) **Nonassignability of Stock Appreciation Rights.** Except as determined by the Board, no Stock Appreciation Right shall be assignable or otherwise transferable by the Participant except by will or by the laws of descent and distribution.
- (d) **Base Appreciation Amount and Term of Stock Appreciation Right.** Notwithstanding anything herein to the contrary, the price used to determine the amount payable to a Participant (in accordance with Section 13(b) above) upon exercise of any Stock Appreciation Right granted under the Plan (referred to in the Plan as the “base appreciation amount”) shall be no less than 100% of the Fair Market Value per Share on the date of grant; provided, however, that Stock Appreciation Rights may be granted with a base appreciation amount other than as required above pursuant to a merger or other corporate transaction. The term of each Stock Appreciation Right shall be the term stated in the Stock Award Agreement; provided, however, that the term shall be no more than ten years from the date of grant thereof or such shorter term as may be provided in the Stock Award Agreement.
- (e) **No Repricings, Exchanges or Buyouts.** Other than in connection with a change in the Company’s capitalization, merger or certain other transactions (as described in Section 17 of the Plan), the following actions will be subject to stockholder approval: (i) the reduction of the base appreciation amount of any Stock Appreciation Right granted under the Plan or (ii) the cancellation of a Stock Appreciation Right at a time when its base appreciation amount exceeds the Fair Market Value of the underlying Shares, in exchange for another Option, Stock Appreciation Right or other Award or for a cash payment. Notwithstanding the foregoing, canceling a Stock Appreciation Right in exchange for another Option, Stock Appreciation Right or other Award with an exercise price, purchase price or base appreciation amount that is equal to or greater than the base appreciation amount of the original Stock Appreciation Right shall not be subject to stockholder approval.
14. **Cash Awards.** Each Cash Award will confer upon the Participant the opportunity to earn a future payment tied to the level of achievement with respect to one or more performance criteria established for a performance period of not less than one (1) year.
- (a) **Cash Award.** Each Cash Award shall contain provisions regarding (i) the target and maximum amount payable to the Participant as a Cash Award, (ii) the performance criteria and level of achievement versus these criteria which shall determine the amount of such payment, (iii) the period as to which performance shall be measured for establishing the amount of any payment, (iv) the timing of any payment earned by virtue of performance, (v) restrictions on the alienation or transfer of the Cash Award prior to actual payment, (vi) forfeiture provisions, and (vii) such further terms and conditions, in each case not inconsistent with the Plan, as may be determined from time to time by the Administrator. The maximum amount payable as a Cash Award may be a multiple of the target amount payable, but the maximum amount payable pursuant to that portion of a Cash Award granted under this Plan for any fiscal year to any Participant that is intended to satisfy the requirements for “performance based compensation” under Section 162(m) of the Code shall not exceed U.S. \$1,000,000.

- (b) **Performance Criteria.** The Administrator shall establish the performance criteria and level of achievement versus these criteria which shall determine the target and the minimum and maximum amount payable under a Cash Award, which criteria may be based on financial performance and/or personal performance evaluations. The Administrator may specify the percentage of the target Cash Award that is intended to satisfy the requirements for “performance-based compensation” under Section 162(m) of the Code. Notwithstanding anything to the contrary herein, the performance criteria for any portion of a Cash Award that is intended to satisfy the requirements for “performance-based compensation” under Section 162(m) of the Code shall be a measure established by the Administrator based on one or more Qualifying Performance Criteria selected by the Administrator and specified in writing not later than 90 days after the commencement of the period of service to which the performance goals relates, provided that the outcome is substantially uncertain at that time (or in such other manner that complies with Section 162(m)).
- (c) **Timing and Form of Payment.** The Administrator shall determine the timing of payment of any Cash Award. The Administrator may provide for or, subject to such terms and conditions as the Administrator may specify, may permit a Participant to elect for the payment of any Cash Award to be deferred to a specified date or event. The Administrator may specify the form of payment of Cash Awards, which may be cash or other property, or may provide for a Participant to have the option for his or her Cash Award, or such portion thereof as the Administrator may specify, to be paid in whole or in part in cash or other property.
- (d) **Termination of Employment.** The Administrator shall have the discretion to determine the effect a Termination of Employment due to (i) disability, (ii) death or (iii) otherwise shall have on any Cash Award.
15. **Section 162(m) Compliance.** Any Stock Award (other than an Option or any other Stock Award having a purchase price equal to 100% of the Fair Market Value on the date such award is made) or Cash Award that is intended as “qualified performance-based compensation” within the meaning of Section 162(m) of the Code must not be granted before achievement of one or more Qualifying Performance Criteria or may be granted before such achievement, provided that the Award does not vest or become exercisable before achievement of the Qualifying Performance Criteria. Notwithstanding anything to the contrary herein, the Committee shall have the discretion to determine the time and manner of compliance with Section 162(m) of the Code as required under applicable regulations and to conform the procedures related to the Award to the requirements of Section 162(m).
16. **Taxes.**
- (a) As a condition of the grant, exercise or vesting of an Option, Stock Award or Cash Award granted under the Plan or issuance of Shares under the Plan, the Participant (or in the case of the Participant’s death, the person exercising the Option, Stock Award or Cash Award) shall make such arrangements as the Administrator may require for the satisfaction of any applicable federal, state, local or foreign withholding tax obligations that may arise in connection with the exercise of Option, Stock Award or Cash Award and the issuance of Shares. The Company shall not be required to issue any Shares or pay any cash under the Plan until such obligations are satisfied.
- (b) In the case of an Employee and in the absence of any other arrangement, the Employee shall be deemed to have directed the Company to withhold or collect from his or her compensation an amount sufficient to satisfy such tax obligations from the next payroll payment otherwise payable after the date of an exercise of the Option or Stock Award.
- (c) In the case of Participant other than an Employee (or in the case of an Employee where the next payroll payment is not sufficient to satisfy such tax obligations, with respect to any remaining tax obligations), in the absence of any other arrangement and to the extent permitted under the Applicable Laws, the Participant shall be deemed to have elected to have the Company withhold from the Shares to be issued upon exercise of the Option or Stock Award that number of Shares having a Fair Market Value determined as of the applicable Tax Date (as defined below) equal to the minimum statutory amounts required to be withheld. For purposes of this Section 16, the Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined under the Applicable Laws (the “**Tax Date**”).
- (d) If permitted by the Administrator, in its discretion, a Participant may satisfy his or her tax withholding obligations upon exercise of an Option or Stock Award by surrendering to the Company Shares that (i) in the case of Shares previously acquired from the Company, have been owned by the Participant for more than six (6) months on the date of surrender, and (ii) have a Fair Market Value determined as of the applicable Tax Date equal to the minimum statutory amounts required to be withheld.
- (e) Any election or deemed election by a Participant to have Shares withheld to satisfy tax withholding obligations under Section 16(c) or (d) above shall be irrevocable as to the particular Shares as to which the election is made and shall be subject to the consent or disapproval of the Administrator. Any election by a Participant under Section 16(d) above must be made on or prior to the applicable Tax Date.



- (f) In the event an election to have Shares withheld is made by a Participant and the Tax Date is deferred under Section 83 of the Code because no election is filed under Section 83(b) of the Code, the Participant shall receive the full number of Shares with respect to which the Option is exercised but such Participant shall be unconditionally obligated to tender back to the Company the proper number of Shares on the applicable Tax Date.

17. **Adjustments Upon Changes in Capitalization, Merger or Certain Other Transactions.**

- (a) **Changes in Capitalization.** Subject to any required action by the stockholders of the Company, the number of shares of Common Stock covered by each outstanding Option or Stock Award, and the number of shares of Common Stock that have been authorized for issuance under the Plan but as to which no Options or Stock Awards have yet been granted or that have been returned to the Plan upon cancellation or expiration of an Option or Stock Award, and the number of shares set forth in Sections 3(i) and 8 above, as well as the price per share of Common Stock covered by each such outstanding Option or Stock Award, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination, recapitalization or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been “effected without receipt of consideration.” In the event of any distribution of cash or other assets to stockholders other than a normal cash dividend, the Board shall also make such adjustments as provided in this Section 17(a) or substitute, exchange or grant Awards to effect such adjustments (collectively “adjustments”). Any such adjustments to outstanding Awards will be effected in a manner that precludes the enlargement of rights and benefits under such Awards. Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Option or Stock Award.
- (b) **Dissolution or Liquidation.** In the event of the proposed dissolution or liquidation of the Company, the Board shall notify the Optionee at least 15 days prior to such proposed action. To the extent it has not been previously exercised, the Option or Stock Award will terminate immediately prior to the consummation of such proposed action.
- (c) **Merger or Sale of Assets.** In the event of a proposed sale of all or substantially all of the Company’s assets or a merger of the Company with or into another corporation, each outstanding Award shall be assumed or an equivalent option or right shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless the successor corporation does not agree to assume the Award or to substitute an equivalent award, in which case such Award shall accelerate immediately prior to the consummation of the merger or sale of assets. For purposes of this Section 17(c), an Option or Stock Award shall be considered assumed, without limitation, if, at the time of issuance of the stock or other consideration upon such merger or sale of assets, each holder of an Option or Stock Award would be entitled to receive upon exercise of the Option or Stock Award the same number and kind of shares of stock or the same amount of property, cash or securities as such holder would have been entitled to receive upon the occurrence of such transaction if the holder had been, immediately prior to such transaction, the holder of the number of Shares of Common Stock covered by the Option or the Stock Award at such time (after giving effect to any adjustments in the number of Shares covered by the Option or Stock Award as provided for in this Section 17); provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of an Option or Stock Award (or, as applicable, vesting of a Stock Award), for each Share subject to such Award, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per Share consideration received by holders of Common Stock in the merger or sale of assets.
- (d) **Certain Distributions.** In the event of any distribution to the Company’s stockholders of securities of any other entity or other assets (other than dividends payable in cash or stock of the Company) without receipt of consideration by the Company, the Administrator may, in its discretion, appropriately adjust the price per share of Common Stock covered by each outstanding Option or Stock Award to reflect the effect of such distribution.

18. **Transferability of Awards.** Incentive Stock Options may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Participant, only by the Participant. Other awards shall be transferable (i) by will and by the laws of descent and distribution and (ii) during the lifetime of the Participant, to the extent and in the manner authorized by the Administrator, but only to the extent such transfers are made in accordance with Applicable Laws to family members, to family trusts, to family controlled entities, to charitable organizations, and pursuant to domestic relations orders or agreements, in all cases without payment for such transfers to the Participant. Notwithstanding the foregoing, the Participant may designate one or more beneficiaries of the Participant’s award in the event of the Participant’s death on a beneficiary designation form provided by the Administrator.

19. **Time of Granting Awards.** The date of grant of an Award shall, for all purposes, be the date on which the Administrator makes the determination granting such Award, or such other date as is determined by the Board; provided, however, that in the case of any Incentive Stock Option, the grant date shall be the later of the date on which the Administrator makes the determination granting such Incentive Stock Option or the date of commencement of the Optionee's employment relationship with the Company. Notice of the determination shall be given to each Employee or Consultant to whom an Award is so granted within a reasonable time after the date of such grant.
20. **Amendment and Termination of the Plan.**
- (a) **Authority to Amend or Terminate.** The Board may at any time amend, alter, suspend or discontinue the Plan, but no amendment, alteration, suspension or discontinuation shall be made that would impair the rights of any Optionee or holder of Stock Awards or Cash Awards under any grant theretofore made, without his or her consent. In addition, to the extent necessary and desirable to comply with the Applicable Laws, the Company shall obtain stockholder approval of any Plan amendment in such a manner and to such a degree as required. In addition, unless approved by the stockholders of the Company, no amendment shall be made that would result in a repricing of Options or Stock Appreciation Rights by (x) reducing the exercise price or base appreciation amount of outstanding Options and Stock Appreciation Rights or (y) canceling an outstanding Option or Stock Appreciation Right held by a Participant and re-granting to the Participant a new Option with a lower exercise price, a Stock Appreciation Right with a lower base appreciation amount, or another Award, in either case other than in connection with a change in the Company's capitalization, merger or certain other transactions pursuant to Section 17 of the Plan.
- (b) **Effect of Amendment or Termination.** No amendment or termination of the Plan shall adversely affect Options, Stock Awards or Cash Awards already granted, unless mutually agreed otherwise between the Optionee or holder of the Stock Awards or Cash Awards and the Board, which agreement must be in writing and signed by the Optionee or holder of the Stock Awards or Cash Awards and the Company.
21. **Conditions Upon Issuance of Shares.** Shares shall not be issued pursuant to the exercise of an Option or Stock Award unless the exercise of such Option or Stock Award and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any Stock Exchange. Notwithstanding any other provision of the Plan or any agreement entered into by the Company pursuant to the Plan, the Company shall not be obligated, and shall have no liability for failure, to issue or deliver any Shares under the Plan unless such issuance or delivery would comply with the Applicable Laws, with such compliance determined by the Company in consultation with its legal counsel.
- As a condition to the exercise of an Option or Stock Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by law.
22. **Reservation of Shares.** The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.
23. **Agreements.** Options, Stock Awards and Cash Awards shall be evidenced by written Option Agreements, and Stock Award Agreements and Cash Award Agreements respectively, in such form(s) as the Administrator shall approve from time to time.
24. **Stockholder Approval.** If required by Applicable Laws, continuance of the Plan shall be subject to approval by the stockholders of the Company within twelve months before or after the date the Plan, as amended and restated effective June 16, 2014, is adopted. Such stockholder approval shall be obtained in the degree and manner required under the Applicable Laws.
25. **Unfunded Obligation.** Participants shall have the status of general unsecured creditors of the Company. Any amounts payable to Participants pursuant to the Plan shall be unfunded and unsecured obligations for all purposes, including, without limitation, Title I of the Employee Retirement Income Security Act of 1974, as amended. Neither the Company nor any Parent or Subsidiary shall be required to segregate any monies from its general funds, or to create any trusts, or establish any special accounts with respect to such obligations. The Company shall retain at all times beneficial ownership of any investments, including trust investments, which the Company may make to fulfill its payment obligations hereunder. Any investments or the creation or maintenance of any trust or any Participant account shall not create or constitute a trust or fiduciary relationship between the Administrator, the Company or any Parent or Subsidiary and a Participant, or otherwise create any vested or beneficial interest in any Participant or the Participant's creditors in any assets of the Company or a Parent or Subsidiary. The Participants shall have no claim against the Company or any Parent or Subsidiary for any changes in the value of any assets that may be invested or reinvested by the Company with respect to the Plan.



**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the following Registration Statements:

- (1) Registration Statements (Form S-8 Nos. 333-126990 and 333-98939) pertaining to the DURECT Corporation 2000 Directors' Stock Option Plan,
- (2) Registration Statements (Form S-8 Nos. 333-166700, 333-161025, 333-152968, 333-124701, 333-86110) pertaining to the DURECT Corporation 2000 Employee Stock Purchase Plan and the DURECT Corporation 2000 Stock Plan,
- (3) Registration Statements (Form S-8 Nos. 333-212842, 333-197980, 333-176113, 333-120405, 333-108390 and 333-226524) pertaining to the DURECT Corporation 2000 Stock Plan,
- (4) Registration Statements (Form S-8 No. 333-219832, 333-206084 and 333-170349) pertaining to the DURECT Corporation 2000 Employee Stock Purchase Plan,
- (5) Registration Statement (Form S-8 No. 333-47400) pertaining to the DURECT Corporation 2000 Employee Stock Purchase Plan and the DURECT Corporation 2000 Stock Plan,
- (6) Registration Statement (Form S-8 No. 333-61224) pertaining to the DURECT Corporation 2000 Employee Stock Purchase Plan, the DURECT Corporation 2000 Stock Plan, and
- (7) Registration Statements (Form S-3 Nos. 333-108398, 333-108396 and 333-226518) of DURECT Corporation,

of our reports dated March 5, 2020, with respect to the financial statements and schedule of DURECT Corporation, and the effectiveness of internal control over financial reporting of DURECT Corporation included in this Annual Report (Form 10-K) of DURECT Corporation for the year ended December 31, 2019.

/s/ ERNST & YOUNG LLP

Redwood City, California  
March 5, 2020

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, James E. Brown, certify that:

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

March 5, 2020

/S/ JAMES E. BROWN

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James E. Brown  
Chief Executive Officer

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael H. Arenberg, certify that:

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

March 5, 2020

/S/ MICHAEL H. ARENBERG

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Michael H. Arenberg  
Chief Financial Officer and Principal Accounting Officer

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

In connection with the Annual Report of DURECT Corporation (the "Company") on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Brown, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

March 5, 2020

/S/ JAMES E. BROWN

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**James E. Brown**  
Chief Executive Officer

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

In connection with the Annual Report of DURECT Corporation (the "Company") on Form 10-K for the year ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael H. Arenberg, Chief Financial Officer and Principal Accounting Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

March 5, 2020

/S/ MICHAEL H. ARENBERG

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**Michael H. Arenberg**  
Chief Financial Officer and Principal Accounting Officer