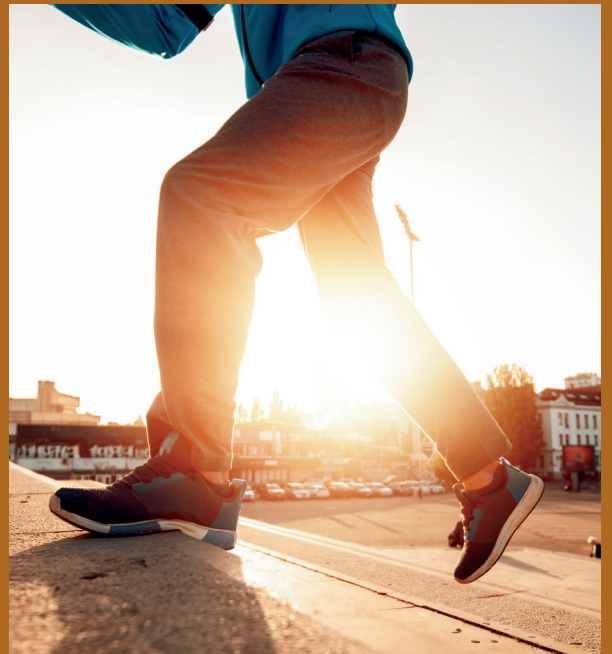




A Season



of Relief



## Dear Stockholders:

Each year, I look forward to writing this letter as it provides me with an opportunity to reflect on Flexion's recent performance and to highlight the opportunities that are ahead of us. As I write today, we are in the midst of an unprecedented health crisis stemming from the coronavirus global pandemic that causes the COVID-19 disease ("COVID-19"). With that backdrop, it is difficult to predict what the coming weeks and months will mean for the world, our nation and for Flexion; however, even as we navigate these uncharted waters, we are proceeding with confidence that we will emerge from this crisis stronger, both as a country and as a company.

First and foremost, we are building Flexion to be a company that lasts, and thanks to the support of our stockholders, our customers and our employees, we believe we have a very bright future. Since our founding in 2007, we have made tremendous progress advancing our vital mission to improve the human condition by developing meaningful medicines for patients with musculoskeletal conditions, beginning with ZILRETTA®, the first and only extended-release, intra-articular injection for osteoarthritis knee pain.

2019 was a remarkable year for ZILRETTA, and it was bounded by two important milestones in the product's brief history. First, on January 1, 2019, ZILRETTA's permanent J code (J3304) took effect, providing our customers with defined and predictable reimbursement. That milestone had a marked impact on our ability to both increase ZILRETTA's utilization in existing practices and penetrate new accounts. In fact, by the end of 2019, we had sold more than 175,000 units of ZILRETTA, and in 2019, we recorded sales of \$73 million reflecting growth of more than 220% over sales in 2018.

Second, on December 26, 2019, we announced that the U.S. FDA had approved a supplemental New Drug Application for an improved product label. The new label eliminates previous Limitation of Use language regarding repeat administration that was confusing to prescribers and payors and now includes language that is clearer and that we believe should reduce barriers to repeat administration.

2019 was also an outstanding year with respect to building Flexion's future with the addition and advancement of two high-quality product candidates, FX201 and FX301. FX201 is our investigational intra-articular gene therapy candidate which, we believe, following a single injection, could provide OA pain relief for at least a year, improve function and modify disease progression. We were delighted to have initiated our single, ascending dose trial for that product candidate – even though enrollment had to be suspended this year in the face of the challenges of COVID-19.

In addition, we executed a cost-effective business development deal to acquire XEN402, a novel, selective sodium channel (NaV1.7) blocker. Leveraging our internal capabilities, we formulated this molecule in a thermosensitive hydrogel developed by our scientists for administration as a peripheral nerve block for control of post-operative pain. The new preclinical product candidate, known as FX301, is designed to be liquid at room temperature and, following peri-neural injection, forms a gel, essentially creating a depot that can pay out drug at therapeutic concentrations locally for at least three to five days. The vision for FX301 is a product that confers persistent, meaningful post-op pain relief while sparing motor function. Assuming the GLP toxicology data which we are generating now is supportive, we expect FX301 to be in the clinic next year.

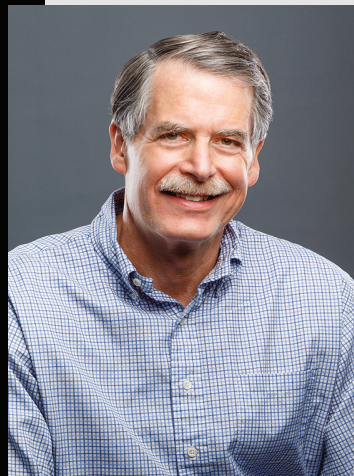
Sadly, while we all are dealing with the tragic impacts of COVID-19, I take solace in the resilience of our country, the selfless commitment of front-line health care professionals who are tending to the afflicted and the grit of our dedicated employees who make Flexion such a remarkable organization. They know there are millions of patients counting on us, and their resolve is unwavering in delivering on the promise of ZILRETTA and our pipeline product candidates.

I look forward to writing next year's letter with the hope and expectation that COVID-19 will be behind us, our nation will be well on its way to recovery and that Flexion will have made substantial progress on its journey to realize its potential to deliver medicines that matter to patients in need.

Be well.

*Michael D. Clayman, MD*

Michael Clayman, MD  
President & Chief Executive Officer



**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 001-36287

**Flexion Therapeutics, Inc.**

(Exact name of Registrant as specified in its Charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**10 Mall Road, Suite 301**

**Burlington, Massachusetts**

(Address of principal executive offices)

**26-1388364**

(I.R.S. Employer  
Identification No.)

**01803**

(Zip Code)

**Registrant's telephone number, including area code: (781) 305-7777**

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, \$0.001 par value per share	FLXN	The Nasdaq Global Market

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

Indicate by check mark whether the Registrant has submitted electronically 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, a 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  Accelerated filer

Non-accelerated filer  Smaller reporting company

Emerging growth company

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

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

The aggregate market value of the Registrant's voting and non-voting common equity held by non-affiliates of the Registrant, based on the closing price of the shares of common stock on The Nasdaq Stock Market on June 28, 2019, was \$409,302,635.

The number of shares of the Registrant's common stock outstanding as of February 28, 2020 was 38,551,706.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the Registrant's 2020 Annual Meeting of Stockholders, which will be filed subsequent to the date hereof, are incorporated by reference into Part III of this Form 10-K. Such proxy statement will be filed with the Securities and Exchange Commission not later than 120 days following the end of the Registrant's fiscal year ended December 31, 2019.

**FLEXION THERAPEUTICS, INC.**  
**FORM 10-K—ANNUAL REPORT**  
**For the Fiscal Year Ended December 31, 2019**

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## PART I

### Special Note Regarding Forward-Looking Statements

This Annual Report on Form 10-K, or this Annual Report, contains “forward-looking statements”—that is, statements related to future, not past, events—as defined in Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, that reflect our current expectations regarding our future discovery, development and commercialization activities, results of operations, financial condition, cash flows, performance and business prospects, and opportunities, as well as assumptions made by, and information currently available to, our management. Forward-looking statements include any statement that does not directly relate to a current or historical fact. We have tried to identify forward-looking statements by using words such as “believe,” “may,” “could,” “will,” “estimate,” “continue,” “anticipate,” “intend,” “seek,” “plan,” “expect,” “should,” or “would.” Among the factors that could cause actual results to differ materially from those indicated in the forward-looking statements are risks and uncertainties inherent in our business including, without limitation: we have incurred significant losses since our inception and we expect to incur substantial losses for the foreseeable future and may never achieve or maintain profitability; we have a limited history of commercializing ZILRETTA<sup>®</sup> and have not received regulatory approval for any other product candidates; we may require additional capital prior to completing development and commercializing any of our product candidates in development; we may be unable to successfully commercialize ZILRETTA or any of our other product candidates; we rely on third parties to manufacture and conduct the clinical trials of ZILRETTA and our development-stage product candidates, which could limit our commercialization efforts or delay or limit their future development or regulatory approval; we may be unable to adequately maintain and protect our proprietary intellectual property assets, which could impair our commercial opportunities; and other risks detailed below in “Item 1A. Risk Factors.”

Although we believe that the expectations reflected in our forward-looking statements are reasonable, we cannot guarantee future results, events, levels of activity, performance or achievement. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

## Item 1. Business

Unless the content requires otherwise, references to “Flexion,” “Company,” “we,” “our,” and “us,” in this Annual Report refer to Flexion Therapeutics, Inc. and our subsidiary, Flexion Therapeutics Securities Corporation.

### Overview

We are a biopharmaceutical company focused on the discovery, development and commercialization of novel, local therapies for the treatment of patients with musculoskeletal conditions, beginning with osteoarthritis, or OA, a type of degenerative arthritis. We have an approved product, ZILRETTA<sup>®</sup>, which we market in the United States. ZILRETTA is the first and only extended-release, intra-articular, or IA (meaning in the joint), injection indicated for the management of OA knee pain. ZILRETTA is a non-opioid therapy that employs our proprietary microsphere technology to provide effective pain relief. The pivotal Phase 3 trial, on which the approval of ZILRETTA was based, showed that ZILRETTA met the primary endpoint of pain reduction at Week 12, with statistically significant pain relief extending through Week 16.

ZILRETTA was approved by the U.S. Food & Drug Administration, or FDA, on October 6, 2017 and launched in the United States shortly thereafter. We market ZILRETTA to prescribing physicians through our own field sales force of approximately 110 Musculoskeletal Business Managers, or MBMs.

ZILRETTA combines a commonly administered steroid, triamcinolone acetonide, or TA, with poly lactic-co-glycolic acid, referred to as PLGA, delivering a 32 mg dose of TA to provide extended therapeutic concentrations in the joint and persistent analgesic effect. Both the magnitude and duration of pain relief provided by ZILRETTA in clinical trials were clinically meaningful with the magnitude of pain relief amongst the largest seen to date in OA clinical trials. The overall frequency of treatment-related adverse events in these trials was similar to those observed with placebo and no drug-related serious adverse events were reported.

Based on the strength of our pivotal and other clinical trials, we believe that ZILRETTA represents an important treatment option for the millions of patients in the U.S. who are in need of safe and effective extended relief from OA knee pain. ZILRETTA is uniquely distinguished by the following attributes:

- in the Phase 3 trial,
  - statistically significant pain relief against placebo (saline) as measured by the weekly mean of the Average Daily Pain, or ADP, score:
    - demonstrated at week 12, the primary endpoint, a p-value of <0.0001, 2-sided, with benefits extending through week 16; and
    - at each week beginning at week 1 and continuing through week 12 nearly 60% of patients reported no pain or mild pain;
  - statistically significant change from baseline as compared to placebo in weekly ADP intensity score through week 12 as measured by the area under effect curve (p<0.0001) (demonstrating a 50% reduction from baseline);
  - numeric improvement when compared with placebo and immediate-release TA at each time point through 12 weeks on exploratory measures – WOMAC A (pain), WOMAC B (stiffness) and WOMAC C (function) and the Knee Injury and Osteoarthritis Outcome Score (KOOS) quality of life subscale; and
  - reduced rescue medicine consumption compared with placebo and immediate-release TA (exploratory endpoint);
- an acceptable safety profile with side effects similar to placebo;
- statistically significant (p<0.05, 2-sided) reduction in the rise of blood glucose compared to that observed following immediate-release TA injection in patients with Type 2 diabetes who also have knee OA as measured by change in average blood glucose from baseline to 72 hours post injection; and
- persistent concentrations of drug in the joint.

ZILRETTA has demonstrated significant, durable relief for OA knee pain and, as such, can address an important unmet need among patients, physicians and healthcare payers. We believe that ZILRETTA holds the potential to become the leading IA medicine for OA knee pain.

In December 2018, we submitted a supplemental New Drug Application, or sNDA, to the FDA to revise the product label for ZILRETTA to allow for repeat administration. The sNDA submission was based on data from a Phase 3b single-arm, open-label clinical trial which evaluated the safety and tolerability of repeat administration of ZILRETTA. On December 26, 2019, we announced that the FDA approved the sNDA. The revised product label removed language which previously stated that ZILRETTA was “not intended for repeat administration” and replaced it with language stating that “the efficacy and safety of repeat administration of ZILRETTA have not been demonstrated.” FDA determined that because the data were not from a randomized, placebo-controlled clinical trial, the Phase 3b results were insufficient to warrant full removal of a Limitation of Use statement, or LOU. The new label includes a study description and safety data from the Phase 3b repeat administration trial and nonclinical toxicology data from previously submitted single and repeat administration studies in non-diseased animals. In addition, the revised label removed a statement that described a single secondary exploratory endpoint in the original Phase 3 pivotal trial comparing ZILRETTA to immediate release TA crystalline suspension.

We believe ZILRETTA’s extended-release profile may also provide effective treatment for OA pain of the shoulder and adhesive capsulitis (AC), commonly referred to as “frozen shoulder,” and in December 2019, we initiated a double-blind, placebo-controlled Phase 2 trial to evaluate the efficacy of ZILRETTA in patients with either shoulder OA or AC. The data are anticipated in 2021.

OA is a type of degenerative arthritis that is caused by the progressive breakdown and eventual loss of cartilage in one or more joints. Arthritis is the most common cause of disability in the U.S. and OA is the most common joint disease, affecting more than 30 million adults in the U.S. and these numbers are expected to grow as a result of aging, obesity and sports injuries. OA commonly affects large weight-bearing joints like the knees and hips, but also occurs in the shoulders, hands, feet and spine. Patients with OA suffer from joint pain, tenderness, stiffness and limited movement. As the disease progresses, it becomes increasingly painful and debilitating, culminating, in many cases, in the need for total joint arthroplasty, or TJA.

Because there is no cure for OA, controlling pain and delaying surgery are the primary goals of prescribing clinicians. Oral drugs, such as non-steroidal anti-inflammatory drugs, or NSAIDs, including COX II inhibitors, and serotonin and norepinephrine reuptake inhibitors, or SNRIs, as well as topical NSAIDs, are used to treat early-stage OA pain but have limited effect and, given the amount and frequency of use in OA patients, are associated with serious side effects. For example, NSAIDs have shown increased risk of serious cardiovascular thrombotic events, myocardial infarction, and stroke. Furthermore, this class of drugs can cause serious gastrointestinal adverse events including bleeding, ulceration and perforation of the stomach or intestines. These serious side effects are particularly worrisome because OA patients often have co-existing medical conditions, including diabetes and hypertension. For patients with moderate to severe OA pain, IA medicines, such as immediate-release steroids and hyaluronic acid, or HA, injected into the joint, are generally considered well-tolerated, but they leave the joint rapidly and often fail to produce or maintain clinically meaningful pain relief. Physicians may prescribe opioids, which in addition to the serious risk of addiction and abuse, have numerous serious side effects including respiratory depression, hypotension, constipation, cardiac events and, increasingly, deaths from unintentional overdose. As a result of these limitations, many OA patients experience persistent and worsening pain, which often culminates in the decision to have TJA, a painful and expensive procedure. Further, because the initial joint replacement wears out over time, the younger the patient is at the time of the joint replacement, the more likely it is that he or she will require repeat surgery in their lifetime.

According to IQVIA, in 2018 approximately 5 million patients in the U.S. received an IA injection treatment for knee OA pain. That population was comprised of approximately 4.5 million patients who were treated with immediate-release steroids and roughly 900,000 patients who received hyaluronic acid, or HA, with some patients receiving both treatments in the same year. The HA utilization occurred despite guidance from prominent medical societies, including the American Academy of Orthopedic Surgeons stating that HA is an ineffective treatment for knee OA, and a number of major commercial payers no longer reimburse for the entire class of HA products. In addition, according to SmartTRAK in 2018, HA sales in the U.S. were \$1 billion, with a cost per course of treatment ranging from \$245 to \$2,000. Our market research indicates that, given the limitations of immediate-release steroids

and HAs, physicians are open to new treatment options, like ZILRETTA, which can provide their patients with enhanced durable pain relief.

We have established a clinical trial program designed to expand ZILRETTA's product label, and we are currently enrolling patients in a Phase 2 trial of ZILRETTA in both shoulder OA and adhesive capsulitis. IQVIA data indicate that, in 2018, healthcare practitioners administered roughly 600,000 immediate release steroid injections for the treatment of shoulder OA. An additional approximately 200,000 injections were administered to patients for the treatment of adhesive capsulitis.

We have a growing pipeline with two product candidates focused on the local treatment of musculoskeletal conditions: FX201 and FX301. FX201, is a gene therapy product candidate designed to stimulate the production of an anti-inflammatory protein, interleukin-1 receptor antagonist (IL-1Ra), with the goal of providing at least one year of pain relief from OA of the knee and improving function. Based on its mechanism of action, we believe FX201 also holds the potential to arrest disease progression. In October of 2019, the FDA cleared the Investigational New Drug (IND) application for FX201, allowing for initiation of a Phase 1 dose-escalation study. If data from that study are supportive, we intend to initiate a Phase 2 proof of concept trial in 2021.

FX301, is a locally administered NaV1.7 inhibitor, known as funapide, formulated for extended release in a thermosensitive hydrogel. The initial development of FX301 is intended to support administration as a peripheral nerve block for management of post-operative pain. We believe FX301 has the potential to provide effective, non-opioid pain relief for 3-5 days, while preserving extremity motor function, which is typically compromised by local anesthetic peripheral nerve block. We held a pre-IND meeting with FDA in January, and we remain on track to initiate FX301 clinical trials in 2021.

We have worldwide commercialization rights for ZILRETTA, FX201 and FX301. We also have an exclusive worldwide license agreement with Southwest Research Institute, or SwRI<sup>®</sup>, with respect to the use of SwRI's proprietary microsphere manufacturing technologies for certain steroids formulated with PLGA, including ZILRETTA. Our PLGA formulation technology is protected through a combination of patents, trade secrets, and proprietary know-how. In addition, we own or have rights to various trademarks, copyrights and trade names used in our business, including FLEXION<sup>®</sup>, ZILRETTA<sup>®</sup> and FLEXFORWARD<sup>®</sup>. Our logos and trademarks are the property of Flexion Therapeutics, Inc. All other brand names or trademarks appearing in this report are the property of their respective holders. Use or display by us of other parties' trademarks, trade dress, or products in this report is not intended to, and does not, imply a relationship with, or endorsement or sponsorship of us, by the trademark or trade dress owners.

## Our Strategy

Our goal is to cost-effectively discover, develop and commercialize novel, locally administered medicines that can safely and effectively address significant unmet medical needs associated with musculoskeletal conditions, with a particular interest in OA, post-operative pain and low back pain. The principal elements of our strategy include the following:

- ***Establish ZILRETTA as the leading IA treatment for OA knee pain and maximize its value by expanding approved indications.*** Based on ZILRETTA's clinical profile, we believe that it can be the first-line IA therapy for OA knee pain. Immediate-release IA steroids leave the joint rapidly and typically fail to confer pain relief of sufficient magnitude or duration. Since, by medical practice, steroids typically are not injected more frequently than every three months, patients can experience a recurrence in, or increasing, pain during that time. ZILRETTA is specifically formulated using our proprietary PLGA-based microsphere technology to slowly and continuously release drug in the joint for over 12 weeks.

ZILRETTA is currently approved for the treatment of OA knee pain, but we believe that it has the potential for broader use, specifically in the shoulder. In December 2019, we initiated a Phase 2 trial of ZILRETTA in OA shoulder pain and adhesive capsulitis.

- ***Bolster our robust pipeline of high-quality product candidates to address unmet medical needs.*** We seek to progress our product candidates, FX201 and FX301, and further build our product pipeline



through a combination of internal research and selective business development activities. In 2017, we established the Flexion Innovation Lab in Woburn, Massachusetts to support our research and development activities.

- ***Leverage our infrastructure to efficiently and cost-effectively develop and commercialize ZILRETTA and our product candidates.*** We have built up extensive knowledge, expertise and capabilities in the development and commercialization of locally delivered medicines for musculoskeletal conditions.
- ***Retain commercial rights in the United States and selectively partner outside of the United States.*** Because IA therapies in the United States are administered by a relatively small number of specialists, particularly orthopedists and rheumatologists, we believe we can realize the greatest value for our shareholders by fully exploiting our know-how and capabilities. The U.S. represents the most attractive market for ZILRETTA, and potentially for FX201 and FX301, and as a result, we aim to retain the commercial rights to our product and programs in the U.S. while we look to selectively partner outside of the United States.

## Overview

### ***Osteoarthritis***

OA, also referred to as degenerative joint disease, is the most common joint disease in the U.S. according to the U.S. Centers for Disease Control and Prevention, or the CDC, affecting more than 30 million adults. These numbers are expected to grow in the years ahead as a result of aging, obesity and sports injuries.

- According to the CDC, approximately 40% of U.S. adults are obese, which increases the risk of developing OA.
- Knee injury is common, particularly amongst young athletes, and increases the risk of developing OA later in life by more than five-fold.
- OA accounts for over \$185 billion of annual healthcare expenditures, which does not include loss of productivity costs.
- According to a study published by the Osteoarthritis Research Society International, U.S. patients with symptomatic radiographic knee OA were 23% more likely to die prematurely than people free from OA independent of age, sex, and race.

According to the CDC, one of every two people in the U.S. is expected to develop symptomatic knee OA, the most common form of OA during their lifetime. Recent research estimates that the average age of physician-diagnosed knee OA has fallen by 16 years, from age 72 in the 1990s to age 56 in the 2010s. According to the same research, U.S. adults between the ages of 35 and 84 in the early 2010s will account for approximately 6.5 million new cases of knee OA over the next decade.

OA is a progressive disease for which there is no cure. As a result, current treatments are intended to address the symptoms of OA, in particular, relief of pain and improvement in functional status. The therapeutic regimen for OA becomes increasingly invasive with progression of the disease, culminating, in many cases, in TJA. In addition, because patients are being diagnosed with OA earlier in their lives, many patients require repeat TJAs. Because the decision to have TJA is based in large part on intractable pain and functional impairment, we believe that therapies which can meaningfully and durably relieve pain and improve function could potentially delay TJA.

### ***Common Treatments for OA***

In early-stage disease, treatment begins with non-pharmacologic therapy including exercise, weight control and physical therapy. As the disease progresses, physicians prescribe pharmacologic therapy, typically beginning with acetaminophen and progressing to oral NSAIDs, including COX II inhibitors, topical NSAIDs or SNRIs. Physicians may also treat OA pain with opioids; however, these drugs have serious drawbacks and are generally considered to be a suboptimal therapy for chronic non-cancer pain, like that associated with OA.

When non-pharmacologic therapy and oral pain medications prove inadequate, physicians typically transition patients to IA injections. Immediate-release steroids have historically served as the first line IA therapy, and TA, the corticosteroid used in ZILRETTA, is amongst the most commonly prescribed IA corticosteroid injections. When

immediate-release steroids no longer provide sufficiently durable pain relief, patients may progress to IA HA, a significantly more expensive therapy with only marginally greater effect than placebo.

Due to severe pain that can no longer be controlled therapeutically, many patients opt to have TJA, which is costly and painful. One of the most prevalent TJA procedures in the U.S. is total knee arthroplasty. Compared to existing drug therapy, total knee arthroplasty is very expensive, with average costs ranging between \$25,000 and \$60,000, and many patients (~20%) are dissatisfied with the outcome of this procedure. The earlier a patient receives TJA, the more likely it is that the knee implant will wear out over time and they will require revision surgery in following years. According to IQVIA, in 2018, there were approximately 1.3 million total knee arthroplasties performed in the U.S.

### ***Limitations of Common Treatments for OA***

Oral therapies, such as NSAIDs, may offer adequate analgesia for early-stage OA pain, but they may be associated with serious side effects such as gastrointestinal bleeding, cardiovascular events and other adverse events. For example, SNRIs may have a role in worsening depression and the emergence of suicidality in certain patients. In addition to their serious side effects, oral drugs may provide limited pain relief and eventually can become insufficient to control OA pain for many patients as the disease progresses.

IA therapies, including immediate-release steroids and HA therapies, are generally well-tolerated but provide pain relief that is often insufficient or inadequate in duration. Historically, all IA steroid therapies approved for OA are immediate-release suspensions or solutions that leave the joint within hours to days, and they are rapidly absorbed systemically, which may result in undesirable side effects. For example, IA immediate-release steroid injections are associated with a rapid elevation of blood glucose in diabetics, which can be of clinical concern. While IA steroids demonstrate large initial analgesic effects relative to other therapies, as a result of leaving the joint quickly, IA steroids typically fail to confer pain relief of sufficient magnitude or duration. In addition, current clinical practice generally indicates that IA steroid suspensions not be administered more frequently than once every three months. Based on market research we have recently conducted, approximately 50% of patients surveyed who received IA immediate-release steroids were unsatisfied with the duration of benefit.

Despite estimated U.S. sales of approximately \$1 billion in 2018, IA HA therapies, which are approved only for treatment in the knee, produce only marginally more effective pain relief than placebo and may have no discernible effect on a patient's ability to carry out their daily activities. In treatment guidelines for non-operative management of knee OA published in May 2013, both the American Academy of Orthopaedic Surgeons (AAOS) and the American College of Rheumatology (ACR) concluded that data from then-current published studies did not show clinically meaningful effectiveness for HA injections. As a result, the guidelines do not recommend HA treatment for symptomatic knee OA due to lack of efficacy and, most recently, certain insurance carriers are no longer providing policy coverage of HA.

While the consequences from the overuse and abuse of opioids are well-known, these powerful medicines are still commonly prescribed for OA related pain, despite the fact that they are not an effective treatment for this chronic condition. A recent study estimated that as many as 70% of patients who are prescribed a medicine for OA pain will receive an opioid because physicians have so few effective treatment options. We further believe that the growing societal awareness of the risks posed by opioids may make new treatment options attractive for patients and physicians seeking non-opioid alternatives. Beyond the significant concerns related to the potential for overuse, abuse and unintentional overdose, opioid use is also associated with a host of other serious side effects including, respiratory depression, hypotension, constipation, cardiac events and, increasingly, death.

### **The Flexion Extended-Release Technology**

Our extended-release technology allows us to incorporate active pharmaceutical ingredients in PLGA microspheres. We believe we are the first company to administer PLGA microspheres into a human joint. PLGA is a proven extended-release delivery vehicle that is metabolized to carbon dioxide and water as it releases drug in the IA space and is used in other approved drug products and surgical devices. The technology is designed to enable novel formulations of pharmaceuticals by providing extended-release of drugs over time and the physical properties of the polymer-drug matrix can be varied to achieve specified drug loads and release rates. Key to the success of our IA therapies is the ability to maintain persistent concentrations of drug in the joint, while minimizing systemic

exposure. Utilizing our PLGA microsphere technology, ZILRETTA is the first and only approved extended-release, IA therapy for patients confronting OA-related knee pain.

We believe ZILRETTA and our technology will be protected primarily through a combination of patents, trade secrets and proprietary know-how, and we intend to seek marketing exclusivity for any approved products. A composition of matter patent has been issued by the United States Patent and Trademark Office, or U.S. PTO, for ZILRETTA, with a patent term into 2031. The U.S. PTO has also issued two patents directed at the methods of manufacturing and using ZILRETTA with patent terms into 2031. Considerable expertise and effort were required to carry out the large body of original work underlying the formulation of ZILRETTA, including experimenting with, and observing the effects of over 50 steroid and PLGA formulations. We believe our extensive know-how and trade secrets relating to the manufacturing process for ZILRETTA, including those that relate to precise pharmaceutical release profiles, represent a meaningful entry barrier.

### The Flexion Pipeline

Our pipeline strategy is to continue to study ZILRETTA in other areas and, if feasible, expand ZILRETTA’s product label to include additional indications and broaden its scope of administration, advance our other product candidates, FX201 and FX301, through clinical development and build a robust pipeline of additional locally administered therapies to address musculoskeletal conditions.

Program	Indication	Preclinical	Phase 1	Phase 2	Phase 3	Submitted	FDA Approval	Status/Expected Next Steps
ZILRETTA® (triamcinolone acetonide extended-release injectable suspension)	Osteoarthritis (OA) Knee Pain							FDA Approval Oct. 2017  U.S. Commercial Launch Nov. 2017  Repeat administration sNDA approved Dec. 2019
ZILRETTA (FX006)	Shoulder OA Pain & Adhesive Capsulitis							Initiated Phase 2 trial H2 2019
FX201	OA Knee Pain & Function/Disease Modification							Initiated first-in-human trial Dec. 2019
FX301	Post-Operative Pain							File IND, initiate first-in-human trial 2021

### FX201

FX201 is an IA gene therapy candidate which is designed to induce the local production of interleukin-1 receptor antagonist (IL-1Ra), an anti-inflammatory protein. Preclinical data suggest that following injection of FX201, its genetic material is incorporated into local cells, and IL-1Ra is expressed in response to inflammation in the joint tissues. Inflammation is a known cause of pain, and chronic inflammation is thought to play a major role in the progression of OA. By persistently suppressing inflammation, we believe FX201 has the potential to both reduce pain and possibly arrest disease progression. In early October 2019, the FDA cleared the IND application for FX201, and we subsequently initiated a Phase 1 first-in-human trial. Nonclinical safety and efficacy data submitted in the IND application indicated that a single administration of FX201 was well-tolerated, had no significant biodistribution outside the target tissues, and pharmacology studies with the rat, mouse, and horse orthologues in animal models of OA showed symptomatic improvement and delay in disease progression. Positive data showing dose-dependent decreases in the severity of cartilage and bone lesions following anterior cruciate ligament transection in rats were presented at the American College of Rheumatology Annual Meeting in November 2019. The preclinical data established a potentially safe and efficacious starting dose for the Phase 1 single ascending dose study. The trial is expected to enroll approximately 15 - 24 patients who will be followed for 104 weeks, with initial

readout anticipated in 2021. In March 2020, the first two patients were treated in the Phase 1 dose-escalation trial. We acquired the global rights to FX201 from GeneQuine Biotherapeutics GmbH, or GeneQuine, and have an exclusive license to the underlying intellectual property rights for human use of FX201 from Baylor College of Medicine, or Baylor.

### ***FX301***

In September 2019, we acquired global rights to develop and commercialize XEN402, Xenon's NaV1.7 inhibitor known as funapide, for management of post-operative pain. Our FX301 preclinical product candidate consists of funapide formulated for extended release within a thermosensitive hydrogel, for administration as a peripheral nerve block for control of post-operative pain. The proprietary formulation of the thermosensitive hydrogel was developed in our Innovation Lab. Within minutes following injection, the thermosensitive formulation has been shown to transition from a liquid to a gel, an effect that we believe can provide local delivery of funapide near target nerves for up to a week. Unlike typical local anesthetics, the selective pharmacology of funapide has the potential to provide effective non-opioid pain relief for 3-5 days, while preserving extremity motor function, which is typically compromised by local anesthetic peripheral nerve block. As such, we believe FX301 could enable ambulation, rapid discharge, and early rehabilitation following musculoskeletal surgery. We are conducting preclinical toxicology studies, and if supportive, we anticipate filing an IND application to initiate FX301 clinical trials in 2021.

## **ZILRETTA – FDA Approved Product for the Management of OA Knee Pain**

### ***Key Regulatory Developments***

On October 6, 2017, ZILRETTA received approval from the FDA for the management of OA pain of the knee. ZILRETTA is the first and only approved extended-release, IA therapy for OA knee pain. It is a non-opioid medicine that employs our proprietary microsphere technology to provide proven pain relief. The approval was based upon data from the pivotal Phase 3 clinical trial, a randomized, double-blind study which evaluated 484 patients at 37 centers worldwide. The pivotal Phase 3 trial showed that ZILRETTA met the primary endpoint of pain reduction at Week 12, with statistically significant pain relief extending through Week 16. ZILRETTA's label reflects its strong safety profile and states the most commonly reported adverse reactions (incidence  $\geq 1\%$ ) in clinical studies included sinusitis, cough and contusions.

In December 2018, we submitted a sNDA to the FDA to revise the product label for ZILRETTA to allow for repeat administration. The sNDA submission was based on data from a Phase 3b single-arm, open-label clinical trial.

On December 26, 2019, we announced that the FDA approved the sNDA. The revised product label removed language which previously stated that ZILRETTA was "not intended for repeat administration" and replaced it with language stating that "the efficacy and safety of repeat administration of ZILRETTA have not been demonstrated." FDA determined that because the data generated were not from a randomized, placebo-controlled clinical trial, the Phase 3b results were insufficient to warrant full removal of a LOU statement. The new label includes a study description and safety data from the Phase 3b repeat administration trial and nonclinical toxicology data from previously submitted single and repeat administration studies in non-diseased animals. In addition, the revised label removed a statement that described a single secondary exploratory endpoint in the original Phase 3 pivotal trial comparing ZILRETTA to immediate release TA crystalline suspension.

### ***Summary of Active and Key Completed Clinical Trials***

Prior to FDA approval, we completed seven clinical trials evaluating ZILRETTA (also known as FX006) against either immediate release TA crystalline suspension, or TAcS, placebo (saline), or both in patients with OA of the knee. In total, 424 patients were treated with a single IA injection (32mg) of ZILRETTA in those trials.

### ***Active Clinical Trials***

- We believe ZILRETTA’s extended-release profile may also provide effective treatment for OA pain of the shoulder and adhesive capsulitis (AC), commonly referred to as “frozen shoulder”, and in December 2019, we initiated a double-blind, placebo-controlled Phase 2 trial to evaluate the efficacy of ZILRETTA in patients with either shoulder OA or AC. The study is expected to enroll up to 250 patients – approximately 135 with shoulder OA and 115 with shoulder AC.

The Phase 2 trial, known as the RANGE study, separates cohorts of patients by their diagnosis of shoulder OA or AC into two parallel groups. Patients in each cohort are randomized (1:1) to either a single intra-articular injection of ZILRETTA or normal saline. The primary endpoint for both cohorts of the trial is the magnitude of pain relief versus placebo as measured by the overall change in daily shoulder pain with movement score from baseline to 8 weeks post injection. Patients in each cohort are then stratified by baseline pain scores. Shoulder AC patients are further stratified by pain duration since onset, and they also utilize a home exercise program during the study.

Each participant will be evaluated for 24 weeks following injection. The trial is expected to be completed in 2021.

- In May 2018, we initiated an open-label Phase 3b trial assessing the effect of a single administration of ZILRETTA on synovitis (inflammation of the synovial membrane) in patients with OA of the knee. Patients in the study undergo initial ultrasound examination and MRI scans with contrast of the index knee at baseline and then return to the clinic at Weeks 6 and 24 for MRI scans and other assessments. We completed a primary endpoint analysis of our open-label, single-arm, Phase 3b trial assessing the effect of a single administration of ZILRETTA on synovitis in patients with knee OA. The data indicate that treatment with ZILRETTA resulted in a significant reduction (>50%) in synovial tissue volume at Week 6 compared to baseline (N=89 patients). These patients also reported improvements in pain and function scores over this time period. Patients continued to be followed in the trial to capture additional, longer-term exploratory measures as synovitis, or inflammation of the synovial membrane, is believed to play an important role in the progression of OA.

#### ***Additional Completed Studies***

- In February 2019, results from an open-label Phase 3b clinical trial evaluating the safety and efficacy of repeat administration of ZILRETTA in patients with OA of the knee were published in the peer-reviewed journal, *Rheumatology and Therapy*. The data indicated that repeat administration of ZILRETTA for treatment of OA knee pain was safe and well tolerated with no deleterious impact on cartilage or joint structure observed through X-ray analysis conducted at baseline and Week 52. The primary endpoint of the study was the safety and tolerability of repeat administration of ZILRETTA in patients with symptomatic OA of the knee. The patients enrolled in the study generally had longstanding and extensive disease, with more than two-thirds of the participants presenting with Kellgren-Lawrence (KL) Grade 3 (37.5%) or Grade 4 (30.3%), the most radiographically severe form of OA. The data also indicate that the magnitude and duration of pain relief experienced by patients after both the first and second injections was comparable and similar to the clinical benefit of ZILRETTA in the pivotal Phase 3 trial. These data served as the basis for our aforementioned sNDA and subsequent label update.
- In April 2019, we announced that results from a post-hoc analysis of data from the pivotal Phase 3 trial of ZILRETTA were published in *Advances in Therapy*. The findings indicated that patients with unilateral OA knee pain experienced significant and durable pain relief with a single intra-articular injection of ZILRETTA compared to TAcS as measured by ADP scores. These results suggest that bilateral knee pain may have been a confounding factor in the pivotal trial, which assessed the impact of ZILRETTA treatment in only one knee.
- At the 2019 Osteoarthritis Research Society International World Congress (OARSI) held in May, we presented positive results from the Phase 2 pharmacokinetic (PK) study evaluating ZILRETTA in patients with hip OA. The data showed PK profiles consistent with previous studies in the knee. Additionally, we presented a poster on the previously published Phase 3b data indicating repeat administration of ZILRETTA resulted in substantial improvements in OA knee pain and had no deleterious impact on cartilage or joint structure. We also gave an

encore poster presentation of data from an *in vitro* study, which suggests that TA can have dose-dependent chondroprotective effects on inflamed and injured cartilage.

- In May 2019, we announced that results from a pooled analysis of data from three Phase 2/3 randomized clinical trials on the use of rescue medications with ZILRETTA were published in the peer-reviewed journal, *Pain and Therapy*. The analysis showed that the overall number of rescue medication tablets used per day through Week 24 was significantly less for ZILRETTA compared to both saline-placebo (LSM difference, -0.43) and immediate-release TAcS (-0.24). The safety profile of ZILRETTA in this pooled analysis was consistent with that of the pivotal Phase 3 trial.
- Also in May 2019, we paused enrollment in a Phase 3 trial of ZILRETTA in hip OA pain due to a non-safety related issue which resulted in the inability to deliver a full dose in a small number of trial participants. In November, we determined that an exploratory study designed to resolve the issue was unsuccessful, and as a result, we made the decision to discontinue the Phase 3 trial.
- In July 2019, we presented new findings from a post-hoc subgroup analysis based on KL Grade of the open-label Phase 3b repeat administration trial of ZILRETTA in patients with knee OA at the American Orthopaedic Society for Sports Medicine (AOSSM). The analysis, which evaluated the efficacy of initial and repeat administration of ZILRETTA in patients with symptomatic knee OA ranging in radiographic severity from KL Grades 2 to 4, indicated that ZILRETTA consistently reduced OA knee pain for at least 12 weeks after each injection, regardless of KL Grade. The incidence of treatment emergent adverse events, or AEs were similar across all KL Grades and the most commonly reported AEs were consistent with those reported in previous clinical studies of ZILRETTA.
- In October 2019, we announced that results from a Phase 2a study evaluating the safety and systemic exposure of concurrent injections of ZILRETTA in patients with bilateral knee OA were published in the peer-reviewed journal, *Therapeutic Advances in Musculoskeletal Disease*. Findings from the open-label randomized study showed that concurrent, bilateral administration of ZILRETTA appeared safe and well tolerated, resulting in reduced systemic exposure and substantially lower plasma concentrations of TA compared to immediate-release TAcS.

### ***Manufacturing***

We believe that the multifaceted nature of PLGA drug product manufacturing and the limited number of capable contract manufacturing companies that offer PLGA drug product manufacturing creates an entry barrier. The technology is designed to enable novel formulations of pharmaceuticals by providing extended-release of drugs over time and the physical properties of the polymer-drug matrix can be varied to achieve specified drug loads and release rates.

We utilize contract manufacturers to produce the drug substances and drug products used in ZILRETTA. Manufacture of PLGA microspheres is a complex process and there are a limited number of contract manufacturing sites with PLGA experience. Our proprietary injectable IA extended-release technology allows us to incorporate pharmaceuticals in PLGA microspheres, such as TA, in the case of ZILRETTA, as well as potentially other product candidates. Following extensive development programs, we have established that a single injection of ZILRETTA sustains local concentrations of TA in the joint for several months. The ZILRETTA microsphere PLGA formulation has gone through numerous iterations and has been optimized to release the drug over an extended period of time. In developing this unique combination of manufacturing process and formulation, we have established numerous trade secrets that relate to precise pharmaceutical release profiles.

The active pharmaceutical ingredient in ZILRETTA, TA, is manufactured and supplied by Farmabios SpA in accordance with current Good Manufacturing Practice, or cGMP, standards. This supplier is subject to regular inspections by the FDA. The PLGA material used in the manufacture of ZILRETTA is supplied by Evonik Corporation, or Evonik. In November 2016, we entered into a Supply Agreement with Evonik for the purchase of PLGA for clinical and commercial supply of ZILRETTA. The initial term of the Supply Agreement is until July 2021 and will renew for two successive two-year terms upon mutual written consent by both parties. Under the Supply Agreement, we are bound to purchase PLGA from Evonik at certain minimum purchase amounts, which

decrease over time, and at a specified price per gram, subject to adjustment from time to time, including due to changes in price indices and in the event the initial term of the Supply Agreement is extended. Upon termination of the Supply Agreement (other than termination due to the bankruptcy of either Evonik or us) we are obligated to pay the costs associated with the binding supply forecast provided to Evonik.

In August 2015, we entered into a Manufacturing Agreement with Patheon U.K. Limited, or Patheon, for the manufacture of clinical and commercial supplies of ZILRETTA finished drug product. In connection with the agreement, Patheon undertook certain technical transfer activities and construction services to prepare its United Kingdom facility for the manufacture of ZILRETTA in dedicated manufacturing suites. The initial term of our Manufacturing Agreement with Patheon is until October 2027. We may terminate this agreement upon one month's notice if a regulatory authority causes the withdrawal from, or halts development of, ZILRETTA (in either case for reasons outside our reasonable control) in the United States or any other market that represents 80% of our overall sales. We may also terminate this agreement at any time for convenience by providing 24 months' notice. Either we or Patheon may terminate this Agreement in the event of (a) an unremedied material breach or bankruptcy of the other party, (b) if a material force majeure event remains uncured for a period of more than 90 days and (c) the granting of a permanent injunction to a third party claiming intellectual property infringement of ZILRETTA in the United States or UK. Upon termination of this agreement, we are obligated to pay for the costs associated with the removal of our manufacturing equipment and for Patheon's termination costs up to a specified maximum amount.

### ***Commercial Strategy***

We have established a commercial infrastructure designed to drive the adoption and sales of ZILRETTA with the approximately 10,500 prescribers who treat approximately 70% of patients diagnosed with OA pain of the knee who receive an IA treatment. Of these prescribers, approximately 80% are orthopedists and rheumatologists. We distribute ZILRETTA through a limited network of third-party specialty distributors, a specialty pharmacy, group purchasing organizations and other third parties. While we believe that the United States represents the most attractive market for ZILRETTA, we continue to evaluate opportunities and potential partnerships to develop and commercialize ZILRETTA in territories outside the United States where we believe there is the potential for value-based pricing and reimbursement.

Of patients who are treated for OA pain of the knee with an IA injection, we estimate that approximately 70% receive IA injections from orthopedic surgeons or their attendant physician extenders (i.e. physician assistants and nurse practitioners). Approximately 8% of patients receive IA injections from physical medicine and rehabilitation specialists and rheumatologists, and approximately 7% of patients are treated by sports medicine specialists. Approximately 10% are treated by primary care physicians. The remaining IA injections are administered by a wider array of health care providers, including physician assistants and nurse practitioners.

### ***Competition***

Our industry is highly competitive and subject to rapid and significant technological change. The large size and expanding scope of the pain market makes it an attractive therapeutic area for biopharmaceutical businesses. Our potential competitors include pharmaceutical, biotechnology, medical device and specialty pharmaceutical companies. Several of these companies have robust drug pipelines, readily available capital and established research and development organizations. We believe our success will be driven by our ability to develop and commercialize treatment options that make a meaningful difference for patients with musculoskeletal conditions, beginning with OA.

The key competitive factors that could affect the success of ZILRETTA's commercialization are likely to be efficacy, safety, price and the availability of reimbursement from government and other third-party payers. Immediate-release steroids and HAs are currently the two marketed classes of IA products that compete directly with ZILRETTA.

Also available are stem cell and platelet rich plasma, or PRP, injections, but these require on site preparation from tissue or blood taken from the patient, have generated questionable efficacy in controlled clinical trials, and we believe they are unlikely to be a broadly embraced therapeutic option for OA patients. Because these are minimally manipulated autologous therapies, they do not require and have not received FDA review or approval. For that

reason, they are generally not reimbursed by payers and patients must pay out of pocket to receive these therapies. Furthermore, the American Association of Hip & Knee Surgeons issued a position statement indicating that it cannot recommend biologic therapies, including stem cell and PRP injections, for the treatment of advanced hip or knee arthritis. The American Academy of Hip and Knee Surgeons (AAHKS) and ACR recently issued guidelines strongly recommending against use of IA stem cell therapy and PRP for the treatment of OA.

In addition to marketed IA medications for OA, other companies have OA product candidates in advanced stages of clinical development. These product candidates include:

- Anika Therapeutics, Inc.'s Cingal<sup>®</sup>, which is a mixture of Anika's Monovisc combined with a low dose of a commonly used immediate-release steroid. Anika filed a Pre-Market Application with the FDA for Cingal based on a single pivotal clinical trial. In December 2015, Anika announced that due to the steroid component of the product, it needed to file this product candidate under an NDA. In June 2018, Anika announced Cingal did not achieve statistical significance at the primary endpoint of 26 weeks in an active comparator study. Subsequently, Anika completed an extension study to 39 weeks and announced an intention to include the data in a package for a meeting with the FDA planned for the first quarter of 2019. In February 2019, Anika announced that, based on their discussions with the FDA, they will need to conduct another Phase 3 clinical trial before they can potentially obtain approval for Cingal in the U.S. Anika announced plans to conduct a pilot study to evaluate the full-scale Phase 3 trial design. Anika previously indicated they expect to initiate the pilot study in the first half of 2020.
- Kolon TissueGene, Inc.'s Invossa<sup>™</sup>, which is a combination of human allogeneic chondrocytes and TGF- $\beta$ 1 transfected allogeneic chondrocytes. In November 2018, Kolon TissueGene announced they enrolled the first patient in a pivotal U.S. Phase 3 trial. In April 2019, the FDA suspended the U.S. Phase 3 trial due to a Chemistry, Manufacturing, and Controls (CMC) concern.
- Ampio Pharmaceuticals, Inc.'s Ampion<sup>™</sup>, which is a derivative of human serum albumin, is described as having anti-inflammatory properties, and is formulated for immediate-release. In 2018, the FDA provided guidance that Ampio should complete an additional Phase 3 trial of KL4 severe OA of the knee patients carried out under Special Protocol Assessment to support a Biologics License Application, or BLA. Ampio previously indicated it expects its Phase 3 trial to be completed in Q1 2020.
- Centrexion Therapeutics Corporation's CNTX-4975, which is a synthetic, ultra-pure injection of trans-capsaicin. Centrexion previously indicated that it expects results from its Phase 3 VICTORY-1 trial and VICTORY-3 trial in Q1 2020 and results from its Phase 3 VICTORY-2 trial in Q3 2020.
- Samumed's SM04690 (lorezivint), a small molecule inhibitor of the Wnt pathway is under development as a potential disease modifying drug. In May 2019, Samumed commenced its first Phase 3 pivotal trial, STRIDES-XRAY, for lorezivint. Samumed previously indicated that the estimated trial completion date is December 2020.
- A number of investigational nerve growth factor antibodies are in development. In January 2019, Pfizer and Lilly announced results from a second Phase 3 study showing that the tanezumab 5 mg treatment arm met all three co-primary endpoints at 24 weeks, demonstrating statistically significant improvement in pain and function compared with those receiving placebo. In contrast, in the 2.5 mg treatment arm, patients' overall assessment of their OA was not statistically different than placebo. Rapidly progressive OA was seen in 2.1% of tanezumab-treated patients and was not observed in the placebo arm. In December 2019, Pfizer filed a U.S. regulatory submission with the FDA for tanezumab 2.5mg SC in patients with moderate to severe OA. Teva and Regeneron's fasinumab is in Phase 3 development, with three trials underway, and key data are expected in 2020.



- In October 2019, Taiwan Liposome Company announced the initiation of a Phase 3 trial for TLC599, which is a liposomal formulation of dexamethasone sodium phosphate. The company previously announced that its estimated primary completion date for the trial is August 2021.
- Servier and Galapagos NV's S201086/GLPG1972, an ADAMTS-5 inhibitor, is currently in Phase 2 clinical development.
- In February 2020, UNITY Biotechnology announced the Phase 2 study of UBX0101 in patients with moderate-to-severe knee OA was fully enrolled with 183 patients. Both 12- and 24-week results are expected in the second half of 2020. UBX0101 is a senolytic small molecule inhibitor of the MDM2/53 protein interaction, which selectively targets the senescent cells that accumulate in osteoarthritic knee tissue and aimed at treating an underlying cause of the disease.

## **Intellectual Property/Patents and Proprietary Rights**

### ***Intellectual Property and Exclusivity***

We are building a broad, worldwide intellectual property portfolio to protect the proprietary position of ZILRETTA, our product candidates and technology through a combination of patents, trade secrets, proprietary know-how, FDA exclusivity and contractual restrictions on disclosure.

### ***Patents and Patent Applications***

We are building a broad, worldwide intellectual property portfolio to protect the proprietary position of ZILRETTA and our product candidates by, among other methods, filing U.S. and foreign patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. We actively apply for, maintain, and plan to defend and enforce, as needed, our internally developed and externally licensed or acquired patent rights. Furthermore, we continue to search for and evaluate opportunities to in-license intellectual property relevant to our business.

### ***ZILRETTA***

We own three U.S. ZILRETTA patents as well as counterpart foreign patents and patent applications covering composition of matter, methods of manufacture and methods of use. Our U.S. ZILRETTA patents have expiration dates in 2031. The ZILRETTA composition of matter invention is the result of several unique discoveries relating to a narrow drug load specification, a certain release profile of polymers, specific polymer weights and ratios and clinical efficacy observed within a dose-range. The U.S. patents directed to ZILRETTA's composition of matter and methods of use are listed in the FDA Orange Book. We also have pending U.S. applications directed at compositions of matter similar to ZILRETTA, as well as methods of making and using the same, if resulting in an issued patent, could provide additional related claims expiring in 2031.

In 2019, we had a patent granted in South Korea, further expanding our global intellectual property portfolio including patents in Australia, Canada, China, Indonesia, Japan, Mexico, New Zealand, Saudi Arabia, the Russian Federation, Singapore, South Africa, Taiwan and Ukraine. These foreign patents cover the composition of matter, methods of manufacturing and methods of using ZILRETTA and are similar in scope to the protection in the U.S. described above. In addition, we are continuing to prosecute our patent applications pending in Europe and additional countries throughout the world directed to ZILRETTA and related inventions.

We have also in-licensed intellectual property, owned by SwRI, which gives us exclusive rights to SwRI patents covering our proprietary microsphere manufacturing technology used in the production of ZILRETTA. These patents are scheduled to expire in 2025.

### ***FX201***

In December 2017, we acquired the global rights to FX201 from GeneQuine. As part of the transaction with GeneQuine, we became the direct exclusive licensee of certain foundational patents, patent applications and other proprietary rights owned by Baylor that are related to FX201 for human applications. These patents generally cover

the composition of matter and method of use of FX201 in the treatment of OA. In June 2019, the U.S. PTO issued patent number 10,301,647, which covers the composition of matter and method of use of FX201 in the treatment of OA with a term through January of 2033. In addition, the Baylor patents related to FX201 are issued in Europe, with an expiry date in 2032, and in Australia, Japan, China and Eurasia with expiry dates in 2033. We are continuing to prosecute the Baylor patent applications related to FX201 which are pending in Canada and India. Further, we have a pending patent application covering effective dosages of FX201 in the treatment of OA in humans, which is expected to provide protection until 2039.

### ***FX301***

In September 2019, we acquired global rights to develop and commercialize funapide from Xenon, which we have formulated for extended release with our proprietary thermosensitive hydrogel as FX301. As part of the transaction with Xenon, we acquired foundational patents and patent applications covering the composition of matter, methods of use and methods of manufacture related to funapide. We own patents directed to funapide granted in the U.S. as well as Australia, Canada, China, Europe, Hong Kong, Mexico and New Zealand with expiry dates in 2030. In addition, we have a pending patent application covering composition of matter, method of use and method of manufacture for FX301, which is expected to provide protection until 2039.

### ***Trade Secrets and Proprietary Information***

The ZILRETTA microsphere PLGA formulation has been refined and optimized to deliver the drug substance released over an extended period of time. In developing this unique combination of manufacturing process and formulation, we have established numerous trade secrets, including those that relate to a precise pharmaceutical release profile. In addition, due to the complexity of the extended-release technology and the time, costs and technical risks involved in demonstrating bioequivalence through clinical trials, we believe that the ability of manufacturers to gain market approval for generic alternatives to ZILRETTA upon expiration of our patents and FDA exclusivity will be challenging.

We seek to protect our proprietary information, including our trade secrets and proprietary know-how, by requiring our employees to execute a Proprietary Information, Inventions, Non-Solicitation, and Non-Competition Agreement upon the commencement of their employment. Consultants and other advisors are required to sign consulting agreements. These agreements generally provide that all confidential information developed or made known during the course of the relationship with us be kept confidential and not be disclosed to third parties except in specific circumstances. In the case of our employees, the agreements also typically provide that all inventions resulting from work performed for us, utilizing our property or relating to our business and conceived or completed during employment shall be our exclusive property to the extent permitted by law. Further, we require confidentiality agreements from entities that receive our confidential data or materials.

### **Intellectual Property Agreements**

#### ***Southwest Research Institute Manufacturing® (SwRI) License***

In July 2014, we executed an exclusive worldwide licensing agreement with SwRI to utilize proprietary microsphere manufacturing technologies for production of our extended-release drug candidates, including ZILRETTA. The SwRI technologies employ a uniquely controlled and continuous atomizing technology that facilitated scale-up of commercial supply. This exclusive agreement provides for an expanded field of use in a variety of musculoskeletal disorders, as well as broader polymer and steroid ranges, which offers the flexibility to potentially explore different doses, disease indications, and drug-PLGA combinations. We have no further payment obligations following the amendment executed by the parties in February 2017 and the license remains in effect through patent term expiry.

#### ***FX201 Related Agreements***

In December 2017, we acquired the global rights to develop and commercialize FX201. As part of the asset purchase transaction with GeneQuine, we made an upfront payment of \$2.0 million. In 2018, we paid GeneQuine a \$750,000 milestone payment for initiating a GLP toxicology study of FX201. In addition, we paid GeneQuine a

\$750,000 payment in November 2019 following the FDA acceptance of the IND application for FX201. This milestone was recognized as research and development expense in the fourth quarter of 2019. The next milestone of \$2.5 million was achieved in March 2020 when the first patient was treated in the Phase 1 clinical trial. We may also be required to make additional milestone payments during the development of FX201, including up to \$4.5 million through the Phase 2 proof of concept, or PoC, clinical trial and, following successful PoC, up to an additional \$51.5 million in development and global regulatory approval milestone payments. As part of the transaction with GeneQuine, we became the direct licensee of certain underlying Baylor patents and other proprietary rights related to FX201 for human applications. The Baylor license agreement grants us an exclusive, royalty-bearing, worldwide right and license (with a right to sublicense) for human applications under its patent and other proprietary rights directly related to FX201, with a similar non-exclusive license to certain Baylor intellectual property rights that are not specific to FX201. The license agreement with Baylor includes a low single-digit royalty on net sales of FX201 and requires us to use reasonable efforts to develop FX201 according to timelines set out in the license agreement. In December 2017, we also entered into a Master Production Services Agreement with SAFC Carlsbad, Inc., a part of MilliporeSigma, for the manufacturing of preclinical and initial clinical supplies of FX201. In addition, we recently entered into a manufacturing agreement that secures clinical trial supply of FX201 through Phase 3 clinical trials.

### ***FX301 Related Agreements***

In September 2019, we acquired from Xenon, global rights to develop and commercialize funapide formulated for extended release with our novel, proprietary thermosensitive hydrogel under our preclinical program known as FX301. As part of the asset purchase transaction with Xenon, we made an upfront payment to Xenon of \$3.0 million. We may also be required to make additional milestone payments during the development of FX301, including up to \$9.0 million through initiation of a Phase 2 proof of concept (PoC) clinical trial and, following successful PoC, up to \$40.8 million in development and global regulatory approval milestone payments and up to an additional \$75.0 million in sales-related milestone payments. The transaction was accounted for as an asset acquisition, as it did not qualify as a business combination. The upfront fee was attributed to the intellectual property acquired and recognized as research and development expense in September 2019 as the FX301 product candidate had not been commercially approved and had no alternative future use. Future milestone payments earned prior to regulatory approval of FX301 will be recognized as research and development expense in the period when the milestone events become probable of being achieved. Future milestones earned subsequent to regulatory approval will be recognized as an intangible asset and amortized to expense over the estimated life of FX301. As of December 31, 2019, no milestones under the arrangement had been achieved. As part of the transaction, we became the direct licensee of certain underlying Xenon patents and other proprietary rights related to funapide for human applications. The Xenon agreement grants us an exclusive, royalty-bearing, world-wide right and license (with a right to sublicense) for human applications under its patents directly related to funapide, with a similar royalty-free license to other Xenon proprietary rights directly related to funapide. The agreement with Xenon includes a tiered royalty ranging from mid-single digits to low double digits that is based on aggregate annual net sales of FX301 and requires us to use reasonable efforts to develop FX301 according to timelines set out in the agreement.

### **Government Regulation and Product Approval**

Government authorities in the United States at the federal, state and local level, and in other countries extensively regulate, among other things, the research, development, testing, manufacture, quality control, approval, labeling, packaging, storage, record-keeping, promotion, advertising, distribution, post-approval monitoring and reporting, marketing and export and import of products such as those we are developing and commercializing.

### ***U.S. Biopharmaceutical Product Development Process***

In the United States, the FDA regulates biopharmaceutical products under the Federal Food, Drug, and Cosmetic Act, or FDCA, the Public Health Service Act, or PHSA, and implementing regulations. Biopharmaceutical products are also subject to other federal, state and local statutes and regulations. The process of obtaining regulatory approvals and the subsequent compliance with appropriate federal, state, local and foreign statutes and regulations requires the expenditure of substantial time and financial resources. Failure to comply with the applicable requirements at any time during the product development process, approval process or after approval, may subject an applicant to a variety of administrative or judicial sanctions, such as the FDA's refusal to approve pending applications, withdrawal of an approval, imposition of a clinical hold, issuance of warning letters, product recalls, product seizures, total or partial suspension of production or distribution injunctions, fines, refusals of government contracts, restitution, disgorgement of profits or civil or criminal penalties. The process required by the FDA before a biopharmaceutical product may be marketed in the United States generally involves the following:

- completion of preclinical laboratory tests, animal studies and formulation studies according to Good Laboratory Practices, or GLP, or other applicable regulations;
- submission to the FDA of an investigational new drug, or IND, application, which must become effective before human clinical trials may begin;
- approval by an independent institutional review board, or IRB, at each clinical site before each trial may be initiated;
- performance of adequate and well-controlled human clinical trials according to the FDA's laws and regulations pertaining to the conduct of human clinical studies, collectively referred to as Good Clinical Practices, or GCP, and according to the International Council for Harmonization, or ICH, GCP guidelines, to establish the safety and efficacy of the proposed biopharmaceutical product for its intended use;
- submission to the FDA of an NDA for a proposed new drug product or a Biologics License Application, or BLA, for a biological product;
- satisfactory completion of an FDA inspection of the manufacturing facility or facilities where the biopharmaceutical product is produced and tested to assess compliance with the FDA's cGMP requirements, to assure that the facilities, methods and controls are adequate to preserve the biopharmaceutical product's identity, strength, quality and purity;
- potential FDA audit of the non-clinical and clinical trial sites that generated the data in support of the NDA or BLA; and
- FDA review and approval or licensure of the NDA or BLA.

The lengthy process of seeking required approvals and the continuing need for compliance with applicable statutes and regulations require the expenditure of substantial resources and approvals are inherently uncertain.

Before testing any compounds with potential therapeutic value in humans, the biopharmaceutical product candidate enters the nonclinical testing stage, also referred to as preclinical testing. Preclinical tests include laboratory evaluations of product chemistry, toxicity and formulation, as well as animal studies to assess the potential safety and activity of the biopharmaceutical product candidate. The conduct of the preclinical tests must comply with federal regulations and requirements including GLP. The sponsor must submit the results of the preclinical tests, together with manufacturing information, analytical data, any available clinical data or literature and a proposed clinical protocol, among other documentation, to the FDA as part of the IND application. The IND automatically becomes effective 30 days after receipt by the FDA, unless the FDA raises concerns or questions related to one or more proposed clinical trials and places the trial on a clinical hold within that 30-day time period. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before the clinical trial can begin. The FDA may also impose clinical holds on a biopharmaceutical product candidate at any time before or during clinical trials due to safety concerns or non-compliance with applicable laws or regulations.

Clinical trials involve the administration of the biopharmaceutical product candidate to healthy subjects or patients with the target disease under the supervision of qualified investigators, generally physicians not employed by or under the trial sponsor's control. Clinical trials are conducted under written study protocols detailing, among other things, the objectives of the clinical trial, dosing procedures, subject selection and exclusion criteria, and the

parameters to be used to monitor subject safety. Each protocol must be submitted to the FDA as part of the IND. Clinical trials must be conducted in accordance with the FDA's regulations which reflect the ICH GCP requirements. Further, each clinical trial must be reviewed and approved by an IRB at, or servicing, each institution at which the clinical trial will be conducted. An IRB is charged with protecting the welfare and rights of trial participants and considers such items as whether the risks to individuals participating in the clinical trials are minimized and are reasonable in relation to anticipated benefits. The IRB also approves the informed consent form that must be provided to each clinical trial subject or his or her legal representative and must monitor the clinical trial until it is completed.

Clinical trials for biopharmaceutical product candidates are typically conducted in humans in three sequential phases that may overlap. In Phase 1 clinical trials, the biopharmaceutical product is initially introduced into healthy human subjects and tested for safety or adverse effects, dosage, tolerance, metabolism, distribution, excretion and clinical pharmacology. In Phase 2 clinical trials, the biopharmaceutical product is evaluated in a limited patient population to identify possible adverse side effects and safety risks, evaluate preliminarily the efficacy of the biopharmaceutical product for specific targeted indications and determine dosage tolerance, optimal dosage and dosing schedule for patients having the specific disease. Once a biopharmaceutical product shows evidence of effectiveness and is found to have an acceptable safety profile in Phase 2 evaluations, Phase 3 clinical trials are undertaken to more fully evaluate clinical outcomes. In Phase 3 clinical trials, the biopharmaceutical product is administered to an expanded patient population in adequate and well-controlled trials to generate sufficient data to statistically confirm the efficacy and safety of the biopharmaceutical product for approval, to establish the overall risk-benefit profile of the biopharmaceutical product and to provide adequate information for its labeling.

Post-approval studies, also referred to as Phase 4 clinical trials, may be conducted after initial marketing approval. These studies are used to gain additional experience from the treatment of patients in the intended therapeutic indication and may be required by the FDA as part of the approval process.

Progress reports detailing the status of biopharmaceutical product development and results of the clinical trials must be submitted at least annually to the FDA and written IND safety reports must be submitted to the FDA and the investigators for serious and unexpected adverse events or any finding from tests in laboratory animals that suggests a significant risk for human subjects or patients. Phase 1, Phase 2 and Phase 3 clinical trials may not be completed successfully within any specified period, if at all. The FDA or the sponsor or its data safety monitoring board (if applicable) may suspend a clinical trial at any time on various grounds, including a finding that the research subjects are being exposed to an unacceptable health risk. Similarly, an IRB can suspend or terminate approval of a clinical trial at its institution if the clinical trial is not being conducted in accordance with the IRB's requirements or if the biopharmaceutical product has been associated with unexpected serious harm to study subjects.

Concurrent with clinical trials, companies usually complete additional animal studies and must also develop additional information about the chemistry and physical characteristics of the biopharmaceutical product as well as finalize a process for manufacturing the product in commercial quantities in accordance with cGMP requirements. The manufacturing process must be capable of consistently producing quality batches of the biopharmaceutical product candidate and, among other things, the manufacturer must develop methods for testing the safety, identity, strength, quality and purity of the final biopharmaceutical product. Additionally, appropriate packaging must be selected and tested, and stability studies must be conducted to demonstrate that the biopharmaceutical product candidate does not undergo unacceptable deterioration over its shelf life.

### ***FDA Review and Approval Processes***

The results of product development, preclinical studies and clinical studies for claimed indications as well as descriptions of the manufacturing process and controls, analytical tests conducted on the biopharmaceutical product, proposed labeling and other relevant information are submitted to the FDA as part of an NDA or BLA requesting approval to market the product. A supplement to an approved NDA or BLA is also required to be submitted for review when seeking major changes to manufacturing or labeling, including additional indications for use. Additionally, the results of product development, preclinical studies and clinical trials for the claimed indications in all relevant pediatric subpopulations and the support for dosing and administration for each pediatric subpopulation for which the product is safe and effective, are contained in an NDA or BLA. The FDA may grant deferrals for submission of pediatric data or full or partial waivers after the initial submission of a pediatric study plan following an end of Phase 2 meeting unless otherwise agreed upon by the FDA and the sponsor. The submission of an NDA or

BLA is subject to the payment of substantial user fees; a waiver of such fees may be obtained under certain limited circumstances.

The FDA reviews all NDAs and BLAs submitted before it accepts them for filing and may request additional information rather than accepting the application for filing. Once the application is accepted for filing, the FDA begins an in-depth review. Under the goals and policies agreed to by the FDA under the Prescription Drug User Fee Act, or PDUFA, the FDA has 12 months after submission for a new molecular entity in which to complete its initial review and respond to the applicant, and eight months for a priority review application. In addition, the FDA has 10 months after submission of an NDA for a non-new molecular entity in which to complete its initial review of a standard NDA and respond to the applicant, and six months for a priority review NDA. The FDA does not always meet its PDUFA goal dates for review of standard and priority review applications. The review process and the PDUFA goal date may be extended by additional three-month review periods whenever the FDA requests or the sponsor otherwise provides additional information or clarification regarding information already provided in the submission at any time during the review cycle.

The FDA reviews the NDA or BLA to determine, among other things, whether the proposed product is safe and effective for its intended use, and whether the product is being manufactured in accordance with cGMP to assure and preserve the product's identity, strength, quality and purity. The FDA may refer applications for novel biopharmaceutical products which present difficult questions of safety or efficacy to an advisory committee, typically a panel that includes clinicians and other experts, for review, evaluation and a recommendation as to whether the application should be approved and under what conditions. The FDA is not bound by the recommendations of an advisory committee, but it considers such recommendations carefully when making decisions. During the approval process, the FDA also will determine whether a risk evaluation and mitigation strategy, or REMS, is necessary to assure the safe use of the biopharmaceutical product. If the FDA concludes a REMS is needed, the sponsor of the NDA must submit a proposed REMS; the FDA will not approve the application without a REMS, if required.

Before approving an NDA or BLA, the FDA will typically inspect the facilities at which the product is to be manufactured. When an inspection is undertaken, the FDA will not approve the product unless it determines that the manufacturing processes and facilities are in compliance with cGMP requirements and adequate to assure consistent production of the product within required specifications. Additionally, before approving an application, the FDA will typically inspect one or more clinical sites to assure compliance with FDA regulations regarding conduct of clinical trials for the product's trials. If the FDA determines that the application, manufacturing process or manufacturing facilities are not acceptable, it will outline the deficiencies in a complete response letter to the applicant and often will request additional testing or information.

If a complete response letter is issued, the applicant may either resubmit the application, addressing all of the deficiencies identified in the letter, or withdraw the application.

If a product receives regulatory approval, the approval may be significantly limited to specific diseases and dosages or the indications for use may otherwise be limited, which could restrict the commercial value of the product. Further, the FDA may require that certain contraindications, warnings or precautions be included in the product labeling or REMS to assure safe use of the product through distribution or other controls. In addition, the FDA may require post approval studies, referred to as Phase 4 testing, which involves clinical trials designed to further assess a product's safety and effectiveness and may require testing and surveillance programs to monitor the safety of approved products that have been commercialized.

### ***Post-Approval Requirements***

Any products for which we receive FDA approval are subject to continuing regulation by the FDA, including, among other things, record-keeping requirements, reporting of adverse experiences with the product, providing the FDA with updated safety and efficacy information, product sampling and distribution requirements, complying with certain electronic records and signature requirements and complying with FDA promotion and advertising requirements. These promotion and advertising requirements include, among other things, standards for direct-to-consumer advertising, prohibitions against promoting drugs for uses or in patient populations that are not described in the drug's approved labeling (known as "off-label use"), rules for conducting industry-sponsored scientific and educational activities, and promotional activities involving the internet. Failure to comply with FDA requirements can have negative consequences, including adverse publicity, enforcement letters from the FDA, mandated

corrective advertising or communications with doctors, and civil or criminal penalties. Although physicians may prescribe legally available drugs for off-label uses, manufacturers may not market or promote such off-label uses.

We rely, and expect to continue to rely, on third parties for the production of clinical and commercial quantities of our products. Manufacturers of our products are required to comply with applicable FDA manufacturing requirements contained in the FDA's cGMP regulations. cGMP regulations require, among other things, quality control and quality assurance as well as the corresponding maintenance of records and documentation. Drug manufacturers and other entities involved in the manufacture and distribution of approved drugs are also required to register their establishments with the FDA and certain state agencies, and are subject to periodic unannounced inspections by the FDA and certain state agencies for compliance with cGMP and other laws. Accordingly, manufacturers must continue to expend time, money, and effort in the area of production and quality control to maintain cGMP compliance. Discovery of problems with a product after approval may result in restrictions on a product, manufacturer, or holder of an approved NDA. These restrictions may include suspension of a product until the FDA is assured that quality standards can be met, continuing oversight of manufacturing by the FDA under a consent decree of permanent injunction, which frequently includes the imposition of costs and continuing inspections over a period of many years, as well as possible withdrawal of the product from the market. In addition, changes to the manufacturing process generally require prior FDA approval before being implemented.

The FDA and other federal and state agencies closely regulate the promotion of drugs. Moreover, the FDA strictly regulates the promotional claims that may be made about drug and biologic products. In particular, a product may not be promoted for off label uses that are not approved by the FDA as reflected in the product's approved packaging label or are otherwise truthful and not misleading statements. The FDA and other agencies actively enforce the laws and regulations prohibiting the promotion of off-label uses.

Other types of changes to the approved product, such as adding new indications and additional labeling changes, are also subject to further FDA review and approval.

### ***Pharmaceutical Coverage, Pricing and Reimbursement***

Significant uncertainty exists as to the coverage and reimbursement status of any biopharmaceutical product for which we obtain regulatory approval. In the United States and markets in other countries, sales of any products for which we receive regulatory approval for commercial sale will depend in part on the availability of coverage and adequate reimbursement from third-party payers.

In the United States, third-party payers include federal and state government payer programs, including Medicare and Medicaid, managed care organizations, private health insurers and other organizations. The process for determining whether a third-party payer will provide coverage for a drug product may be separate from the process for setting the price or reimbursement rate that the third-party payer will pay for the drug product. Third-party payers may limit coverage to specific drug products on an approved list, or formulary, which might not include all of the FDA-approved drug products for a particular indication. Third-party payers are increasingly challenging the price and examining the medical necessity and cost-effectiveness of medical products and services, in addition to their safety and efficacy. We may need to conduct expensive pharmacoeconomic studies in order to demonstrate the medical necessity and cost-effectiveness of our products, in addition to the costs required to obtain FDA approvals. In addition, our biopharmaceutical products may not be considered medically necessary or cost-effective.

A third-party payer's decision to provide coverage for a drug product does not imply that an adequate reimbursement rate will be approved. Further, one payer's determination to provide coverage for a drug product does not ensure that other payers also will provide coverage or an adequate reimbursement rate for the drug product. Adequate third-party reimbursement may not be available to enable us to maintain price levels sufficient to realize an appropriate return on our investment in product development.

The cost of pharmaceuticals continues to generate substantial governmental and third-party payer scrutiny. We expect that the pharmaceutical industry will continue experiencing pricing pressures due to the trend toward managed healthcare, the increasing influence of managed care organizations and additional legislative proposals. Third-party payers are increasingly challenging the prices charged for medical products and services and examining the medical necessity and cost-effectiveness of medical products and services, in addition to their safety and

efficacy. If these third-party payers do not consider our products to be cost-effective compared to other available therapies, they may not cover our products after approval as a benefit under their plans or, if they do, the level of payment may not be sufficient to allow us to sell our products at a profit. The U.S. government, state legislatures and foreign governments have shown significant interest in implementing cost containment programs to limit the growth of government-paid healthcare costs, including price controls, restrictions on reimbursement and requirements for substitution of generic products for branded prescription drugs. Adoption of such controls and measures, and tightening of restrictive policies in jurisdictions with existing controls and measures, could limit payments for pharmaceuticals such as the drug candidates that we are developing and could adversely affect our net revenue and results.

Different pricing and reimbursement schemes exist in other countries. In the European Community, governments influence the price of pharmaceutical products through their pricing and reimbursement rules and control of national healthcare systems that fund a large part of the cost of those products to consumers. Some jurisdictions operate positive and negative list systems under which products may only be marketed once a reimbursement price has been agreed. To obtain reimbursement or pricing approval, some of these countries may require the completion of clinical trials that compare the cost-effectiveness of a particular drug candidate to currently available therapies. Other member states allow companies to fix their own prices for medicines but monitor and control company profits. The downward pressure on healthcare costs in general, and on prescription drugs in particular, has become very intense. As a result, increasingly high barriers are being erected to the entry of new products. In addition, in some countries, cross-border imports from low-priced markets exert a commercial pressure on pricing within a country. There can be no assurance that any country that has price controls or reimbursement limitations for drug products will allow favorable reimbursement and pricing arrangements for any company.

Additionally, in order to be eligible for certain federal agencies and grantees to purchase ZILRETTA, or to have it paid for with federal funds under the Medicaid and Medicare Part B programs, we participate in the Department of Veterans Affairs, or VA, Federal Supply Schedule, or FSS, pricing program. We are obligated through the FSS program to sell ZILRETTA through a FSS contract and charge a price that is no higher than the statutory Federal Ceiling Price, or FCP, to four federal agencies (VA, U.S. Department of Defense, Public Health Service, and Coast Guard). The FCP is based on the non-federal Average Manufacturer Price, which we will need to calculate and report to the VA on a quarterly and annual basis. These obligations contain extensive disclosure and certification requirements.

### ***Healthcare Reform***

In the United States and foreign jurisdictions, there have been a number of legislative and regulatory changes to the healthcare system that could affect our future results of operations. In particular, there have been and continue to be a number of initiatives at the United States federal and state levels that seek to reduce healthcare costs, improve healthcare quality or expand access to healthcare.

In the United States, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, or the MMA, changed the way Medicare covers and pays for pharmaceutical products. The MMA expanded Medicare coverage to include outpatient prescription drug purchases made by the elderly by establishing Medicare Part D and introduced a new reimbursement methodology based on average sales prices for physician administered drugs under Medicare Part B. In addition, the MMA provided authority for limiting the number of drugs that would be covered in any therapeutic class under the Medicare Part D program. Cost reduction initiatives and other provisions of this legislation could decrease the coverage and reimbursement rate that we receive for ZILRETTA and any of our other approved products. While the MMA applies only to drug benefits for Medicare beneficiaries, private payers often follow Medicare coverage policy and payment limitations in setting their own reimbursement rates. Therefore, any reduction in reimbursement that results from the MMA may result in a similar reduction in payments from private payers.

In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010, or collectively PPACA, was enacted as a sweeping law intended 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. Among the provisions of PPACA of importance to our potential drug candidates are the following:

- an annual, non-deductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents, apportioned among these entities according to their market share in certain government healthcare programs;
- an increase in the rebates a manufacturer must pay under the Medicaid Drug Rebate Program to 23.1% and 13% of the average manufacturer price for branded and generic drugs, respectively;
- a new methodology by which rebates owed by manufacturers under the Medicaid Drug Rebate Program are calculated for drugs that are inhaled, infused, instilled, implanted or injected;
- a new Medicare Part D coverage gap discount program, in which manufacturers must now agree to offer 70% point-of-sale discounts to negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer's outpatient drugs to be covered under Medicare Part D;
- extension of manufacturers' Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations;
- expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals and by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level, thereby potentially increasing manufacturers' Medicaid rebate liability;
- expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;
- new requirements under the federal Open Payments program, created under Section 6002 of PPACA, and its implementing regulations, that manufacturers of drugs, devices, biologics and medical supplies for which payment is available under Medicare, Medicaid or the Children's Health Insurance Program (with certain exceptions) report annually to Centers for Medicare and Medicaid Services, or CMS, information related to "payments or other transfers of value" made or distributed to physicians, as defined by such law, and teaching hospitals, and that applicable manufacturers and applicable group purchasing organizations report annually to CMS ownership and investment interests held by physicians (as defined above) and their immediate family members;
- a requirement to annually report drug samples that manufacturers and distributors provide to physicians;
- expansion of healthcare fraud and abuse laws, including the federal False Claims Act and the federal Anti-Kickback Statute, new government investigative powers, and enhanced penalties for non-compliance;
- an FDA-approval framework for follow-on biologic products;
- a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research; and
- establishment of a Center for Medicare & Medicaid Innovation at CMS to test innovative payment and service delivery models to lower Medicare and Medicaid spending, potentially including prescription drug spending.

There remain judicial and Congressional challenges to numerous provisions of PPACA. Since January 2017, President Trump has signed two Executive Orders and other directives designed to delay the implementation of certain provisions of PPACA or otherwise circumvent some of the requirements for health insurance mandated by PPACA. Concurrently, Congress has considered legislation that would repeal or repeal and replace all or part of PPACA. While Congress has not passed comprehensive repeal legislation, several bills affecting the implementation of certain taxes under PPACA have been signed into law. The Tax Cuts and Jobs Act of 2017, or Tax Act, signed into law on December 22, 2017, includes a provision repealing, effective January 1, 2019, the tax-based shared responsibility payment imposed by PPACA on certain individuals that fail to maintain qualifying health coverage for all or part of a year commonly referred to as the "individual mandate". In addition, the 2020 federal spending

package permanently eliminated, effective January 1, 2020, the PPACA-mandated “Cadillac” tax on high-cost employer-sponsored health coverage and medical device tax and, effective January 1, 2021, also eliminates the health insurer tax. The Bipartisan Budget Act of 2018, or the BBA, among other things, amended PPACA, effective January 1, 2019, to close the coverage gap in most Medicare drug plans, commonly referred to as the “donut hole.” In December 2018, CMS published a new final rule permitting further collections and payments to and from certain PPACA qualified health plans and health insurance issuers under PPACA risk adjustment program in response to the outcome of federal district court litigation regarding the method CMS uses to determine this risk adjustment. On December 14, 2018, a Texas U.S. District Court Judge ruled that PPACA is unconstitutional in its entirety because the “individual mandate” was repealed by Congress as part of the Tax Act. Additionally, on December 18, 2019, the U.S. Court of Appeals for the 5th Circuit upheld the District Court ruling that the individual mandate was unconstitutional and remanded the case back to the District Court to determine whether the remaining provisions of the PPACA are invalid as well. It is unclear how this decision, future decisions, subsequent appeals, and other efforts to repeal and replace PPACA will impact PPACA.

In addition, since the PPACA was enacted, other legislative changes have been proposed and adopted that may impact the extent to which we are able to successfully commercialize any of our product candidates that receive regulatory approval. For example, in August 2011, then-President Obama signed into law the Budget Control Act of 2011, which, among other things, created the Joint Select Committee on Deficit Reduction to recommend to Congress proposals in spending reductions. The Joint Select Committee on Deficit Reduction did not achieve a targeted deficit reduction, which triggered the legislation’s automatic reduction to several government programs. This includes aggregate reductions to Medicare payments to providers of, on average, two percent per fiscal year through 2029 unless Congress takes additional action. The American Taxpayer Relief Act of 2012, among other things, further reduced Medicare payments to several providers, including hospitals and cancer treatment centers, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years.

There has been increasing legislative and enforcement interest in the United States with respect to specialty drug pricing practices, including at the federal level several recent U.S. Congressional inquiries and legislation designed to, among other things, increase drug pricing transparency, reduce the cost of drugs under Medicare, review relationships between pricing and manufacturer patient assistance programs, and reform government program drug reimbursement methodologies. At the federal level, the Trump administration’s budget proposal for fiscal year 2020 contains further drug price control measures that could be enacted during the budget process or in other future legislation, including, for example, measures to permit Medicare Part D plans to negotiate the price of certain drugs under Medicare Part B, to allow some states to negotiate drug prices under Medicaid, and to eliminate cost sharing for generic drugs for low-income patients. Further, the Trump administration released a “Blueprint”, or plan, to lower drug prices and reduce out of pocket costs of drugs that contains additional proposals to increase drug manufacturer competition, increase the negotiating power of certain federal healthcare programs, incentivize manufacturers to lower the list price of their products, and reduce the out of pocket costs of drug products paid by consumers. HHS has solicited feedback on some of these measures and has implemented others under its existing authority. For example, in May 2019, CMS issued a final rule to allow Medicare Advantage plans the option to use step therapy for Part B drugs beginning January 1, 2020. This final rule codified CMS’s policy change that was effective January 1, 2019. Although a number of these, and other measures may require additional authorization to become effective, Congress and the Trump administration have each indicated that it will continue to seek new legislative and/or administrative measures to control drug costs. Any reduction in reimbursement from Medicare or other government-funded programs may result in a similar reduction in payments from private payers. At the state level, legislatures have increasingly passed legislation and implemented regulations designed to control pharmaceutical and biological product pricing, including price or patient reimbursement constraints, discounts, restrictions on certain product access and marketing cost disclosure and transparency measures, and, in some cases, to encourage importation from other countries and bulk purchasing. The implementation of cost containment measures or other healthcare reforms may prevent us from being able to generate revenue, attain profitability, or commercialize ZILRETTA and any future products for which we receive regulatory approval.

We expect that PPACA reform, as well as other healthcare reform measures that have been and may be adopted in the future, may result in more rigorous coverage criteria and lower reimbursement, as well as additional downward pressure on the price that we receive for any approved product, including ZILRETTA.

### ***Regenerative Medicine Advanced Therapies***

As part of the 21st Century Cures Act, Congress amended the FDCA to create the regenerative medicine advanced therapies, or RMAT, designation. The RMAT designation is intended to facilitate efficient development and expedite review of regenerative medicine advanced therapies, which are intended to treat, modify, reverse, or cure a serious or life-threatening disease or condition. RMAT covers cell therapies, gene therapies, therapeutic tissue engineering products, human cell and tissue products, and combination products using any such therapies or products. A sponsor may request that the FDA designate a regenerative medicine advanced therapy concurrently with or at any time after submission of an IND. The FDA has 60 calendar days to determine whether the criteria are met, including whether there is preliminary clinical evidence indicating the potential to address unmet medical needs for a serious or life-threatening disease or condition. A BLA for a regenerative medicine advanced therapy may be eligible for priority review or accelerated approval through surrogate or intermediate endpoints reasonably likely to predict long-term clinical benefit, or reliance upon data obtained from a meaningful number of clinical trial sites. Benefits of such designation also include early interactions with the FDA to discuss any potential surrogate or intermediate endpoint to be used to support accelerated approval. A regenerative medicine advanced therapy that is granted accelerated approval and is subject to post-approval requirements may fulfill such requirements through the submission of clinical evidence, clinical studies, patient registries, or other sources of real-world evidence, such as electronic health records; the collection of larger confirmatory data sets; or post-approval monitoring of all patients treated with such therapy prior to its approval.

### ***Other U.S. Healthcare Laws and Compliance Requirements***

In the United States, our activities are subject to regulation by various federal, state and local authorities in addition to the FDA, including CMS, other divisions of HHS (e.g., the Office of Inspector General), the United States Department of Justice and individual United States Attorney offices within the Department of Justice, and state and local governments. For example, various activities, including but not limited to sales, marketing and scientific/educational grant programs, must comply with the anti-fraud and abuse provisions of the Social Security Act, the federal Anti-Kickback Statute, the federal False Claims Act and similar state laws, each as amended. Failure to comply with such requirements could potentially result in substantial penalties to us. Even if we structure our programs with the intent of compliance with such laws, there can be no certainty that we would not need to defend against enforcement or litigation, in light of the fact that there is significant enforcement interest in pharmaceutical companies in the United States, and some of the applicable laws are quite broad in scope.

The federal Anti-Kickback Statute prohibits any person or entity, including a prescription drug manufacturer (or a party acting on its behalf), from knowingly and willfully soliciting, receiving, offering or providing remuneration, directly or indirectly, to induce or reward either the referral of business, or the furnishing, recommending, or arranging for the purchase, lease or order of a good, facility, item or service, for which payment may be made under a federal healthcare program, such as the Medicare or Medicaid program. This statute has been interpreted broadly to apply to arrangements between pharmaceutical manufacturers on the one hand and prescribers, purchasers, and formulary managers, among others, on the other. The term “remuneration” has been broadly interpreted to include anything of value, including for example, gifts, discounts, the furnishing of supplies or equipment, credit arrangements, payments of cash, waivers of payments, ownership interests and providing anything at less than its fair market value.

Federal false claims and false statements laws, including the federal False Claims Act, prohibit, among other things, any person or entity from knowingly presenting, or causing to be presented, a false or fraudulent claim for items or services, including drugs, for payment to, or approval by, a federal healthcare program, including Medicare or Medicaid. The qui tam provisions of the federal False Claims Act allow a private individual to bring a civil action on behalf of the federal government alleging that the defendant has submitted a false claim to the federal government, and to share in any monetary recovery. In recent years, the number of suits brought by private individuals has increased dramatically.

The Health Insurance Portability and Accountability Act of 1996, or HIPAA, created several new federal crimes, including healthcare fraud and false statements relating to healthcare matters. The healthcare fraud statute prohibits knowingly and willfully executing, or attempting to execute, a scheme to defraud any healthcare benefit program, including third-party payers. The false statements statute prohibits knowingly and willfully falsifying,

concealing or covering up a material fact or making any materially false, fictitious or fraudulent statement in connection with the delivery of or payment for healthcare benefits, items or services.

The federal Physician Payments Sunshine Act requires certain manufacturers of drugs, devices, biologics and medical supplies for which payment is available under Medicare, Medicaid or the Children's Health Insurance Program, with specific exceptions, to report annually to CMS information related to payments or other transfers of value made to physicians, as defined by such law, and teaching hospitals, as well as ownership and investment interests held by physicians and their immediate family members.

Also, many states have similar laws and regulations, such as anti-kickback and false claims laws that may be broader in scope and may apply regardless of payer, in addition to items and services reimbursed under Medicaid and other state programs. Additionally, we may be subject to state laws that require pharmaceutical companies to comply with the federal government's and/or pharmaceutical industry's voluntary compliance guidelines, state laws that require drug manufacturers to report information related to payments and other transfers of value to physicians and other healthcare providers or marketing expenditures, as well as state and foreign laws governing the privacy and security of health information, many of which differ from each other in significant ways and often are not preempted by HIPAA.

HIPAA, as amended by the Health Information Technology and Clinical Health Act of 2009, and their respective implementing regulations, impose requirements on certain healthcare providers, health plans, and healthcare clearinghouses, known as covered entities, as well as their business associates that perform services involving the use or disclosure of individually identifiable health information, relating to the privacy, security and transmission of individually identifiable health information.

Where our activities involve foreign government officials, they may also potentially be subject to the Foreign Corrupt Practices Act, which prohibits companies and individuals from engaging in specified activities to obtain or retain business or to influence a person working in an official capacity. Under the FCPA, it is illegal to pay, offer to pay, or authorize the payment of anything of value to any foreign government official, governmental staff members, political party or political candidate in an attempt to obtain or retain business or to otherwise influence a person working in an official capacity. The FCPA also requires public companies to make and keep books and records that accurately and fairly reflect the transactions of the corporation and to devise and maintain an adequate system of internal accounting controls.

If we seek to have a product covered in the United States by the Medicaid programs, various obligations, including government price reporting, are required under the Medicaid rebate requirements of the Omnibus Budget Reconciliation Act of 1990 and the Veterans Health Care Act of 1992, each as amended, which generally require products to be offered at substantial rebates/discounts to such programs and certain purchasers. In order to distribute products commercially, we must comply with state laws that require the registration of manufacturers and wholesale distributors of pharmaceutical products in a state, including, in certain states, manufacturers and distributors who ship products into the state even if such manufacturers or distributors have no place of business within the state. Some states also impose requirements on manufacturers and distributors to establish the pedigree of product in the chain of distribution, including some states that require manufacturers and others to adopt new technology capable of tracking and tracing product as it moves through the distribution chain. Many of our current as well as possible future activities are potentially subject to federal and state consumer protection and unfair competition laws. We must also comply with laws that require clinical trial registration and reporting of clinical trial results on the publicly available clinical trial databank maintained by the National Institutes of Health at [www.ClinicalTrials.gov](http://www.ClinicalTrials.gov). We are subject to various environmental, health and safety regulations, including those governing laboratory procedures and the handling, use, storage, treatment and disposal of hazardous substances. From time to time, and in the future, our operations may involve the use of hazardous materials.

To the extent that any of our products are sold in a foreign country, we may be subject to similar foreign laws and regulations, which may include, for instance, applicable post-marketing requirements, including safety surveillance, anti-fraud and abuse laws, and implementation of corporate compliance programs and reporting of payments or transfers of value to healthcare professionals.

### ***U.S. Marketing Exclusivity***

***Hatch-Waxman Exclusivity.*** Market exclusivity provisions under the FDCA can delay the submission or approval of certain applications of other companies seeking to reference another company's NDA. If the new drug is a new chemical entity subject to an NDA, the FDCA provides a five-year period of non-patent marketing exclusivity within the United States to the first applicant to obtain approval of an NDA for a new chemical entity. A drug is a new chemical entity if the FDA has not previously approved any other new drug containing the same active moiety, which is the molecule or ion responsible for the action of the drug substance. During the exclusivity period, the FDA may not accept for review an abbreviated new drug application, or ANDA, or a Section 505(b)(2) NDA submitted by another company for another version of such drug where the applicant does not own or have a legal right of reference to all the data required for approval. However, such an application may be submitted after four years if it contains a certification of patent invalidity or non-infringement to one of the patents listed with the FDA by the innovator NDA holder. The FDCA also provides three years of marketing exclusivity for an NDA, or supplement to an existing NDA if new clinical investigations, other than bioavailability studies, that were conducted or sponsored by the applicant are deemed by the FDA to be essential to the approval of the application, for example new indications, dosages or strengths of an existing drug. This three-year exclusivity covers only the conditions associated with the new clinical investigations and does not prohibit the FDA from approving ANDAs for drugs containing the original active agent. Five-year and three-year exclusivity will not delay the submission or approval of a full NDA. However, an applicant submitting a full NDA would be required to conduct or obtain a right of reference to all of the preclinical studies and adequate and well-controlled clinical trials necessary to demonstrate safety and effectiveness.

### ***Rest of World Government Regulation***

In addition to regulations in the United States, we will be subject to a variety of regulations in other jurisdictions governing, among other things, clinical trials and any commercial sales and distribution of our future products.

Whether or not we obtain FDA approval for a product, we must obtain the requisite approvals from regulatory authorities in foreign countries prior to the commencement of clinical trials or marketing of the product in those countries. Certain countries outside of the United States have a similar process that requires the submission of a clinical trial application much like the IND prior to the commencement of human clinical trials.

If we fail to comply with applicable foreign regulatory requirements, we may be subject to, among other things, fines, suspension or withdrawal of regulatory approvals, product recalls, seizure of products, operating restrictions and criminal prosecution.

### **Employees**

As of December 31, 2019, we had 288 full-time employees. None of our employees is represented by labor unions or covered by collective bargaining agreements. We consider our relationship with our employees to be good.

### **Research and Development**

We invested \$69.6 million, \$53.1 million, and \$51.2 million in research and development in the years ended December 31, 2019, 2018 and 2017, respectively.

### **Corporate and Other Information**

We were incorporated in Delaware in November 2007. Our principal executive offices are located at 10 Mall Road, Suite 301, Burlington, Massachusetts 01803, and our telephone number is (781) 305-7777. Our corporate website address is [www.flexiontherapeutics.com](http://www.flexiontherapeutics.com). Information contained on or accessible through our website is not a part of this Annual Report, and the inclusion of our website address in this Annual Report is an inactive textual reference only. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Exchange Act are available free of

charge on our website as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. We also regularly post copies of our press releases as well as copies of presentations and other updates about our business on our website at [www.flexiontherapeutics.com](http://www.flexiontherapeutics.com). Information contained in our website does not constitute a part of this Annual Report or our other filings with the SEC. The SEC maintains an internet site that contains our public filings with the SEC and other information regarding our company, at [www.sec.gov](http://www.sec.gov).

This Annual Report contains references to our trademarks and to trademarks belonging to other entities. Solely for convenience, trademarks and trade names referred to in this Form 10-K, including logos, artwork and other visual displays, may appear without the ® or TM symbols, but such references are not intended to indicate, in any way, that their respective owners will not assert, to the fullest extent under applicable law, their rights thereto. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any other companies.

## **ITEM 1A. RISK FACTORS**

*You should consider carefully the risks described below, together with the other information contained in this Annual Report on Form 10-K and other documents we file with the Securities and Exchange Commission. The risks and uncertainties below are those identified by us as material, but there are also additional risks and uncertainties that we are unaware of that may become important factors that affect us. If any of the following risks actually occurs, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected, and the market price of our common stock would likely decline.*

### **Risks Related to Our Financial Condition and Need for Additional Capital**

*We have incurred significant losses since our inception and anticipate that we will continue to incur significant losses over the next few years.*

We have a limited operating history. To date, we have focused primarily on developing our commercialized product, ZILRETTA. Any additional product candidates we develop will require substantial development time and resources before we would be able to apply for or receive regulatory approvals and begin generating revenue from product sales. We have incurred significant net losses in each year since our inception, including net losses of \$149.8 million, \$169.7 million, and \$137.5 million for fiscal years 2019, 2018, and 2017, respectively. As of December 31, 2019, we had an accumulated deficit of \$668.6 million. We expect to incur net losses over the next few years as we continue to invest in the commercialization of ZILRETTA and advance our development programs.

We have devoted most of our financial resources to product development and commercialization. To date, we have financed our operations exclusively through the sale of equity securities and debt. The size of our future net losses will depend, in part, on the rate of future expenditures and our ability to generate revenue. The U.S. Food and Drug Administration, or FDA, granted marketing approval and we launched commercial sales of ZILRETTA in the fourth quarter of 2017. We have a limited history of commercializing ZILRETTA and cannot guarantee that our commercialization efforts will result in product revenues that meet our peak sales expectations or those of analysts and investors.

We also expect to continue to incur substantial and increased expenses as we invest in the commercialization of ZILRETTA, scale up commercial manufacturing of ZILRETTA, conduct additional clinical trials for this product and continue our development activities with respect to our pipeline product candidates. As a result of the foregoing, we expect to continue to incur significant losses and negative cash flows over the next few years.

***Our revenues may not be sufficient to cover our future expenses and we may never be profitable.***

Our ability to generate significant revenue and achieve profitability depends primarily on our ability to successfully commercialize ZILRETTA, as well as our ability to obtain regulatory approval for and then successfully commercialize other product candidates. We may never succeed in these activities and may never generate revenues that are significant enough to achieve profitability.

Because of the numerous risks and uncertainties associated with new pharmaceutical products and development efforts, we are unable to predict the timing or amount of increased expenses, when, or if, we will begin to generate revenue from product sales sufficient to cover our operating expenses or when, or if, we will be able to achieve or maintain profitability. In addition, our expenses could increase beyond expectations if we determine that additional sales and marketing personnel or other resources are necessary to successfully commercialize ZILRETTA or if we face any legal or regulatory action related to the commercialization of ZILRETTA.

If we are unable to generate sufficient revenues from product sales, particularly from sales of ZILRETTA, or to maintain an acceptable cost structure related to our operations, we may not become profitable and may need to obtain additional funding to continue operations.

***If we fail to obtain additional financing, we may be forced to delay, reduce or eliminate our product development programs and/or commercialization activities.***

Developing and commercializing pharmaceutical products, including conducting preclinical studies and clinical trials, and building and maintaining sales and marketing capabilities, is expensive. We expect our expenses to increase in connection with our ongoing activities, particularly as we expand our sales and marketing activities, continue to commercialize ZILRETTA and advance our clinical programs.

As of December 31, 2019, we had cash, cash equivalents and marketable securities of approximately \$136.7 million and working capital of \$159.5 million. Based upon our current operating plan, we believe that our existing cash, cash equivalents, and marketable securities will enable us to fund our operating expenses and capital requirements for at least the next 12 months from the issuance date of the financial statements included in this report. Regardless of our expectations as to how long our cash, cash equivalents, and marketable securities will fund our operations, changing circumstances may cause us to consume capital more rapidly than we currently anticipate.

Attempting to secure additional financing may divert our management from our day-to-day activities, which may adversely affect our ability to develop and commercialize our product candidates. In addition, we cannot guarantee that future financing will be available in sufficient amounts or on terms acceptable to us, if at all. If we are unable to raise additional capital when required or on acceptable terms, we may be required to:

- significantly scale back or discontinue commercialization of ZILRETTA or the further development of ZILRETTA or our product candidates;
- seek corporate partners for our product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available;
- seek corporate partners to assist in the commercialization of ZILRETTA on terms that are less favorable than might otherwise be available;
- relinquish or license on unfavorable terms, our rights to ZILRETTA or product candidates that we otherwise would seek to develop or commercialize ourselves; or
- significantly curtail, or cease, operations.

***We may sell additional equity or debt securities to fund our operations, which may result in dilution to our stockholders and impose restrictions on our business.***

In order to raise additional funds to support our operations, we may sell additional equity or debt securities, which could adversely impact our existing stockholders as well as our business. The sale of additional equity or convertible debt securities would result in the issuance of additional shares of our capital stock and dilution to all of our stockholders. The incurrence of indebtedness would result in increased fixed payment obligations and could also result in certain restrictive covenants, such as limitations on our ability to incur additional debt, limitations on our ability to acquire, sell or license intellectual property rights and other operating restrictions that could adversely impact our ability to conduct our business.

***Our existing indebtedness contains restrictions that limit our flexibility in operating our business. In addition, we may be required to make a prepayment or repay our outstanding indebtedness earlier than we expect, which could have a materially adverse effect on our business, or may otherwise be unable to repay our indebtedness as it becomes due.***

On August 2, 2019, we entered into the Amended and Restated Credit and Security Agreement with Silicon Valley Bank, MidCap Financial Trust, and Flexpoint MCLS Holdings, LLC which provides for a term loan of \$40.0 million and a revolving credit facility up to \$20.0 million. We concurrently drew down the \$40.0 million term loan and used \$7.7 million of the proceeds to repay the remaining amount owed on our prior credit facility. In February 2020, we drew down \$20.0 million from the revolving credit facility. The Amended and Restated Credit and Security Agreement contains various covenants that limit our ability to engage in specified types of transactions. These covenants limit our ability to, among other things:

- incur or assume certain debt;
- merge or consolidate or acquire all or substantially all of the capital stock or property of another entity;
- enter into any transaction or series of related transactions that would be deemed to result in a change in control of us under the terms of the agreement;
- change the nature of our business;
- change our organizational structure or type;
- amend, modify or waive any of our organizational documents;
- license, transfer or dispose of certain assets;
- grant certain types of liens on our assets;
- make certain investments;
- pay cash dividends;
- enter into material transactions with affiliates; and
- amend or waive provisions of material agreements in certain manners.

The Amended and Restated Credit and Security Agreement also contains a minimum revenue covenant that only applies if our liquidity (defined as cash and cash equivalents held with Silicon Valley Bank) falls below \$80.0 million. If the revenue covenant becomes applicable to us and we fail to meet it, the commitments under the Amended and Restated Credit and Security Agreement could be terminated and any outstanding borrowings, together with accrued interest, under the Amended and Restated Credit and Security Agreement could be declared immediately due and payable. The restrictive covenants in the Amended and Restated Credit and Security Agreement could prevent us from pursuing business opportunities that we or our stockholders may consider beneficial. The revenue covenant is set annually and is based on the greater of a conservative percentage of that year's approved forecast and modest growth over the trailing twelve months of actual sales.

A breach of any of these covenants could result in an event of default under the Amended and Restated Credit and Security Agreement. An event of default will also occur if, among other things, a material adverse change in our business, operations or condition occurs, which could potentially include a material impairment of the prospect of our repayment of any portion of the amounts we owe under the Amended and Restated Credit and Security Agreement occurs. In the case of a continuing event of default under the Amended and Restated Credit and Security



Agreement, the lenders could elect to declare all amounts outstanding to be immediately due and payable, proceed against the collateral in which we granted the lenders a security interest under the Amended and Restated Credit and Security Agreement, or otherwise exercise the rights of a secured creditor. Amounts outstanding under the Amended and Restated Credit and Security Agreement are secured by all of our existing and future assets, excluding intellectual property, which is subject to a negative pledge arrangement.

In April 2017, we also issued \$201.3 million principal amount of our 3.375% Convertible Senior Notes due 2024, or the 2024 Convertible Notes. The 2024 Convertible Notes will mature on May 1, 2024, unless earlier redeemed, repurchased or converted in accordance with the terms of the indenture governing the notes. If specified bankruptcy, insolvency or reorganization-related events of default occur, or if certain other events of default occur and the trustee or certain holders of the 2024 Convertible Notes elect, the principal of, and accrued and unpaid interest on, all of the then-outstanding 2024 Convertible Notes will automatically become due and payable. In addition, if we undergo certain fundamental change transactions specified in the indenture governing the 2024 Convertible Notes, the holders of the notes may require us to repurchase their notes at a price equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest.

We may not have enough available cash or be able to raise additional funds on satisfactory terms, if at all, through equity or debt financings to repay or refinance our indebtedness at the time any such repayment or repurchase is required. In such an event, we may be required to delay, limit, reduce or terminate our product development or commercialization efforts or grant to others rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves. Our business, financial condition and results of operations could be materially adversely affected as a result.

#### **Risks Related to Commercialization Activities**

***Our prospects are highly dependent on the successful commercialization of ZILRETTA. To the extent ZILRETTA is not commercially successful, our business, financial condition and results of operations may be materially adversely affected.***

ZILRETTA is our only drug that has been approved for sale and it has only been approved for the management of OA pain of the knee for patients in the United States. We are focusing a significant portion of our activities and resources on ZILRETTA, and we believe our prospects are highly dependent on, and a significant portion of the value of our company relates to, our ability to successfully commercialize ZILRETTA in the United States.

Successful commercialization of ZILRETTA is subject to many risks. We have never, as an organization, commercialized a product prior to ZILRETTA, and there is no guarantee that we will be able to do so successfully with ZILRETTA for its approved indication. There are numerous examples of failures to meet expectations of market potential, including by pharmaceutical companies with more experience and resources than us.

Market acceptance of ZILRETTA and any other product for which we receive approval, will depend on a number of factors, including:

- the efficacy and safety as demonstrated in clinical trials;
- the ability to demonstrate the impact of real world evidence;
- the timing and market introduction of competitive products;
- the clinical indications for which the product is approved;
- acceptance by physicians, the medical community and patients of the product as a safe and effective treatment;
- the ability to distinguish safety and efficacy from existing, less expensive generic alternative therapies;
- the convenience of prescribing, administering and initiating patients on the product;
- the potential and perceived advantages and/or value of the product over alternative treatments;
- the cost of treatment in relation to alternative treatments, including any similar generic treatments;

- the availability of coverage and adequate reimbursement by third-party payers and government authorities to support ZILRETTA's pricing;
- the prevalence and severity of adverse side effects; and
- the effectiveness of sales and marketing efforts.

With respect to ZILRETTA, while we have established our commercial team and sales force, there are many factors that could cause the commercialization of ZILRETTA to be unsuccessful, including a number of factors that are outside our control. The commercial success of ZILRETTA depends on the extent to which patients and physicians accept and adopt ZILRETTA as a treatment for OA pain of the knee, and we do not know whether our or others' revenue estimates in this regard will be accurate. For example, if the patient population suffering from OA pain of the knee is smaller than we estimate or if physicians are unwilling to prescribe or patients are unwilling to use ZILRETTA, the commercial potential of ZILRETTA will be limited. In addition, if ZILRETTA is not convenient for physicians to use, then it may not achieve widespread adoption, regardless of its efficacy and safety. For example, ZILRETTA is a buy-and-bill product and must be administered only by a health care professional in an office, clinic or hospital setting. In addition, ZILRETTA requires a multi-step preparation process, which may discourage some physicians from using ZILRETTA. Moreover, ZILRETTA's product label indicates that the efficacy and safety of repeat administration have not been demonstrated, and we believe this may impact our commercialization efforts. While we successfully completed a Phase 3b repeat dose study of ZILRETTA and our sNDA was approved and the product label was modified the FDA did not agree to remove the limitation of use with respect to repeat administration. We also do not know how physicians, patients and payers will respond to the pricing of ZILRETTA in the long-term. In the second half of 2019, we introduced a volume-based rebate program to eligible purchasers and healthcare providers of ZILRETTA that positively impacted sales and we intend to continue to use rebate and discount programs in the future. We are unable to predict how these rebate programs could potentially affect buying patterns and net sales in future quarters.

If we experience any disruption in the commercial supply of ZILRETTA due to manufacturing or distribution issues, the disruption would impact ZILRETTA sales and may adversely affect physicians', patients' and payers' assessment of ZILRETTA, negatively impacting uptake and long-term commercialization efforts.

Physicians may not prescribe ZILRETTA and patients may be unwilling to use ZILRETTA if coverage is not provided or reimbursement is inadequate to cover a significant portion of the cost. Additionally, any negative development for ZILRETTA in terms of label updates or clinical development in additional indications, may adversely impact the commercial results and potential of ZILRETTA. Thus, significant uncertainty remains regarding the commercial potential of ZILRETTA.

If the commercialization of ZILRETTA is unsuccessful or perceived as disappointing, our stock price could decline significantly, and the long-term success of the product and our company could be harmed.

***If we are unable to differentiate ZILRETTA from existing generic therapies for the treatment of OA, or if the FDA or other applicable regulatory authorities approve generic products that compete with ZILRETTA, our ability to successfully commercialize ZILRETTA would be adversely affected.***

Immediate-release TA and other injectable immediate-release steroids, which are the current intra-articular, or IA, standard of care for OA pain, are available in generic form and are therefore relatively inexpensive compared to the pricing for ZILRETTA. These generic steroids also have well-established market positions and familiarity with physicians, healthcare payers and patients. Although we believe the proven and extended pain relief evidenced in our clinical trials demonstrate that ZILRETTA represents a clinically meaningful and highly efficacious option for patients and physicians, it is possible that we will receive data from additional clinical trials or in a post-marketing setting from physician and patient experiences with the commercial product that does not continue to support such interpretations. It is also possible that the FDA, physicians and healthcare payers will not agree with our interpretation of our existing and future clinical trial data. If we are unable to demonstrate the value of ZILRETTA based on our clinical data, patient experience, as well as real world evidence, our opportunity for ZILRETTA to maintain premium pricing and be commercialized successfully would be adversely affected. For example, although ZILRETTA showed numeric improvements through week 12 in validated, OA specific pain, stiffness, function and quality of life exploratory measures and showed numeric improvements in average daily pain, it did not achieve

statistical significance at the week 12 ADP timepoint compared to immediate-release TA. As a result, it is possible that healthcare payers will not agree with our assessment that ZILRETTA's proven pain relief supports premium pricing.

In addition to existing generic steroids, such as immediate-release TA, the FDA or other applicable regulatory authorities may approve other generic products that could compete with ZILRETTA, if we cannot adequately protect it with our patent portfolio. Once an NDA, including a Section 505(b)(2) application, is approved, the product covered thereby becomes a "listed drug" which can, in turn, be cited by potential competitors in support of approval of an abbreviated new drug application, or ANDA. The FDCA, FDA regulations and other applicable regulations and policies provide incentives to manufacturers to create modified, non-infringing versions of a drug to facilitate the approval of an ANDA or other application for generic substitutes. These manufacturers might only be required to conduct a relatively inexpensive study to show that their product has the same active ingredient(s), dosage form, strength, route of administration, conditions of use, or labeling as our product candidate and that the generic product is bioequivalent to ours, meaning it is absorbed in the body at the same rate and to the same extent as ZILRETTA. These generic equivalents, which must meet the same quality standards as branded pharmaceuticals, would be significantly less costly than ours to bring to market and companies that produce generic equivalents are generally able to offer their products at lower prices. Thus, after the introduction of a generic competitor, a significant percentage of the sales of any branded product is typically lost to the generic product. Accordingly, competition from generic equivalents to our products would materially adversely impact our ability to successfully commercialize ZILRETTA.

***We face significant competition from other biopharmaceutical companies, and our operating results will suffer if we fail to compete effectively.***

The biopharmaceutical industries are intensely competitive and subject to rapid and significant technological change. In addition, the competition in the pain and OA market is intense. We have competitors both in the United States and internationally, including major multinational pharmaceutical and biotechnology companies. For example, the injectable OA treatment market today includes many injectable immediate-release steroids, including TA, the active ingredient in ZILRETTA, as well as hyaluronic acid, or HA, injections. In addition, we expect that injectable therapies, such as ZILRETTA, will continue to be used primarily after oral medications no longer provide adequate pain relief. To the extent that new or improved oral or other systemically administered pain medications are introduced that demonstrate better long-term efficacy and safety, patients and physicians may further delay the introduction of injectable therapies, such as ZILRETTA in the OA treatment continuum. ZILRETTA could also face competition from other formulations or devices that deliver pain medication on an extended basis, such as transdermal delivery systems or implantable devices.

Many of our competitors have substantially greater financial, technical and other resources, such as larger research and development staffs and experienced commercial and manufacturing organizations. Mergers and acquisitions in the biotechnology and pharmaceutical industries may result in even more resources being concentrated in our competitors. As a result, these companies may obtain regulatory approval more rapidly than we are able and may be more effective in selling and marketing their products as well. Smaller or early-stage companies may also prove to be significant competitors, particularly through collaborative arrangements with large, established companies. Competition may increase further as a result of advances in the commercial applicability of technologies and greater availability of capital for investment in these industries. Our competitors may succeed in developing, acquiring or licensing on an exclusive basis drug products or drug delivery technologies that are more effective or less costly than ZILRETTA or any other product candidate that we are currently developing or that we may develop.

We believe that our ability to successfully compete will depend on, among other things:

- the efficacy and safety of ZILRETTA and our other product candidates, including relative to marketed products and product candidates in development by third parties;
- the ability to distinguish safety and efficacy from existing, less expensive generic alternative therapies;
- the time it takes for our product candidates to complete clinical development and receive marketing approval;
- the ability to maintain a good relationship with regulatory authorities;

- the ability to commercialize and market ZILRETTA and any of our other product candidates that receive regulatory approval;
- the price of ZILRETTA and any of our future products, including in comparison to branded or generic competitors;
- whether coverage and adequate levels of reimbursement are available under private and governmental health insurance plans, including Medicare;
- the ability to protect our intellectual property rights;
- the ability to manufacture on a cost-effective basis and sell commercial quantities of ZILRETTA and any of our other product candidates that receive regulatory approval; and
- acceptance of ZILRETTA and any of our other product candidates that receive regulatory approval by patients, physicians and other healthcare providers.

If our competitors market products that are more effective, safer, less expensive or offer discounts that allow physicians to receive more net reimbursement than ZILRETTA, we may not achieve commercial success. In addition, the biopharmaceutical industry is characterized by rapid technological change. Because we have limited research and development capabilities, it may be difficult for us to stay abreast of the rapid changes in each technology. If we fail to stay at the forefront of technological change, we may be unable to compete effectively. Technological advances or products developed by our competitors may render our products or product candidates obsolete, less competitive or not economical.

***If we are unable to maintain sales and marketing capabilities or enter into agreements with third parties to market, distribute and sell our product candidates, we may be unable to generate adequate revenue.***

Our strategy is to commercialize ZILRETTA in the United States with a targeted sales and marketing organization. While we have established our commercial team and our sales force, we do not have prior experience commercializing pharmaceutical products as an organization. In order to successfully market ZILRETTA, we must continue to build and maintain our sales, marketing, managerial, compliance and related capabilities or make arrangements with third parties to perform these services. These efforts will continue to be expensive and time-consuming, and we will be competing with other pharmaceutical and biotechnology companies to recruit, hire, train and retain marketing and sales personnel. If we are unable to maintain adequate sales, marketing and distribution capabilities, whether independently or with third parties, we may not generate significant revenue from ZILRETTA.

Additionally, our strategy in the United States includes distributing ZILRETTA through a limited network of third-party specialty distributors, a specialty pharmacy, group purchasing organizations and other third parties. While we have entered into these agreements to purchase and/or distribute ZILRETTA in the United States, the counterparties may not perform as agreed or they may terminate their agreements with us. For example, ZILRETTA sales are concentrated with two specialty distributors, which together represented approximately 68% and 81% of our sales for the years ended December 31, 2019 and 2018, respectively. Loss of either specialty distributor through contract termination or its failure to distribute effectively would adversely affect ZILRETTA's distribution. While we have entered into these agreements on commercially reasonable terms, there is no guarantee that we will be able to continue to do so, if at all.

To date, we have not entered into any strategic collaborations for ZILRETTA or any of our other product candidates. We face significant competition in seeking appropriate strategic partners, and these strategic collaborations can be intricate and time consuming to negotiate and finalize. We may not be able to negotiate strategic collaborations for territories outside of the United States on acceptable terms, or at all. We are unable to predict when, if ever, we will enter into any strategic collaboration outside of the United States because of the numerous risks and uncertainties associated with establishing strategic collaborations. To the extent that we enter into strategic collaborations, our future collaborators may not dedicate sufficient resources to the commercialization of our product candidates or may otherwise fail in their commercialization due to factors beyond our control. If we are unable to establish effective collaborations to enable the sale of ZILRETTA or our other product candidates in territories outside of the United States, or if our potential future collaborators do not successfully commercialize our product candidates in these territories, our ability to generate revenue from product sales will be adversely affected.

We and any future collaborators that we may engage will be competing with many companies that currently have extensive and well-funded marketing and sales operations. If we, alone or with commercialization partners, are unable to compete successfully against these established companies, the commercial success of ZILRETTA or any other approved products will be limited. In addition, if we are unable to effectively develop and maintain our commercial team, including our U.S. sales force, or maintain and, if needed, expand, our customer base, including specialty distributors, specialty pharmacies, group purchasing organizations and other direct customers, our ability to effectively commercialize ZILRETTA and generate product revenues would be limited.

***Customer buying patterns and other factors may cause our quarterly results to fluctuate, and these fluctuations may adversely affect our short-term results.***

Our results of operations, including, in particular, product revenues, may vary from period to period due to a variety of factors, including the buying patterns of our specialty distributors, specialty pharmacy, group purchasing organizations, and other direct purchasers, which vary from quarter to quarter, and may be impacted by seasonality (such as in the first quarter of the year when patient deductibles tend to be reset). In the event these customers with whom we do business limit their purchases of ZILRETTA, sales of ZILRETTA could be adversely affected. For example, in advance of an anticipated price increase or a reduction in expected rebates or discounts, customers may order ZILRETTA in larger than normal quantities which could cause sales of ZILRETTA to be lower in subsequent quarters than they would have been otherwise. Further, any changes in purchasing patterns, inventory levels, increases in returns of ZILRETTA, delays in purchasing products or delays in payment for products by our customers could also have a negative impact on our revenue and results of operations.

***If we are unable to effectively train and equip our sales force, our ability to successfully commercialize ZILRETTA will be harmed.***

We are required to expend significant time and resources to train our sales force to be credible, persuasive and compliant with applicable laws in marketing ZILRETTA for the treatment of patients with OA of the knee. In addition, we must train our sales force to ensure that an appropriate and compliant message about ZILRETTA is being delivered. If we are unable to maintain an effectively trained sales force and equip them with compliant and effective materials, including medical and sales literature to help them appropriately inform and educate customers regarding the potential benefits and safety of ZILRETTA and its proper administration, our efforts to successfully commercialize ZILRETTA could be put in jeopardy, which would negatively impact our ability to generate product revenues.

***If we are unable to achieve and maintain adequate levels of third-party payer coverage and reimbursement for ZILRETTA, or, if approved, any other product candidates, on reasonable pricing terms, their commercial success may be severely hindered.***

Successful sales of ZILRETTA and any other approved product candidates depend on the availability of coverage and adequate reimbursement from third-party payers, including governmental healthcare programs, such as Medicare and Medicaid, managed care organizations and commercial payers, among others. Patients who are prescribed medicine for the treatment of their conditions generally rely on third-party payers to reimburse all or part of the costs associated with their prescription drugs. Coverage and adequate reimbursement from third-party payers are critical to new product acceptance. Coverage decisions may depend upon clinical and economic standards that disfavor new drug products when more established or lower cost therapeutic alternatives are already available or subsequently become available. The resulting reimbursement payment rates for ZILRETTA and, if approved, our other product candidates, might not be adequate or may require co-payments that patients find unacceptably high.

As of January 1, 2019, we received a product-specific J-Code for ZILRETTA (J-3304), which helped reduce reluctance by physicians to prescribe ZILRETTA based on reimbursement concerns. However, some third-party payers nevertheless may still require documented proof that patients meet certain eligibility criteria in order to be reimbursed for ZILRETTA, for example requiring that a patient first try and fail treatment with an injection of generic corticosteroid. Also, third-party payers may require that pre-approval, or prior-authorization, be obtained from the payer for reimbursement of ZILRETTA, or limit coverage to one injection or a limited number of injections over a set time period. Patients are unlikely to use ZILRETTA and, if approved, any other products,

unless coverage is provided, and reimbursement is adequate to cover a significant portion of the cost of our products. For example, ZILRETTA is sold to physicians on a “buy and bill” basis. Buy and bill products must be purchased by healthcare providers before they can be administered to patients. Healthcare providers subsequently must seek reimbursement for the product from the applicable third-party payer, such as Medicare or a health insurance company. Healthcare providers may be reluctant to administer ZILRETTA because they would have to fund the purchase of the product and then seek reimbursement, because they may consider ZILRETTA reimbursement rates to be lower as compared with other treatments, or because they do not want the additional administrative burden required to obtain reimbursement for the product.

In addition, the market for ZILRETTA and any of our other product candidates may depend significantly on access to third-party payers’ medical policies, drug formularies, or lists of medications for which third-party payers provide coverage and reimbursement, as well as inclusion of ZILRETTA on the reimbursement policies and formularies used by large physician practices and hospitals. The industry competition to be included in such policies or formularies often leads to downward pricing pressures on pharmaceutical companies, and we may be required to offer discounted rates to certain government and other payers to ensure coverage of our drugs. Also, third-party payers, physician practices and hospitals may refuse to include a particular branded drug in their policies or formularies or otherwise restrict patient access to a branded drug when a less costly generic equivalent or other alternative is available, or when the reimbursement landscape is unclear.

Third-party payers, whether governmental or commercial, are developing increasingly sophisticated methods of controlling healthcare costs. The U.S. government, state legislatures and foreign governments have shown significant interest in implementing cost-containment programs, including price controls, restrictions on reimbursement and requirements for substitution of generic products. In addition, in the United States, no uniform policy of coverage and reimbursement for drug products exists among third-party payers. Therefore, coverage and reimbursement for drug products can differ significantly from payer to payer and one payer’s determination to provide coverage for ZILRETTA does not ensure that other payers also will provide coverage. As a result, the coverage determination process is often a time-consuming and costly process that will require us to provide scientific and clinical support for the use of our products to each payer separately, with no assurance that coverage and adequate reimbursement will be obtained.

Further, we believe that future coverage and reimbursement will likely be subject to increased restrictions both in the United States and in international markets. Third-party coverage and reimbursement for ZILRETTA or, if approved, any of our other product candidates, may not be available or adequate in either the United States or international markets, or may be more limited than the indications for which the drug is approved by the FDA or comparable foreign regulatory authorities. Moreover, eligibility for coverage and reimbursement does not imply that a drug will be paid for in all cases or at a rate that covers our costs, including research, development, manufacture, sales and distribution costs. If coverage and reimbursement are not available or only available at limited levels, we may not be able to successfully commercialize any product candidate for which we obtain marketing approval, including ZILRETTA, which could have a material adverse effect on our business, results of operations, financial condition and prospects.

***Guidelines and recommendations published by various organizations can reduce the use of ZILRETTA and any other products we may commercialize.***

Government agencies promulgate regulations and guidelines directly applicable to us and to our products and product candidates. In addition, professional societies, such as the American Academy of Orthopedic Surgeons, practice management groups, private health and science foundations and organizations involved in various diseases from time to time may also publish guidelines or recommendations to the healthcare and patient communities with respect to specific products. Recommendations of government agencies or these other groups or organizations may relate to such matters as usage, dosage, route of administration and use of concomitant therapies. Recommendations or guidelines that do not recognize ZILRETTA or our other product candidates, suggest limitations or inadequacies of ZILRETTA or our other product candidates, or suggest the use of competitive or alternative products as the standard of care to be followed by patients and healthcare providers, could result in decreased use or adoption of ZILRETTA or any future products.

***ZILRETTA is available to a much larger number of patients and in broader populations through our commercialization efforts as compared to the patients in the clinical studies. We do not know whether the results of ZILRETTA's use in such larger number of patients and broader populations will be consistent with the results from our clinical studies.***

While the FDA granted approval of ZILRETTA based on the data included in the NDA, including data from our completed pivotal Phase 3 clinical trial, we do not know whether the results that served as the basis for the FDA's approval of ZILRETTA will be consistent with commercial results as a large number of patients and broader populations are exposed to ZILRETTA and are exposed over longer periods of time, including results related to safety and efficacy. New data relating to ZILRETTA, including from adverse event reports or our ongoing studies of ZILRETTA in other indications, may result in additional changes to the product label and may adversely affect sales, or result in withdrawal of ZILRETTA from the market. The FDA and regulatory authorities in other jurisdictions may also consider any new data in connection with further marketing approval applications. If ZILRETTA or any additional approved products cause serious or unexpected side effects after receiving market approval, a number of potentially significant negative consequences could result, including:

- regulatory authorities may withdraw their approval of the product or impose restrictions on its distribution in the form of a Risk Evaluation and Mitigation Strategy;
- regulatory authorities may require the addition of labeling statements, such as warnings or contraindications;
- we may be required to change the way the product is promoted or administered or conduct additional clinical studies;
- we could be sued and held liable for harm caused to patients; or
- our reputation may suffer.

Any of these events could prevent us from maintaining market acceptance of the affected product and could substantially increase the costs of commercializing ZILRETTA or any additional products.

***Recently enacted and future legislation, including health care reform measures, may increase the difficulty and cost for us to commercialize ZILRETTA and any future products and may affect the prices we may obtain.***

The United States and some foreign jurisdictions are considering, or have enacted, a number of legislative and regulatory proposals to change the healthcare system in ways that could affect our ability to sell ZILRETTA, and if approved for sale, our other potential products, profitably. Among policy makers and third-party payers in the United States and elsewhere, there is significant interest in promoting changes in healthcare systems with the stated goals of containing healthcare costs, improving quality and/or expanding access. In the United States, the pharmaceutical industry has been a particular focus of these efforts and has been, and may continue to be, significantly affected by major legislative, congressional and enforcement initiatives. Moreover, in some foreign jurisdictions, pricing of prescription pharmaceuticals is already subject to government control.

In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, or PPACA, was enacted, which was intended to, among other items, broaden access to health insurance, reduce or constrain the growth of healthcare spending, enhance remedies against fraud and abuse, add transparency requirements for the healthcare and health insurance industries, impose taxes and fees on the health industry and impose additional health policy reforms. Among the PPACA provisions of importance to the pharmaceutical industry are the following:

- an annual, non-deductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents, apportioned among these entities according to their market share in certain government healthcare programs;
- an increase in the rebates a manufacturer must pay under the Medicaid Drug Rebate Program to 23.1% and 13% of the average manufacturer price for branded and generic drugs, respectively;

- a new methodology by which rebates owed by manufacturers under the Medicaid Drug Rebate Program are calculated for drugs that are inhaled, infused, instilled, implanted or injected;
- a new Medicare Part D coverage gap discount program, in which manufacturers must now agree to offer 70% point-of-sale discounts to negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer’s outpatient drugs to be covered under Medicare Part D;
- extension of manufacturers’ Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations;
- expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals and by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level, thereby potentially increasing manufacturers’ Medicaid rebate liability;
- expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;
- new requirements under the federal Open Payments program, created under Section 6002 of PPACA, and its implementing regulations that require manufacturers of drugs, devices, biologics and medical supplies for which payment is available under Medicare, Medicaid or the Children’s Health Insurance Program (with certain exceptions) to report annually to the Centers for Medicare & Medicaid Services, or CMS, information related to “payments or other transfers of value” made or distributed to physicians, as defined by such law, and teaching hospitals, and that applicable manufacturers and applicable group purchasing organizations report annually to CMS ownership and investment interests held by physicians and their immediate family members;
- a requirement to annually report drug samples that manufacturers and distributors provide to physicians;
- expansion of healthcare fraud and abuse laws, including the federal False Claims Act and the federal Anti-Kickback Statute, new government investigative powers, and enhanced penalties for non-compliance;
- an FDA-approval framework for follow-on biologic products;
- a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research; and
- establishment of a Center for Medicare & Medicaid Innovation at CMS to test innovative payment and service delivery models to lower Medicare and Medicaid spending, potentially including prescription drug spending.

There remain legal and political challenges to certain aspects of PPACA. Since January 2017, President Trump has signed two Executive Orders and other directives designed to delay, circumvent, or loosen certain requirements mandated by PPACA. Concurrently, Congress has considered legislation that would repeal or repeal and replace all or part of PPACA. While Congress has not passed comprehensive repeal legislation, several bills affecting the implementation of certain taxes under PPACA have been signed into law. The Tax Cuts and Jobs Act of 2017, or the Tax Act, signed into law on December 22, 2017, includes a provision repealing, effective January 1, 2019, the tax-based shared responsibility payment imposed by PPACA on certain individuals that fail to maintain qualifying health coverage for all of part of a year commonly referred to as the “individual mandate.” In addition, the 2020 federal spending package permanently eliminated, effective January 1, 2020, the PPACA-mandated “Cadillac” tax on high-cost employer-sponsored health coverage and medical device tax and, effective January 1, 2021, also eliminates the health insurer tax. The Bipartisan Budget Act of 2018, among other things, amended PPACA, effective January 1, 2019, to close the coverage gap in most Medicare drug plans, commonly referred to as the “donut hole.” In December 2018, CMS published a new final rule permitting further collections and payments to and from certain PPACA qualified health plans and health insurance issuers under PPACA risk adjustment program in response to the outcome of federal district court litigation regarding the method CMS uses to determine this risk adjustment. On December 14, 2018, a Texas U.S. District Court Judge ruled that PPACA is unconstitutional in its entirety because the “individual mandate” was repealed by Congress as part of the Tax Act. Additionally, on December 18, 2019, the U.S. Court of Appeals for the 5th Circuit upheld the District Court ruling



that the individual mandate was unconstitutional and remanded the case back to the District Court to determine whether the remaining provisions of the PPACA are invalid as well. It is unclear how this decision, future decisions, subsequent appeals, and other efforts to repeal and replace PPACA will impact PPACA and our business.

In addition, since the PPACA was enacted, other legislative changes have been proposed and adopted that may impact the extent to which we are able to successfully commercialize any of our product candidates that receive regulatory approval. For example, in August 2011, then-President Obama signed into law the Budget Control Act of 2011, which, among other things, created the Joint Select Committee on Deficit Reduction to recommend to Congress proposals in spending reductions. The Joint Select Committee on Deficit Reduction did not achieve a targeted deficit reduction, which triggered the legislation's automatic reduction to several government programs. This includes aggregate reductions to Medicare payments to providers of, on average, two percent per fiscal year through 2029 unless Congress takes additional action. The American Taxpayer Relief Act of 2012, among other things, further reduced Medicare payments to several providers, including hospitals and cancer treatment centers, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years.

There has been increasing legislative and enforcement interest in the United States with respect to specialty drug pricing practices, including at the federal level several recent U.S. Congressional inquiries and legislation designed to, among other things, increase drug pricing transparency, reduce the cost of drugs under Medicare, review relationships between pricing and manufacturer patient assistance programs, and reform government program drug reimbursement methodologies. Any reduction in reimbursement from Medicare, Medicaid or other government-funded programs may result in a similar reduction in payments from private payers. The Trump administration's budget proposal for fiscal year 2020 contains further drug price control measures that could be enacted during the 2020 budget process or in other future legislation, including, for example, measures to permit Medicare Part D plans to negotiate the price of certain drugs under Medicare Part B, to allow some states to negotiate drug prices under Medicaid, and to eliminate cost sharing for generic drugs for low-income patients. Further, the Trump administration released a "Blueprint," or plan, to lower drug prices and reduce out of pocket costs of drugs that contains additional proposals to increase drug manufacturer competition, increase the negotiating power of certain federal healthcare programs, incentivize manufacturers to lower the list price of their products, and reduce the out of pocket costs of drug products paid by consumers. The Department of Health and Human Services, or HHS, has solicited feedback on some of these measures and implemented others under its existing authority. For example, in May 2019, CMS issued a final rule to allow Medicare Advantage plans the option to use step therapy for Part B drugs beginning January 1, 2020. This final rule codified CMS's policy change that was effective January 1, 2019. Although a number of these and other measures may require additional authorization to become effective, Congress and the Trump administration have each indicated that it will continue to seek new legislative and/or administrative measures to control drug costs. At the state level, legislatures have increasingly passed legislation and implemented regulations designed to control pharmaceutical and biological product pricing, including price or patient reimbursement constraints, discounts, restrictions on certain product access and marketing cost disclosure and transparency measures, and, in some cases, to encourage importation from other countries and bulk purchasing. The implementation of cost containment measures or other healthcare reforms may prevent us from being able to generate revenue, attain profitability or commercialize ZILRETTA and any future products for which we receive regulatory approval.

We expect that PPACA, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria and lower reimbursement, as well as additional downward pressure on the price that we receive for any approved product, including ZILRETTA.

### **Risks Related to Product Development and Regulatory Compliance**

***We may never obtain regulatory approval of ZILRETTA for repeat administration or additional indications, approval of our other product candidates in the United States, or we may never obtain approval for or commercialize ZILRETTA or our other product candidates outside of the United States, which would limit our ability to realize their full market potential.***

While ZILRETTA has been approved for the management of OA pain of the knee, the approved product label originally contained a limitation of use, or LOU, stating that ZILRETTA is not intended for repeat administration.

On December 26, 2019, the FDA approved our supplemental new drug application, or sNDA, to revise the product label for ZILRETTA. The sNDA was based on data from an open-label Phase 3b clinical trial, which indicated that repeat administration of ZILRETTA for treatment of OA knee pain was safe and well tolerated with no deleterious impact on cartilage or joint structure observed through X-ray analysis. While the LOU was updated from stating ZILRETTA was not intended for repeat administration to stating that the efficacy and safety of repeat administration of ZILRETTA have not been demonstrated, we were not successful in our efforts to remove the LOU entirely. The FDA did not find the data submitted in the sNDA sufficient to approve a removal of the LOU. If we are unable to remove the LOU or expand the label for ZILRETTA, our ability to fully market ZILRETTA may be limited.

While ZILRETTA has been approved by the FDA for the treatment of patients with OA of the knee in the United States, it has not been approved in any other jurisdiction for this indication or for any other indication. In order to market ZILRETTA for other indications or in other jurisdictions, or in order to market any of our other product candidates, we must obtain regulatory approval for each indication and in each applicable jurisdiction, and we may never be able to get such approval for ZILRETTA or our other product candidates. In particular our pipeline product candidates, FX201 and FX301, are at early stages of development and if we cannot complete development of these product candidates and obtain regulatory approvals to market them, we may never recover our investment.

Clinical trials conducted in one country may not be accepted by regulatory authorities in other countries, and regulatory approval in one country does not mean that regulatory approval will be obtained in any other country. Approval processes vary among countries and can involve additional product testing and validation and additional administrative review periods. Seeking foreign regulatory approval could result in difficulties and costs for us and require additional non-clinical studies or clinical trials, which could be costly and time consuming. Regulatory requirements can vary widely from country to country and could delay or prevent the introduction of our potential future products in those countries. Other than ZILRETTA in the United States, we do not have any products approved for sale in any jurisdiction, and we do not have experience in obtaining regulatory approval in international markets. If we do not receive marketing approval for ZILRETTA for any other indication or from any regulatory agency other than the FDA, we will never be able to commercialize ZILRETTA for any other indication in the United States or for any indication in any other jurisdiction. If we fail to comply with regulatory requirements in international markets or to obtain and maintain required approvals for our other product candidates, or if regulatory approval in international markets is delayed, our potential market will be reduced and our ability to realize the full market potential of ZILRETTA or our other product candidates will be harmed. Even if we do receive additional regulatory approvals, we may not be successful in commercializing those opportunities.

***Clinical development is a lengthy and expensive process with an uncertain outcome, and results of earlier studies and trials may not be predictive of future trial results. Clinical failure can occur at any stage of clinical development.***

Clinical testing is expensive and can take many years to complete, and its outcome is inherently uncertain. Failure can occur at any time during the clinical trial process. The results of preclinical studies and early clinical trials of our product candidates may not be predictive of the results of subsequent clinical trials. In particular, the results generated in our completed ZILRETTA pivotal Phase 3 clinical trial do not ensure that any ongoing or future ZILRETTA clinical trial, including our ongoing clinical trials of ZILRETTA in other indications, will be successful or consistent with the results generated in the Phase 3 trial.

Product candidates may fail to show the desired safety and efficacy traits despite having progressed through preclinical studies and initial clinical trials. For example, while FX201 has demonstrated successful results in numerous animal models, it has not been tested in humans yet and we cannot predict if it will behave similarly in our planned first-in human trials as it has in the animal studies. In addition to the safety and efficacy trials of any product candidate, clinical trial failures may result from a multitude of factors including flaws in trial design, dose selection, placebo effect and patient enrollment criteria. A number of companies in the biopharmaceutical industry have suffered significant setbacks in advanced clinical trials due to lack of efficacy or adverse safety profiles, notwithstanding promising results in earlier trials. In addition, data obtained from trials and studies are susceptible to varying interpretations, and regulators may not interpret our data as favorably as we do, which may delay, limit or prevent regulatory approval. In any event, our future clinical trials may not be successful.

If ZILRETTA or any other product candidate is found to be unsafe or lack efficacy or feasibility in particular indications, we will not be able to obtain regulatory approval for the indication and our business could be materially harmed.

***Delays in clinical trials are common and have many causes, and any delay could result in increased costs to us and jeopardize or delay our ability to obtain regulatory approval for our product candidates.***

We may experience delays in clinical trials of our products and product candidates. Our clinical trials may not begin on time, have an effective design, enroll a sufficient number of patients, or be completed on schedule, if at all. Our clinical trials can be delayed for a variety of reasons, including:

- inability to raise funding necessary to initiate or continue a trial;
- delays in obtaining regulatory approval to commence a trial;
- delays in reaching agreement with the FDA on final trial design;
- imposition of a clinical hold for safety reasons or following an inspection of our clinical trial operations or trial sites by the FDA or other regulatory authorities;
- delays in reaching agreement on acceptable terms with prospective contract research organizations, or CROs, and clinical trial sites;
- delays in obtaining required institutional review board approval at each site;
- delays in recruiting suitable patients to participate in a trial;
- delays in having patients complete participation in a trial or return for post-treatment follow-up;
- clinical sites dropping out of a trial to the detriment of enrollment;
- time required to add new clinical sites; or
- delays by our contract manufacturers to produce and deliver sufficient supply of clinical trial materials.

If initiation or completion of our clinical trials are delayed for any of the above reasons or other reasons, our development costs may increase, our approval process could be delayed and our ability to commercialize our product candidates could be materially harmed, which could have a material adverse effect on our business.

***The regulatory approval process of the FDA is lengthy, time consuming and inherently unpredictable, and if we are ultimately unable to obtain regulatory approval for our product candidates or for ZILRETTA in additional indications, our business will be harmed.***

The time required to obtain approval by the FDA and comparable foreign authorities is unpredictable but typically takes many years following the commencement of clinical trials and depends upon numerous factors, including the substantial discretion of the regulatory authorities. In addition, approval policies, regulations, or the type and amount of clinical data necessary to gain approval may change during the course of a product candidate's clinical development and may vary among jurisdictions. Although we received regulatory approval of ZILRETTA for the treatment of OA knee pain, it is possible that none of our other product candidates will ever obtain regulatory approval or that we will not be able to obtain regulatory approval for ZILRETTA in additional indications.

Our product candidates could fail to receive regulatory approval for many reasons, including the following:

- the FDA or comparable foreign regulatory authorities may disagree with the design, scope or implementation of our clinical trials;
- we may be unable to demonstrate to the satisfaction of the FDA or comparable foreign regulatory authorities that a product candidate is safe and effective for its proposed indication;
- the results of clinical trials may not meet the level of statistical significance required by the FDA or comparable foreign regulatory authorities for approval;
- we may be unable to demonstrate that a product candidate's clinical and other benefits outweigh its safety risks;

- the FDA or comparable foreign regulatory authorities may disagree with our interpretation of data from preclinical studies or clinical trials;
- the data collected from clinical trials of our product candidates may not be sufficient to support the submission of an NDA or other submission or to obtain regulatory approval in the United States or elsewhere;
- the FDA or comparable foreign regulatory authorities may fail to approve the manufacturing processes or facilities of third-party manufacturers with which we contract for clinical and commercial supplies; and
- the approval policies or regulations of the FDA or comparable foreign regulatory authorities may change significantly in a manner rendering our clinical data insufficient for approval.

The lengthy approval process, as well as the unpredictability of future clinical trial results, may result in our failing to obtain regulatory approval to market ZILRETTA in additional indications or to market our other product candidates at all, which would harm our business, results of operations and prospects.

In addition, even if we were to obtain approval for other product candidates or for ZILRETTA in other indications, regulatory authorities may approve such product candidates or indications for fewer or more limited indications than we request, may grant approval contingent on the performance of costly post-marketing clinical trials, or may approve a product candidate with a label that does not include the labeling claims necessary or desirable for the successful commercialization of that product candidate. Any of the foregoing scenarios could harm the commercial prospects for our product candidates.

Our product candidates may not receive regulatory approval despite success in clinical trials. Even if we successfully obtain regulatory approval to market one or more of our product candidates, our revenue will be dependent, to a significant extent, upon the size of the markets in the territories for which we gain regulatory approval. If the markets for patients or indications that we are targeting are not as significant as we estimate, we may not generate significant revenue from sales of such products, if approved.

***Changes in funding for the FDA and other government agencies could hinder their ability to hire and retain key leadership and other personnel, prevent new products from being developed or commercialized in a timely manner or otherwise prevent those agencies from performing normal functions on which the operation of our business may rely, which could negatively impact our business.***

The ability of the FDA to review and approve new products can be affected by a variety of factors, including government budget and funding levels, ability to hire and retain key personnel and accept payment of user fees, and statutory, regulatory, and policy changes. Average review times at the agency have fluctuated in recent years as a result. In addition, government funding of other government agencies on which our operations may rely, including those that fund research and development activities is subject to the political process, which is inherently fluid and unpredictable.

Disruptions at the FDA and other agencies may also slow the time necessary for new drugs to be reviewed and/or approved by necessary government agencies or for labeling supplements and other regulatory requests to be acted upon, which would adversely affect our business. For example, over the last several years, including beginning on December 22, 2018 and ending on January 25, 2019, the U.S. government has shut down several times and certain regulatory agencies, such as the FDA, have had to furlough critical government employees and stop critical activities. If repeated or prolonged government shutdowns occur, it could significantly impact the ability of the FDA to timely review and process our regulatory submissions, and negatively impact other government operations on which we rely, which could have a material adverse effect on our business.

***The FDA granted marketing approval of ZILRETTA for the treatment of patients with OA pain of the knee, and we could face liability if a regulatory authority determines that we are promoting ZILRETTA for any off-label uses.***

A company may not promote “off-label” uses for its drug products. An off-label use is the use of a product for an indication that is not described in the product’s FDA-approved label in the United States or for uses in other jurisdictions that differ from those approved by the applicable regulatory agencies. Physicians, on the other hand, may prescribe products for off-label uses. Although the FDA and other regulatory agencies do not regulate a physician’s choice of drug treatment made in the physician’s independent medical judgment, they do restrict promotional communications from pharmaceutical companies or their employees, including sales representatives, with respect to off-label uses of products for which marketing clearance has not been issued. A company that is found to have promoted off-label use of its product may be subject to significant liability, including civil and criminal sanctions. We intend to comply with the requirements and restrictions of the FDA and other regulatory agencies with respect to our promotion of ZILRETTA and any future products, but we cannot be sure that the FDA or other regulatory agencies will agree that we have not violated these restrictions. For example, as part of our promotion strategy for ZILRETTA we communicate certain results from our Phase 3 clinical trial and other clinical data that are consistent with, but not directly included in, the product label. While we believe our communication of this data is in accordance with FDA guidance and applicable laws, we cannot be certain that the FDA or other regulatory agencies will agree with our use of this data or our sales force may use such data in a way that is inconsistent with our policies. As a result, we may be subject to criminal and civil liability. In addition, our management’s attention could be diverted to handle any such alleged violations. A significant number of pharmaceutical companies have been the target of inquiries and investigations by various U.S. federal and state regulatory, investigative, prosecutorial and administrative entities in connection with the promotion of products for unapproved uses and other sales practices, including the Department of Justice and various U.S. Attorneys’ Offices, the Office of Inspector General of HHS, the FDA, the Federal Trade Commission and various state Attorneys General offices. These investigations have alleged violations of various U.S. federal and state laws and regulations, including claims asserting antitrust violations, violations of the Federal Food, Drug, and Cosmetic Act, or the FDCA, the federal False Claims Act, the Prescription Drug Marketing Act, anti-kickback laws, and other alleged violations in connection with the promotion of products for unapproved uses, pricing and Medicare and/or Medicaid reimbursement. If the FDA or any other governmental agency initiates an enforcement action against us or if we are the subject of a qui tam suit and it is determined that we violated prohibitions relating to the promotion of products for unapproved uses, we could be subject to substantial civil or criminal fines or damage awards and other sanctions such as consent decrees and corporate integrity agreements pursuant to which our activities would be subject to ongoing scrutiny and monitoring to ensure compliance with applicable laws and regulations. Any such fines, awards or other sanctions would have an adverse effect on our revenue, business, financial prospects and reputation.

***Any relationships with healthcare professionals, principal investigators, consultants, actual and potential customers, and third-party payers in connection with our current and future business activities are and will continue to be subject, directly or indirectly, to federal and state healthcare laws. If we are unable to comply, or have not fully complied, with such laws, we could face criminal sanctions, civil penalties, administrative penalties, imprisonment, exclusion, contractual damages, reputational harm, diminished profits and future earnings, additional reporting requirements and/or oversight, and curtailment or restructuring of our operations.***

Our operations are directly or indirectly subject to various federal and state healthcare laws, including without limitation, fraud and abuse laws, false claims laws, marketing expenditure tracking and disclosure (or “sunshine”) laws, government price reporting, and health information privacy and security laws. Our potential exposure under such laws increased significantly with the commercialization of ZILRETTA in the United States through our dedicated sales force. Our costs associated with compliance are also likely to increase. These laws may impact, among other things, our current activities with investigators and research subjects, as well as sales, marketing, promotion, manufacturing, distribution, pricing, discounting, customer incentive programs, physician speaker programs, and other business arrangements and activities. In addition, we may be subject to patient privacy regulation by the federal government and by the U.S. states and foreign jurisdictions in which we conduct our business. The laws that may affect our ability to operate include, but are not limited to:

- the federal Anti-Kickback Statute, which prohibits, among other things, individuals and entities from knowingly and willfully soliciting, receiving, offering or paying remuneration, directly or indirectly, in

cash or in kind, to induce or reward, or in return for, either the referral of an individual, or the purchase, lease, order or arranging for the purchase, lease, or order of any good, item or service for which payment may be made under a federal healthcare program, such as the Medicare and Medicaid programs;

- federal civil and criminal false claims laws and civil monetary penalties laws, including the federal False Claims Act, which prohibit, among other things, individuals or entities from knowingly presenting, or causing to be presented, to the federal government claims for payment that are false or fraudulent or making a false statement to avoid, decrease or conceal an obligation to pay money to the federal government;
- the federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, which imposes criminal and civil liability for, among other things, executing a scheme to defraud any healthcare benefit program or making false statements relating to healthcare matters;
- HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act of 2009, and their respective implementing regulations, which impose requirements on certain healthcare providers, health plans, and healthcare clearinghouses, known as covered entities, as well as their business associates that perform services involving the use or disclosure of individually identifiable health information, relating to the privacy, security and transmission of individually identifiable health information;
- the federal Open Payments program, created under Section 6002 of the PPACA, and its implementing regulations, which requires manufacturers of drugs, devices, biologics and medical supplies for which payment is available under Medicare, Medicaid or the Children’s Health Insurance Program (with certain exceptions) to report annually to CMS information related to “payments or other transfers of value” made to physicians (defined to include doctors, dentists, optometrists, podiatrists and chiropractors) and teaching hospitals, and applicable manufacturers and applicable group purchasing organizations to report annually to CMS ownership and investment interests held by physicians (as defined above) and their immediate family members. Beginning in 2022, applicable manufacturers also will be required to report such information regarding payments and transfers of value provided, as well as ownership and investment interests held, during the previous year to physician assistants, nurse practitioners, clinical nurse specialists, certified nurse anesthetists and certified nurse-midwives;
- state, local, and foreign law equivalents of each of the above federal laws and regulations, 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 any third-party payer, including commercial insurers; state and foreign laws that require pharmaceutical companies to comply with the pharmaceutical industry’s voluntary compliance guidelines and the relevant compliance guidance promulgated by the federal government or otherwise restrict payments that may be made to healthcare providers; state and foreign laws that require drug manufacturers to report information related to payments and other transfers of value to healthcare providers and entities, or marketing expenditures; state and local laws requiring the registration of pharmaceutical sales representatives; and state and foreign laws governing the privacy and security of health information in certain circumstances, many of which differ from each other in significant ways and may not have the same effect, and often are not preempted by HIPAA, thus complicating compliance efforts;
- the Foreign Corrupt Practices Act, or FCPA, a U.S. law which regulates certain financial relationships with foreign government officials (which could include, for example, certain medical professionals);
- federal and state consumer protection and unfair competition laws, which broadly regulate marketplace activities and activities that potentially harm consumers;
- state and federal government price reporting laws that require us to calculate and report complex pricing metrics to government programs, where such reported prices may be used in the calculation of reimbursement, rebates and/or discounts on our marketed drugs (participation in these programs and compliance with the applicable requirements may subject us to potentially significant discounts on our products, increased infrastructure costs, and potentially limit our ability to offer certain marketplace discounts); and

- the European Union’s General Data Protection Regulation ((EU) 2016/679), or GDPR, which went into effect in May 2018, and which introduces strict requirements for processing personal data of individuals within the EU.

Efforts to ensure that our business arrangements with third parties will comply with applicable healthcare laws and regulations may involve substantial costs. It is possible that governmental and enforcement authorities will conclude that our business practices, including activities undertaken by third parties on our behalf, may not comply with current or future statutes, regulations or case law interpreting applicable fraud and abuse or other healthcare laws and regulations. For example, we participate in the Medicaid Drug Rebate Program, as administered by CMS, and other federal and state government pricing programs in the United States. These programs generally require us to pay rebates or otherwise provide discounts to government payers in connection with drugs that are dispensed to beneficiaries/recipients of these programs. In some cases, such as with the Medicaid Drug Rebate Program, the rebates are based on pricing that we report on a monthly and quarterly basis to the government agencies that administer the programs. Pricing requirements and rebate/discount calculations are complex, vary among products and programs, and are often subject to interpretation by governmental or regulatory agencies and the courts. Thus, there can be no assurance that we will be able to identify all factors that may cause our discount and rebate payment obligations, including as a result from recent changes to our commercial contracting and pricing strategies, to vary from period to period, and our actual results may differ significantly from our estimated allowances for discounts and rebates. Changes in estimates and assumptions may have a material adverse effect on our business, results of operations and financial condition. In addition, the HHS Office of Inspector General and other Congressional, enforcement and administrative bodies have recently increased their focus on pricing requirements for products, including, but not limited to the methodologies used by manufacturers to calculate average manufacturer price, or AMP, and best price, or BP, for compliance with reporting requirements under the Medicaid Drug Rebate Program. If our operations are found to be in violation of any of the laws described above or any other governmental regulations that apply to us, we may be subject to significant penalties, including, without limitation, civil, criminal, and administrative penalties, damages, fines, disgorgement, imprisonment, possible exclusion from participation in Medicare, Medicaid and other government healthcare programs, contractual damages, reputational harm, diminished profits and future earnings, additional reporting requirements and/or oversight if we become subject to a corporate integrity agreement or similar agreement to resolve allegations of non-compliance with these laws, and curtailment or restructuring of our operations. Moreover, while we do not bill third-party payers directly and our customers make the ultimate decision on how to submit claims, from time-to-time we may provide reimbursement guidance to patients and healthcare providers. If a government authority were to conclude that we provided improper advice and/or encouraged the submission of a false claim for reimbursement, we could face action against us by government authorities. If any of the physicians or other providers or entities with whom we do business is found to be not in compliance with applicable laws, they may be subject to significant criminal, civil or administrative sanctions, including exclusions from government funded healthcare programs and imprisonment. If any of the above occurs, it could adversely affect our ability to operate our business and our results of operations. In addition, the approval and commercialization of any of our product candidates outside of the United States will also likely subject us to foreign equivalents of the healthcare laws mentioned above, among other foreign laws.

***ZILRETTA is still subject to substantial, ongoing regulatory requirements, and our other product candidates may face future development and regulatory difficulties.***

The FDA approved ZILRETTA only for the treatment of OA knee pain. If any other ongoing clinical studies of ZILRETTA are negative, the FDA could decide to withdraw approval, add warnings or narrow the approved indication in the product label.

ZILRETTA is, and, if approved, our other product candidates, will also be, subject to ongoing FDA requirements governing the labeling, packaging, storage, distribution, safety surveillance, advertising, promotion, record-keeping and reporting of safety and other post-market information. The holder of an approved NDA is obligated to monitor and report adverse events, or AEs, and any failure of a product to meet the specifications in the NDA. The holder of an approved NDA must also submit new or supplemental applications and obtain FDA approval for certain changes to the approved product, product labeling or manufacturing process. Advertising and promotional materials must comply with FDA rules and are subject to FDA review, in addition to other potentially applicable federal and state laws.

In addition, manufacturers of drug products and their facilities are subject to payment of user fees and continual review and periodic inspections by the FDA and other regulatory authorities for compliance with current good manufacturing practices, or cGMP, and adherence to commitments made in the NDA. If we or a regulatory agency discover previously unknown problems with a product, such as AEs of unanticipated severity or frequency, or problems with the facility where the product is manufactured, a regulatory agency may impose restrictions relative to that product or the manufacturing facility, including requiring recall or withdrawal of the product from the market or suspension of manufacturing.

We rely on third-party collaborators to assist us in meeting our reporting and related obligations. While we work closely with these third parties, we do not control all of their activities. If our third-party collaborators do not meet the relevant commitments, we may fail to meet our applicable regulatory requirements.

If we fail to comply with applicable regulatory requirements for ZILRETTA or for any other approved product candidate, a regulatory agency may:

- issue a warning letter asserting that we are in violation of the law;
- seek an injunction or impose civil or criminal penalties or monetary fines;
- suspend or withdraw regulatory approval;
- suspend any ongoing clinical trials;
- refuse to approve a pending NDA or supplements to an NDA submitted by us;
- seize product; or
- refuse to allow us to enter into supply contracts, including government contracts.

Any government investigation of alleged violations of law could require us to expend significant time and resources in response and could generate negative publicity. The occurrence of any event or penalty described above may inhibit our ability to commercialize our products and generate revenue.

***If we fail to develop, acquire or in-license other potential future product candidates or products, our business and prospects will be limited.***

Our long-term growth strategy is to develop, acquire or in-license and commercialize a portfolio of potential future product candidates in addition to ZILRETTA. Our primary means of expanding our pipeline of product candidates is to select and acquire or in-license product candidates for the treatment of therapeutic indications that complement or augment our current pipeline, or that otherwise fit into our development or strategic plans on terms that are acceptable to us, and/or develop improved formulations and delivery methods for existing FDA-approved products. Developing new formulations or delivery methods of existing or potential future product candidates or identifying, selecting and acquiring or in-licensing promising product candidates requires substantial technical, financial and human resources expertise. Efforts to do so may not result in the actual development, acquisition or in-license of a particular product candidate, potentially resulting in a diversion of our management's time and the expenditure of our resources with no resulting benefit. If we are unable to add additional product candidates to our pipeline, our long-term business and prospects will be limited.

#### **Risks Related to Our Reliance on Third Parties**

***We rely completely on third parties to manufacture our commercial supplies of ZILRETTA and our preclinical and clinical drug supplies for our other product candidates.***

If we were to experience an unexpected loss of supply of ZILRETTA or our other product candidates for any reason, whether as a result of manufacturing, supply or storage issues or otherwise, we could experience disruptions in commercial supply of ZILRETTA or delays, suspensions or terminations of clinical trials or regulatory submissions. We do not currently have nor do we plan to acquire the infrastructure or capability internally to manufacture our preclinical and clinical drug supplies and we lack the resources and the capability to manufacture any of our product candidates on a clinical or commercial scale. The facilities used by our contract manufacturers or



other third-party manufacturers to manufacture our products and product candidates, including Patheon with respect to finished drug supplies of ZILRETTA, must obtain and maintain approval by the FDA. While we work closely with our third-party manufacturers on the manufacturing process for our products and product candidates, including quality audits, we generally do not control the implementation of the manufacturing process of, and are completely dependent on, our contract manufacturers or other third-party manufacturers for compliance with cGMP regulatory requirements and for manufacture of both active drug substances and finished drug products. If our contract manufacturers or other third-party manufacturers cannot successfully manufacture material that conforms to applicable specifications and the strict regulatory requirements of the FDA or others, they will not be able to secure and/or maintain regulatory approval for their manufacturing facilities.

In addition, we have no control over the ability of our contract manufacturers or other third-party manufacturers to maintain adequate quality control, quality assurance and qualified personnel. If the FDA or a comparable foreign regulatory authority does not approve, or withdraws approval for, these facilities for the manufacture of our products and product candidates, we may need to find alternative manufacturing facilities, which would significantly impact our ability to commercialize, develop, or obtain or maintain regulatory approval for our products and product candidates.

We are particularly reliant on Patheon with respect to maintaining ZILRETTA manufacturing capacity. These Patheon facilities required approval from the FDA as a condition of regulatory approval for ZILRETTA, as we rely exclusively on Patheon for commercial supplies of ZILRETTA. In addition, because Patheon manufactures ZILRETTA in the United Kingdom, or U.K., it needs to maintain and update its facility license with the applicable U.K. regulatory agencies and any delay or inability to do so would delay or prevent Patheon from being able to produce commercial supplies of ZILRETTA. Furthermore, the manufacturing process for ZILRETTA is unique and involves specialized equipment and proprietary processes, which subjects us to heightened risks that Patheon will experience delays in the manufacturing process.

We also rely on our manufacturers to purchase from third-party suppliers the materials necessary to produce ZILRETTA and our other product candidates for our clinical trials and commercial sales. There are a limited number of suppliers for raw materials that we use to manufacture our products and product candidates and we may need to assess alternate suppliers to prevent a possible disruption of the manufacture of the materials necessary to produce our product candidates for our clinical trials and ZILRETTA for commercial sale. We do not have any control over the process or timing of the acquisition of these raw materials by our manufacturers. Moreover, we currently do not have any agreements for the commercial production of these raw materials. Although we generally do not begin a clinical trial unless we believe we have a sufficient supply of a product candidate to complete the clinical trial, any significant delay in the supply of a product candidate, or the raw material components thereof, for an ongoing clinical trial due to the need to replace a contract manufacturer or other third-party manufacturer could considerably delay completion of our clinical trials, product testing and potential regulatory approval of our product candidates. If our manufacturers or we are unable to purchase these raw materials for ZILRETTA or for any other approved products, there would be a shortage in supply, which would impair our ability to generate revenue from the sale of our products, including ZILRETTA.

We expect to continue to depend on contract manufacturers or other third-party manufacturers for the foreseeable future. We have entered into long-term commercial supply agreements with our current contract manufacturers in order to maintain adequate supplies to manufacture finished ZILRETTA drug product. We may, however, be unable to enter into such agreements or do so on commercially reasonable terms for potential future product candidates, which could have a material adverse impact upon our business.

***We rely on certain sole sources of supply for our products and product candidates and any disruption in the chain of supply may disrupt commercialization of ZILRETTA or cause delay in developing, obtaining approval for, and commercializing our products and product candidates.***

Currently, we use the following sole sources of supply for manufacturing ZILRETTA: Farmabios SpA for TA, Evonik Corporation for PLGA, and Patheon for finished microspheres drug product. Because of the unique equipment and process for loading TA onto PLGA microspheres, transferring finished drug product manufacturing activities for ZILRETTA to an alternate supplier would be a time-consuming and costly endeavor, and there are only a limited number of manufacturers that we believe are capable of performing this function for us. Switching

ZILRETTA finished drug suppliers may involve substantial cost and could result in a failure to maintain adequate supplies of ZILRETTA. We expect that for the foreseeable future Patheon will be the only manufacturer qualified as a commercial supplier of ZILRETTA with the FDA. From time to time, commercial batches of ZILRETTA may fail to meet required specifications and be unavailable for commercial sale. If we experience multiple successive batch failures, or if supply from Patheon is otherwise interrupted, there could be a significant disruption in commercial supply. Any alternative vendor would need to be qualified through an NDA supplement, which could result in further delay. The FDA or other regulatory agencies outside of the United States may also require additional studies if a new ZILRETTA supplier is relied upon for commercial production.

These factors could cause the disruption of the commercialization of ZILRETTA; delay clinical trials, regulatory submissions, required approvals or commercialization of any of our other product or product candidates; cause us to incur higher costs; or prevent us from commercializing them successfully. Furthermore, if our suppliers fail to deliver the required clinical or commercial quantities of active pharmaceutical ingredient on a timely basis and at commercially reasonable prices and we are unable to secure one or more replacement suppliers capable of production at a substantially equivalent cost, our clinical trials may be delayed or we could lose potential revenue in the event of a product stockout for ZILRETTA or any of our other product candidates that is approved and launched

Our other product candidates also rely on sole sources of supply for the preclinical and clinical supply of materials. The manufacturing processes for our product candidates are complex, and it may be difficult or impossible to finalize appropriate processes for the scaled manufacture of the product candidates.

***Manufacturing issues may arise that could increase product and regulatory approval costs or disrupt or delay commercialization.***

As we scale up manufacturing of ZILRETTA and other product candidates, we may encounter product, packaging, equipment and process-related issues that may require refinement or resolution in order to proceed with our planned clinical trials or maintain regulatory approval for commercial marketing. In the future, we may identify impurities or other product related issues, which could result in increased scrutiny by regulatory authorities, suspensions of commercial activities or product recalls, delays in our clinical program and regulatory approval, increases in our operating expenses, or failure to obtain or maintain approval for our products or product candidates.

***We rely on third parties to conduct our preclinical studies and clinical trials. If these third parties do not successfully carry out their contractual duties or meet expected deadlines, we may not be able to obtain regulatory approval for or commercialize our product candidates and our business could be substantially harmed.***

We rely upon and plan to continue to rely upon third-party CROs to monitor and manage data for our preclinical and clinical programs. We rely on these parties for execution of our preclinical studies and clinical trials, and control only certain aspects of their activities. Nevertheless, we are responsible for ensuring that each of our trials is conducted in accordance with the applicable protocol, legal, regulatory and scientific standards and our reliance on the CROs does not relieve us of our regulatory responsibilities. We and our CROs are required to comply with FDA laws and regulations regarding current good clinical practice, or GCP, which are also required by the Competent Authorities of the Member States of the European Economic Area and comparable foreign regulatory authorities in the form of International Council for Harmonization guidelines for all of our products in clinical development. Regulatory authorities enforce GCP through periodic inspections of trial sponsors, principal investigators and trial sites. If we or any of our CROs fail to comply with applicable GCP, the clinical data generated in our clinical trials may be deemed unreliable and the FDA or comparable foreign regulatory authorities may require us to perform additional clinical trials before approving our marketing applications. We cannot be certain that upon inspection by a given regulatory authority, such regulatory authority will determine that any of our clinical trials comply with GCP regulations. In addition, our clinical trials must be conducted with product produced under cGMP regulations. While we have agreements governing activities of our CROs, we have limited influence over their actual performance. In addition, portions of the clinical trials for our product candidates may be conducted outside of the United States, which will make it more difficult for us to monitor CROs and perform visits of our clinical trial sites and will force us to rely heavily on CROs to ensure the proper and timely conduct of our clinical trials and compliance with applicable regulations, including GCP. Failure to comply with applicable regulations in

the conduct of the clinical trials for our product candidates may require us to repeat clinical trials, which would delay the regulatory approval process.

Some of our CROs have an ability to terminate their respective agreements with us if, among other reasons, it can be reasonably demonstrated that the safety of the subjects participating in our clinical trials warrants such termination, if we make a general assignment for the benefit of our creditors or if we are liquidated. If any of our relationships with these third-party CROs terminate, we may not be able to enter into arrangements with alternative CROs or to do so on commercially reasonable terms. In addition, our CROs are not our employees, and except for remedies available to us under our agreements with such CROs, we cannot control whether or not they devote sufficient time and resources to our preclinical and clinical programs. If CROs do not successfully carry out their contractual duties or obligations or meet expected deadlines, if they need to be replaced or if the quality or accuracy of the clinical data they obtain is compromised due to the failure to adhere to our clinical protocols, regulatory requirements or for other reasons, our clinical trials may be extended, delayed or terminated and we may not be able to obtain regulatory approval for or successfully commercialize our product candidates. Consequently, our results of operations and the commercial prospects for our product candidates would be harmed, our costs could increase substantially and our ability to generate revenue could be delayed significantly.

Switching or adding additional CROs involves additional cost and requires management time and focus. In addition, there is a natural transition period when a new CRO commences work. As a result, delays occur, which can materially impact our ability to meet our desired clinical development timelines. Though we carefully manage our relationships with our CROs, there can be no assurance that we will not encounter challenges or delays in the future or that these delays or challenges will not have a material adverse impact on our business, financial condition and prospects.

***We may not be successful in establishing development and commercialization collaborations, which could adversely affect, and potentially prohibit, our ability to fully commercialize ZILRETTA or to develop our product candidates.***

Because developing pharmaceutical products, conducting clinical trials, obtaining regulatory approval, establishing manufacturing capabilities and marketing approved products are expensive, we are exploring collaborations with third parties that have more resources and experience. For example, we are exploring selective partnerships with third parties for ZILRETTA's development and commercialization outside of the United States. If we are unable to obtain a partner for ZILRETTA, we may be unable to advance the development of ZILRETTA in territories outside of the United States, which may limit its market potential. In situations where we enter into a development and commercial collaboration arrangement for a product candidate, we may also seek to establish additional collaborations for development and commercialization in territories outside of those addressed by the first collaboration arrangement for such product candidate. If any of our product candidates, in addition to ZILRETTA, receives marketing approval, we may enter into sales and marketing arrangements with third parties with respect to otherwise unlicensed or unaddressed territories outside of the United States. There are a limited number of potential partners, and we expect to face competition in seeking appropriate partners. If we are unable to enter into any development and commercial collaborations and/or sales and marketing arrangements on acceptable terms, or at all, we may be unable to successfully develop and seek regulatory approval for our product candidates and/or effectively market and sell ZILRETTA and any other future approved products, if any, in all of the territories outside of the United States where it may otherwise be valuable to do so.

***We may not be successful in maintaining development and commercialization collaborations, and our partners may not devote sufficient resources to the development or commercialization of our products or product candidates or may otherwise fail in development or commercialization efforts, which could adversely affect our ability to develop or commercialize certain of our products or product candidates and our financial condition and operating results.***

Even if we are able to establish collaboration arrangements, any such collaboration may not ultimately be successful, which could have a negative impact on our business, results of operations, financial condition and growth prospects. If we partner with a third party for development and commercialization of a product candidate, we can expect to relinquish some or all of the control over the future success of that product candidate to the third party. It is possible that a partner may not devote sufficient resources to the development or commercialization of our

product candidate or may otherwise fail in development or commercialization efforts, in which event the development and commercialization of such product candidate could be delayed or terminated, and our business could be substantially harmed. In addition, the terms of any collaboration or other arrangement that we establish may not prove to be favorable to us or may not be perceived as favorable, which may negatively impact the trading price of our common stock. In some cases, we may be responsible for continuing development of a product or product candidate or research program under collaboration and the payment we receive from our partner may be insufficient to cover the cost of this development. Moreover, collaborations and sales and marketing arrangements are complex and time consuming to negotiate, document and implement and they may require substantial resources to maintain.

We may become subject to a number of additional risks associated with our dependence on collaborations with third parties, the occurrence of which could cause our collaboration arrangements to fail. Conflicts may arise between us and partners, such as conflicts concerning the interpretation of clinical data, the achievement of milestones, the division of development or commercialization responsibilities or expenses, the interpretation of financial provisions or the ownership of intellectual property developed during the collaboration. If any such conflicts arise, a partner could act in its own self-interest, which may be adverse to our best interests. Any such disagreement between us and a partner could result in one or more of the following, each of which could delay or prevent the development or commercialization of our products or product candidates, and in turn prevent us from generating sufficient revenue to achieve or maintain profitability:

- reductions in the payment of royalties or other payments we believe are due pursuant to the applicable collaboration arrangement;
- actions taken by a partner inside or outside our collaboration which could negatively impact our rights or benefits under our collaboration; or
- unwillingness on the part of a partner to keep us informed regarding the progress of its development and commercialization activities or to permit public disclosure of the results of those activities.

## **Risks Related to Our Business Operations and Industry**

***The novel coronavirus global pandemic could adversely impact our business, including our supply chain, clinical trials and commercialization of ZILRETTA.***

In December 2019, a novel strain of coronavirus, which causes the COVID-19 disease, was first reported in Wuhan, China and has since become a global pandemic (the “Coronavirus”). If the Coronavirus continues to spread, particularly in the United States and Europe, we may experience disruptions that could severely impact our supply chain, on-going and future clinical trials and commercialization of ZILRETTA.

For example, the Coronavirus has resulted in increased travel restrictions and the shutdown or delay of business activities in various regions, including certain activities of one of our suppliers in Italy. To the extent our suppliers and service providers are unable to comply with their obligations under our agreements with them or they are otherwise unable to deliver or are delayed in delivering goods and services to us due to the Coronavirus, our ability to continue meeting commercial demand for ZILRETTA in the United States or advancing development of our product candidates may become impaired. Travel restrictions and shutdowns in business operations as a result of the outbreak may also limit our ability to pursue business development activities.

In addition, our commercialization of ZILRETTA may be adversely impacted by the Coronavirus, which could result in patients postponing visits to healthcare provider facilities, healthcare providers closing temporarily closing their offices or restricting patient visits, healthcare provider employees being unavailable and general disruptions in the operations of payors, distributors, logistics providers and other third parties that are necessary for ZILRETTA to be prescribed, reimbursed and administered to patients.

The Coronavirus continues to rapidly evolve. The extent to which the Coronavirus may impact our business, including our supply chain, clinical trials and commercialization of ZILRETTA, will depend on future developments, which are highly uncertain and cannot be predicted with confidence, such as the ultimate geographic spread of the pandemic, the duration of the pandemic, travel restrictions and social distancing in the United States

and other countries, business closures or business disruptions and the effectiveness of actions taken in the United States and other countries to contain and treat the pandemic.

***Our future success depends on our ability to retain key executives and to attract, retain and motivate qualified personnel.***

We are highly dependent on the principal members of our executive team, the loss of whose services may adversely impact the achievement of our objectives. While we have entered into employment agreements or offer letters with each of our executive officers, any of them could leave our employment at any time, as all of our employees are “at will” employees. Recruiting and retaining other qualified employees for our business, including scientific and technical personnel, will also be critical to our success. There is currently a shortage of skilled executives and other technically qualified personnel in our industry, particularly in the greater Boston, Massachusetts area where our headquarters is located, which is likely to continue. As a result, competition for skilled personnel is intense and the turnover rate can be high. We may not be able to attract and retain personnel on acceptable terms given the competition among numerous biotechnology and pharmaceutical companies for individuals with similar skill sets. In addition, failure to succeed in the commercialization of ZILRETTA or clinical studies of our product candidates may make it more challenging to recruit and retain qualified personnel. The inability to recruit or the loss of the services of any executive or key employee might impede the progress of our development and commercialization objectives.

***We face potential product liability, and, if successful claims are brought against us, we may incur substantial liability.***

The use of our product candidates in clinical trials and the sale of ZILRETTA and any other products for which we obtain marketing approval exposes us to the risk of product liability claims. Product liability claims might be brought against us by consumers, healthcare providers, or others coming into contact with our products or product candidates. If we cannot successfully defend against product liability claims, we could incur substantial liability and costs. In addition, regardless of merit or eventual outcome, product liability claims may result in:

- impairment of our business reputation and perception of our products in the market;
- withdrawal or suspension of marketing approvals;
- withdrawal of clinical trial participants;
- costs due to related litigation;
- distraction of management’s attention from our primary business;
- substantial monetary awards to patients or other claimants;
- the inability to commercialize our product candidates;
- decreased demand for our products approved for commercial sale; and
- reputational harm.

Our current product liability insurance coverage may not be sufficient to reimburse us for any expenses or losses we may suffer. Moreover, insurance coverage is becoming increasingly expensive and in the future we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. On occasion, large judgments have been awarded in class action or mass tort lawsuits based on drugs that had unanticipated adverse effects. A successful product liability claim or series of claims brought against us could cause our stock price to decline and, if judgments exceed our insurance coverage, could adversely affect our results of operations and business.

***If we collaborate with third parties to develop and commercialize products outside of the United States, a variety of risks associated with international operations could materially and adversely affect our business.***

If we enter into agreements with third parties to market ZILRETTA, and if approved, our other product candidates, outside of the United States, we expect to be subject to additional risks related to entering into international business relationships, including:

- different regulatory requirements for drug approvals in foreign countries;
- reduced protection for intellectual property rights;
- unexpected changes in tariffs, trade barriers and regulatory requirements;
- economic weakness, including inflation, or political instability in particular foreign economies and markets;
- compliance with tax, employment, immigration and labor laws for employees living or traveling abroad;
- foreign taxes, including withholding of payroll taxes;
- foreign currency fluctuations, which could result in increased operating expenses and reduced revenue, and other obligations incidental to doing business in another country;
- workforce uncertainty in countries where labor unrest is more common than in the United States;
- different government payer systems, multiple payer-reimbursement regimes or patient self-pay systems, and price controls;
- potential noncompliance with the FCPA, the U.K. Bribery Act 2010, or similar antibribery and anticorruption laws in other jurisdictions as well as various regulations pertaining to data privacy, such as the GDPR;
- production shortages resulting from any events affecting raw material supply or manufacturing capabilities abroad; and
- business interruptions resulting from geopolitical actions, including war and terrorism, or natural disasters, including earthquakes, typhoons, floods and fires.

***We rely significantly on information technology and any failure, inadequacy, interruption or security lapse of that technology, including any cybersecurity incidents, could harm our ability to operate our business effectively.***

Despite the implementation of security measures, our internal computer systems and those of third parties with which we contract are vulnerable to damage from cyber-attacks, computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failures. System failures, accidents or security breaches could cause interruptions in our operations and could result in a material disruption of our commercial and clinical activities and business operations, in addition to possibly requiring substantial expenditures of resources to remedy. The loss of clinical trial data could result in delays in our regulatory approval efforts and significantly increase our costs to recover or reproduce the data. To the extent that any disruption or security breach were to result in a loss of, or damage to, our data or applications, or inappropriate disclosure of confidential or proprietary information, we could incur liability and our development programs, and the development of our product candidates could be delayed.

***If we fail to comply with applicable U.S. and foreign privacy and data protection laws and regulation, we may be subject to liabilities that adversely affect our business, operations and financial performance.***

We are subject to laws and regulations requiring that we take measures to protect the privacy and security of certain information we gather and use in our business. For example, HIPAA, and its implementing regulations impose, among other requirements, certain regulatory and contractual requirements regarding the privacy and security of personal health information on covered entities, such as health plans, healthcare clearinghouses and

certain healthcare providers, as well as their business associates that perform certain services involving the use or disclosure of personal health information. In addition to HIPAA, numerous other federal and state laws, including, without limitation, state security breach notification laws, state health information privacy laws and federal and state consumer protection laws, govern the collection, use, and storage of personal information.

We may also be subject to or affected by foreign laws and regulation, including regulatory guidance, governing the collection, use, disclosure, security, transfer and storage of personal data, such as information that we collect about employees, patients and healthcare providers in connection with clinical trials and our other operations in the U.S. and abroad. The global legislative and regulatory landscape for privacy and data protection continues to evolve, and implementation standards and enforcement practices are likely to remain uncertain for the foreseeable future. This evolution may create uncertainty in our business, result in liability or impose additional costs on us. The cost of compliance with these laws, regulations and standards is high and is likely to increase in the future. For example, the EU has adopted the GDPR, which introduced strict requirements for processing personal data. The GDPR is likely to increase compliance burdens on us, including by mandating potentially burdensome documentation requirements and granting certain rights to individuals to control how we collect, use, disclose, retain and leverage information about them. In addition, the GDPR provides for breach reporting requirements, more robust regulatory enforcement and fines of up to 20 million euros or up to 4% of the annual global revenue. While companies are afforded some flexibility in determining how to comply with the GDPR's various requirements, it has and will continue to require significant effort and expense to ensure continuing compliance with the GDPR. Moreover, the requirements under the GDPR may change periodically or may be modified by European Union, or EU, national law, and could have an effect on our business operations if compliance becomes substantially costlier than under current requirements. It is possible that each of these privacy laws may be interpreted and applied in a manner that is inconsistent with our practices. Any failure or perceived failure by us to comply with federal, state or foreign laws or self-regulatory standards could result in negative publicity, diversion of management time and effort and proceedings against us by governmental entities or others. In many jurisdictions, enforcement actions and consequences for noncompliance are rising. As we continue to expand into other foreign countries and jurisdictions, we may be subject to additional laws and regulations that may affect how we conduct business.

***Business interruptions could delay us in the process of developing or commercializing our products and product candidates.***

Our headquarters are located in Burlington, Massachusetts. We are vulnerable to natural disasters such as hurricanes, tornadoes and severe storms, as well as other events that could disrupt our operations. We do not carry insurance for natural disasters and we may not carry sufficient business interruption insurance to compensate us for losses that may occur. Any losses or damages we incur could have a material adverse effect on our business operations. Further, our operations, and those of our contractors, consultants and collaborators, could be subject to earthquakes, power shortages, telecommunications failures, water shortages, floods, hurricanes, typhoons, fires, extreme weather conditions, medical epidemics and other natural or man-made disasters or business interruptions, for which we are predominantly self-insured. To the extent our suppliers and service providers are unable to comply with their obligations under our agreements with them or they are otherwise unable to deliver or are delayed in delivering goods and services to us, our ability to continue meeting commercial demand for ZILRETTA in the United States or advancing development of our product candidates may become impaired.

***Exposure to U.K. political developments, including the outcome of the referendum on membership in the European Union, could impact our suppliers and harm our business.***

The U.K.'s referendum to leave the EU, or "Brexit," has caused and may continue to cause disruptions to capital and currency markets worldwide. The full impact of the Brexit decision, however, remains uncertain. A process of negotiation will determine the future terms of the U.K.'s relationship with the EU. During this period of negotiation, our results of operations and access to capital may be negatively affected by interest rate, exchange rate and other market and economic volatility, as well as regulatory and political uncertainty. The tax consequences of the U.K.'s withdrawal from the EU are uncertain as well. Brexit may also have a detrimental effect on our suppliers, which could, in turn, adversely affect our revenues and financial condition.

## Risks Related to Our Intellectual Property

*If we are unable to obtain or protect intellectual property rights, we may not be able to compete effectively in our market.*

We rely upon a combination of patents, trade secret protection, confidentiality agreements and proprietary know how, and intend to seek marketing exclusivity for any approved product, including ZILRETTA, in order to protect the intellectual property related to our products and product candidates, and to date we have three issued patents covering ZILRETTA in the United States.

The strength of patents in the biotechnology and pharmaceutical field involves complex legal and scientific questions and can be uncertain. As a result, the issuance, scope, validity, enforceability and commercial value of our patent rights and our current or future licensors' or collaborators' patent rights are highly uncertain. The patent applications that we own or in-license may fail to result in issued patents with claims that cover our products or product candidates in the United States, including through the inter-partes review process, or in other foreign countries. Even for our issued patents and if other patents do successfully issue, third parties may challenge their inventorship, ownership, validity, enforceability or scope in the courts or patent offices in the United States and abroad. This may result in such patents being narrowed or invalidated, which could limit our ability to stop others from using or commercializing similar or identical technologies or products, or limit the duration of the patent protection for our technologies and products. If this were to occur, early generic competition could be expected against ZILRETTA and potentially reduce the value of our product candidates in development. Also, a third party may challenge our rights to patents and patent applications that we license from third parties. Furthermore, even if they are unchallenged, our patents and patent applications may not adequately protect our intellectual property or prevent others from designing around our claims.

If our patent applications with respect to ZILRETTA or our other product candidates fail to issue or if their breadth or strength of protection is threatened, it could dissuade companies from collaborating with us to develop ZILRETTA or our other product candidates and threaten our ability to commercialize any resulting products. We cannot offer any assurances about which, if any, patents will issue or whether any issued patents will not be found invalid and unenforceable or will go unthreatened by third parties. Further, if we encounter delays in regulatory approvals for additional indications or in additional jurisdictions, the period of time during which we could market ZILRETTA or any product candidate under patent protection could be reduced. See "Business—Patents and Patent Applications" in this Annual Report on Form 10-K for additional information regarding our material patents and patent applications.

In addition to the protection afforded by patents, we rely on trade secret protection and confidentiality agreements to protect proprietary know-how that is not patentable, processes for which patents are difficult to enforce and any other elements of our drug development process that involve proprietary know-how, information or technology that is not covered by patents. For example, we maintain trade secrets with respect to certain of the formulation and manufacturing techniques related to the TA-formulated PLGA microspheres in ZILRETTA, including those that relate to precise pharmaceutical release. Although we generally require all of our employees to assign their inventions to us, and all of our employees, consultants, advisors and any third parties who have access to our proprietary know-how, information or technology to enter into confidentiality agreements, we cannot provide any assurances that all such agreements have been duly executed or that our trade secrets and other confidential proprietary information will not be disclosed or that competitors will not otherwise gain access to our trade secrets or independently develop substantially equivalent information and techniques. Further, the laws of some foreign countries do not protect proprietary rights to the same extent or in the same manner as the laws of the United States. As a result, we may encounter significant problems in protecting and defending our intellectual property both in the United States and abroad. If we are unable to prevent material disclosure of the non-patented intellectual property related to our technologies to third parties, and there is no guarantee that we will have any such enforceable trade secret protection, we may not be able to establish or maintain a competitive advantage in our market, which could materially adversely affect our business, results of operations and financial condition.



***Third party claims of intellectual property infringement may prevent or delay our development and commercialization efforts.***

Our commercial success depends in part on our avoiding infringement of the patents and proprietary rights of third parties. There is a substantial amount of litigation, both within and outside the United States, involving patent and other intellectual property rights in the biotechnology and pharmaceutical industries, including patent infringement lawsuits, interferences, oppositions and inter party reexamination proceedings before the U.S. Patent and Trademark Office, or U.S. PTO. Numerous U.S. and foreign issued patents and pending patent applications, which are owned by third parties, exist in the fields in which we and our collaborators are commercializing or developing product candidates. As the biotechnology and pharmaceutical industries expand and more patents are issued, the risk increases that our products and product candidates may be subject to claims of infringement of the patent rights of third parties.

Third parties may assert that we are employing their proprietary technology without authorization. There may be third-party patents or patent applications with claims to materials, formulations, methods of manufacture or methods for treatment related to the use or manufacture of ZILRETTA and/or our product candidates. Because patent applications can take many years to issue, there may be currently pending patent applications which may later result in issued patents that our products or product candidates may infringe. In addition, third parties may obtain patents in the future and claim that use of our technologies infringes upon these patents. If any third-party patents were held by a court of competent jurisdiction to cover the manufacturing process of any of our products or product candidates, any drug substance formed during the manufacturing process or any final product itself, the holders of any such patents may be able to block our ability to commercialize such product or product candidate unless we obtain a license under the applicable patents, or until such patents expire. Similarly, if any third-party patent were held by a court of competent jurisdiction to cover aspects of our formulations or methods of use, the holders of any such patent may be able to block our ability to develop and commercialize the applicable product or product candidate unless we obtain a license or until such patent expires. In either case, such a license may not be available on commercially reasonable terms or at all.

Parties making claims against us may request and/or obtain injunctive or other equitable relief, which could effectively block our ability to further develop and commercialize one or more of our products or product candidates. Defense of these claims, regardless of their merit, would involve substantial litigation expense and would be a substantial diversion of employee resources from our business. In the event of a successful claim of infringement against us, we may have to pay substantial damages, including treble damages and attorneys' fees for willful infringement, obtain one or more licenses from third parties, pay royalties or redesign our infringing products or manufacturing processes, which may be impossible or require substantial time and monetary expenditure. We cannot predict whether any such license would be available at all or whether it would be available on commercially reasonable terms. Furthermore, even in the absence of litigation, we may need to obtain licenses from third parties to advance our research, manufacture clinical trial supplies or allow commercialization of our product candidates. We may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, we would be unable to further develop and commercialize one or more of our products or product candidates, which could harm our business significantly. We cannot provide any assurances that third party patents do not exist which might be enforced against our products, resulting in either an injunction prohibiting our sales, or, with respect to our sales, an obligation on our part to pay royalties and/or other forms of compensation to third parties.

***We may be involved in lawsuits to protect or enforce our patents or the patents of our licensors, which could be expensive, time consuming and unsuccessful.***

Competitors may infringe our issued patents, licensed patents or our other intellectual property. In some cases, it may be difficult or impossible to detect third-party infringement or misappropriation of our intellectual property rights, even in relation to issued patent claims, and proving any such infringement may be even more difficult. Accordingly, for such undetectable infringement or misappropriation our ability to recover damages will be negligible, and we could be at a market disadvantage because we may lack the resources of some of our competitors to monitor for and detect infringement. To counter infringement or unauthorized use, we may be required to file infringement claims, which can be expensive and time consuming. Any claims we assert against perceived infringers could provoke these parties to assert counterclaims against us alleging that we infringe their patents. In addition, in any patent infringement proceeding, a court may decide that a patent of ours is invalid or unenforceable, in whole or in part, construe the patent's claims narrowly or refuse to stop the other party from using the technology at issue on

the grounds that our patents do not cover the technology. An adverse result in litigation proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly. Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation.

***Obtaining and maintaining our patent protection depends on compliance with various procedural, document submissions, fee payment and other requirements imposed by governmental patent agencies, and our patent protection could be reduced or eliminated for non-compliance with these requirements.***

Periodic maintenance fees on any issued patent are due to be paid to the U.S. PTO and foreign patent agencies in several stages over the lifetime of the patent. The U.S. PTO and various foreign governmental patent agencies require compliance with a number of procedural, documentary, fee payment and other similar provisions during the patent application process. While an inadvertent lapse can in many cases be cured by payment of a late fee or by other means in accordance with the applicable rules, there are situations in which non-compliance can result in abandonment or lapse of the patent or patent application, resulting in partial or complete loss of patent rights in the relevant jurisdiction. Non-compliance events that could result in abandonment or lapse of a patent or patent application include, but are not limited to, failure to respond to official actions within prescribed time limits, non-payment of fees and failure to properly legalize and submit formal documents. If we fail to maintain the patents and patent applications covering our product candidates, our competitors might be able to enter the market, which would have a material adverse effect on our business.

***We may not be able to protect our intellectual property rights throughout the world.***

Filing, prosecuting and defending patents on all of our product candidates throughout the world would be prohibitively expensive, and the laws of foreign countries may not protect our rights to the same extent as the laws of the United States. Consequently, we may not be able to prevent third parties from infringing on our intellectual property rights in all countries outside the United States, and competitors may use our technologies in jurisdictions where we have not obtained patent protection to develop their own products and further, may export otherwise infringing products to territories where we have patent protection, but enforcement is not as strong as that in the United States. These products may compete with our products in jurisdictions where we do not have any issued patents and our patent claims or other intellectual property rights may not be effective or sufficient to prevent them from so competing.

Many companies have encountered significant problems in protecting and defending intellectual property rights in foreign jurisdictions. The legal systems of certain countries, particularly certain developing countries, do not favor the enforcement of patents and other intellectual property protection, which could make it difficult for us to stop the infringement of our patents or marketing of competing products in violation of our proprietary rights generally. Proceedings to enforce our patent rights in foreign jurisdictions could result in substantial cost and divert our efforts and attention from other aspects of our business.

***We may be subject to claims that our employees, consultants or independent contractors have wrongfully used or disclosed confidential information of third parties.***

We employ individuals who were previously employed at other biotechnology or pharmaceutical companies. We may be subject to claims that we or our employees, consultants or independent contractors have inadvertently or otherwise used or disclosed confidential information of our employees' former employers or other third parties. We may also be subject to claims that former employers or other third parties have an ownership interest in our patents. Litigation may be necessary to defend against these claims. There is no guarantee of success in defending these claims, and if we are successful, litigation could result in substantial cost and be a distraction to our management and other employees.

***Our owned or licensed patents directed to our product candidates may expire or have limited commercial life before the product candidate is approved for marketing in a relevant jurisdiction.***

Given the amount of time required for the development, testing and regulatory review of new product candidates, patents protecting our product candidates might expire before or shortly after our product candidates obtain regulatory approval, which may subject us to increased competition and reduce or eliminate our ability to

recover our development costs. As a result, our owned and licensed patent portfolio may not provide us with sufficient rights to exclude others from commercializing products similar or identical to ours. Although we may be able to seek extensions of patent terms where available, including in the United States under the Drug Price Competition and Patent Term Restoration Act of 1984, which permits a patent term extension of up to five years beyond the expiration of the patent, we cannot be certain that an extension will be granted, or if granted, what the applicable time period or the scope of patent protection afforded during any extended period will be. The applicable authorities, including the EMA, FDA, and any equivalent regulatory authority in other countries, may not agree with our assessment of whether such extensions are available, and may refuse to grant extensions to our patents, or may grant more limited extensions than we request. If this occurs, our competitors may take advantage of our investment in development and trials by referencing our clinical and preclinical data and launch their product earlier than might otherwise be the case.

***Changes in U.S. patent law could diminish the value of patents in general, thereby impairing our ability to protect our products.***

Our success is heavily dependent on intellectual property, particularly patents. Obtaining and enforcing patents in the biotechnology industry involve both technological and legal complexity and is therefore costly, time-consuming and inherently uncertain. In addition, the United States has recently enacted and is currently implementing wide-ranging patent reform legislation. Recent U.S. Supreme Court rulings have narrowed the scope of patent protection available in certain circumstances and weakened the rights of patent owners in certain situations. In addition to increasing uncertainty with regard to our ability to obtain patents in the future, this combination of events has created uncertainty with respect to the value of patents, once obtained. Depending on decisions by the U.S. Congress, the federal courts, and the U.S. PTO, the laws and regulations governing patents could change in unpredictable ways that would weaken our ability to obtain new patents or to enforce our existing patents and patents that we might obtain in the future.

***We have in-licensed or acquired a portion of our intellectual property necessary to develop our product candidates, and if we fail to comply with our obligations under any of these arrangements, we could lose such intellectual property rights.***

We are a party to and rely on several arrangements with third parties, which give us rights to intellectual property that is necessary for the manufacture of ZILRETTA and the development of FX201 and FX301. Our current arrangements impose various development, royalty and other obligations on us. If we materially breach these obligations or if our counterparts fail to adequately perform their respective obligations, these exclusive arrangements could be terminated, which would result in our inability to develop, manufacture and sell products that are covered by such intellectual property.

We may need to obtain licenses from third parties to advance our research or allow commercialization of our product candidates, and we have done so from time to time. We may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, we may be required to expend significant time and resources to develop or license replacement technology. If we are unable to do so, we may be unable to develop or commercialize our affected product candidates, which could harm our business significantly. We cannot provide any assurances that third-party patents do not exist which might be enforced against our current product candidates or future products, resulting in either an injunction prohibiting our sales, or, with respect to our sales, an obligation on our part to pay royalties and/or other forms of compensation to such third parties.

In many cases, patent prosecution of our licensed technology is controlled solely by the licensor. If our licensors fail to obtain and maintain patent or other protection for the proprietary intellectual property we license from them, we could lose our rights to the intellectual property or our exclusivity with respect to those rights, and our competitors could market competing products using the intellectual property. In certain cases, we control the prosecution of patents resulting from licensed technology. In the event we breach any of our obligations related to such prosecution, we may incur significant liability to our licensing partners. Licensing of intellectual property is of critical importance to our business and involves complex legal, business and scientific issues and is complicated by the rapid pace of scientific discovery in our industry. Disputes may arise regarding intellectual property subject to a licensing agreement, including:

- the scope of rights granted under the license agreement and other interpretation-related issues;
- the extent to which our technology and processes infringe on intellectual property of the licensor that is not subject to the licensing agreement;
- the sublicensing of patent and other rights under our collaborative development relationships;
- our diligence obligations under the license agreement and what activities satisfy those diligence obligations;
- the ownership of inventions and know-how resulting from the joint creation or use of intellectual property by our licensors and us and our partners; and
- the priority of invention of patented technology.

If disputes over intellectual property that we have licensed prevent or impair our ability to maintain our current licensing arrangements on acceptable terms, we may be unable to successfully develop and commercialize the affected product candidates.

***If our trademarks and trade names are not adequately protected, then we may not be able to build name recognition in our markets of interest and our business may be adversely affected.***

If our trademarks and trade names are not adequately protected, then we may not be able to build name recognition in our markets of interest and our business may be adversely affected. Our unregistered trademarks or trade names may be challenged, infringed, circumvented or declared generic or determined to be infringing on other marks. We may not be able to protect our rights to these trademarks and trade names, which we need to build name recognition among potential partners or future, potential customers in our markets of interest. At times, competitors may adopt trade names or trademarks similar to ours, thereby impeding our ability to build brand identity and possibly leading to market confusion. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of our unregistered trademarks or trade names. If we are unable to successfully register our trademarks and trade names and establish name recognition based on our trademarks and trade names, then we may not be able to compete effectively, and our business may be adversely affected. Our efforts to enforce or protect our proprietary rights related to trademarks, trade secrets, domain names, copyrights or other intellectual property may be ineffective and could result in substantial costs and diversion of resources and could adversely impact our financial condition or results of operations.

#### **Risks Related to Ownership of Our Common Stock**

***The market price of our common stock may be highly volatile, you may not be able to resell your shares at a desired market price and you could lose all or part of your investment.***

The trading price of our common stock is likely to be volatile. Our stock price could be subject to wide fluctuations in response to a variety of factors, including the following:

- the success or perceived success of the commercialization of ZILRETTA;
- inability to obtain approval for additional indications for ZILRETTA;
- failure to successfully develop and commercialize additional product candidates;
- changes in the structure of healthcare payment systems;

- adverse results or delays in clinical trials;
- inability to obtain additional funding;
- changes in laws or regulations applicable to our products or product candidates;
- inability to obtain adequate product supply for our products or product candidates, or the inability to do so at acceptable prices;
- adverse regulatory decisions;
- introduction of new products or technologies by our competitors;
- failure to meet or exceed product development or financial projections we provide to the public;
- failure to meet or exceed the estimates and projections of the investment community;
- the perception of the pharmaceutical industry by the public, legislatures, regulators and the investment community;
- announcements of significant acquisitions, strategic partnerships, joint ventures or capital commitments by us or our competitors;
- disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our technologies;
- additions or departures of key scientific or management personnel;
- significant lawsuits, including patent, product liability or stockholder litigation;
- changes in the market valuations of similar companies;
- sales of our common stock by us or our stockholders in the future; and
- trading volume of our common stock.

The trading price of our common stock may also be dependent upon the valuations and recommendations of the analysts who cover our company. If our results do not meet these analysts' forecasts, the expectations of our investors or any financial guidance or expectations we provide to investors in any period, the market price of our common stock could decline. Our ability to meet analysts' forecasts (including revenue and profitability), investors' expectations and our own guidance or financial expectations is substantially dependent on our ability to increase sales of ZILRETTA and to successfully commercialize ZILRETTA in the United States. Because we are in the early stages of the ZILRETTA launch, we and the analysts who cover our company have limited ability to accurately predict future sales results, and actual results may differ materially from our expectations or those of such analysts.

In addition, the stock market in general, and the Nasdaq Global Market in particular, have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of companies like ours. Broad market and industry factors may continue to negatively affect the market price of our common stock, regardless of our actual operating performance.

***If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud. As a result, stockholders could lose confidence in our financial and other public reporting, which would harm our business and the trading price of our common stock.***

Effective internal controls over financial reporting are necessary for us to provide reliable financial reports and, together with adequate disclosure controls and procedures, are designed to prevent fraud. Any failure to implement required new or improved controls, or difficulties encountered in their implementation could cause us to fail to meet our reporting obligations. In addition, any testing by us conducted in connection with Section 404 of the Sarbanes-Oxley Act, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal controls over financial reporting that are deemed to be material weaknesses or that may require prospective or retroactive changes to our consolidated financial statements or identify other areas for further

attention or improvement. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our common stock.

***We will continue to incur significant increased costs as a result of operating as a public company, and our management is required to devote substantial time to new compliance initiatives.***

As a public company, we incur significant legal, accounting and other expenses that we did not incur as a private company. For example, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, which require, among other things, that we file with the SEC annually, quarterly and current reports with respect to our business and financial condition. We have incurred and will continue to incur costs associated with the preparation and filing of these reports. In addition, the Sarbanes-Oxley Act, as well as rules subsequently implemented by the SEC, and the Nasdaq Global Market have imposed various other requirements on public companies. In July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or the Dodd-Frank Act, was enacted. There are significant corporate governance and executive compensation related provisions in the Dodd-Frank Act that require the SEC to adopt additional rules and regulations in these areas such as “say on pay” and proxy access. Stockholder activism, the current political environment and the current high level of government intervention and regulatory reform may lead to substantial new regulations and disclosure obligations, which may lead to additional compliance costs and impact (in ways we cannot currently anticipate) the manner in which we operate our business. Our management and other personnel devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations have and will continue to increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, these rules and regulations have made it more difficult and more expensive for us to obtain director and officer liability insurance and we may be required to incur substantial costs to maintain our current levels of such coverage.

***If the estimates we make, or the assumptions on which we rely, in preparing our consolidated financial statements prove inaccurate, our actual results may vary from those reflected in our projections and accruals.***

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of our assets, liabilities, revenues and expenses, the amounts of charges accrued by us, and the related disclosure of contingent assets and liabilities. On an ongoing basis, our management evaluates our critical and other significant estimates and judgments, including among others, those associated with revenue recognition and the sales allowances and accruals, valuation of inventory, accrued research and development expenses, and stock-based compensation expense. We base our estimates on historical experience, known trends and events, contractual milestones, and various other factors that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Any significant differences between our actual results and our estimates could materially affect our financial position, results of operations and cash flows.

***Sales of a substantial number of shares of our common stock in the public market by our existing stockholders could cause our stock price to fall.***

Sales of a substantial number of shares of our common stock in the public market or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity and/or convertible debt securities. We are unable to predict the effect that sales may have on the prevailing market price of our common stock.

***Future sales and issuances of our common stock or rights to purchase common stock, including pursuant to our equity incentive plans, could result in additional dilution of the percentage ownership of our stockholders and could cause our stock price to fall.***

We may need significant additional capital in the future to continue our planned operations. To the extent we raise additional capital by issuing equity securities; our stockholders may experience substantial dilution. We may sell common stock, convertible securities or other equity securities in one or more transactions at prices and in a

manner we determine from time to time. If we sell common stock, convertible securities or other equity securities in more than one transaction, investors may be materially diluted by subsequent sales. These sales may also result in material dilution to our existing stockholders, and new investors could gain rights superior to our existing stockholders.

Pursuant to our 2013 equity incentive plan, our management is authorized to grant stock options and other equity-based awards to our employees, directors and consultants. The number of shares available for future grant under the 2013 plan will automatically increase each year by 4% of all shares of our capital stock outstanding as of December 31 of the prior calendar year, subject to the ability of our board of directors to take action to reduce the size of the increase in any given year. Currently, we plan to register the increased number of shares available for issuance under the 2013 plan each year. If our board of directors elects to increase the number of shares available for future grant by the maximum amount each year, our stockholders may experience additional dilution, which could cause our stock price to fall.

***We are at risk of securities class action litigation.***

In the past, securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because pharmaceutical companies have experienced significant stock price volatility in recent years. If we face such litigation, it could result in substantial costs and a diversion of management's attention and resources, which could harm our business.

***Our ability to use our net operating loss carryforwards and certain other tax attributes may be limited.***

Section 382 of the Internal Revenue Code of 1986, as amended, or Section 382, contains rules that limit the ability of a company that undergoes an ownership change to utilize its net operating losses, or NOLs, and tax credits existing as of the date of such ownership change. Under the rules, such an ownership change is generally any change in ownership of more than 50% of a company's stock within a rolling three-year period. The rules generally operate by focusing on changes in ownership among stockholders considered by the rules as owning, directly or indirectly, 5% or more of the stock of a company and any change in ownership arising from new issuances of stock by the company. We have experienced multiple ownership changes since our inception, however, based on the annual limitations calculated at each ownership change date, we expect that substantially all net operating loss carryforwards will be available to offset future taxable income. Approximately \$0.3 million of NOLs are expected to expire unused. Future ownership changes as defined by Section 382 may further limit the amount of NOL carryforwards that could be utilized annually to offset future taxable income.

Under the currently enacted federal income tax law, federal NOLs incurred in 2018 and in future years may be carried forward indefinitely, but the deductibility of such federal NOLs is limited and could be subject to future limitations under Section 382.

***We do not intend to pay dividends on our common stock so any returns will be limited to the value of our stock.***

We have never declared or paid any cash dividend on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Additionally, our Amended and Restated Credit and Security Agreement with Silicon Valley Bank, MidCap Financial Trust, and Flexpoint MCLS Holdings, LLC contains covenants that restrict our ability to pay dividends. Any return to stockholders will therefore be limited to the appreciation of their stock.

*Provisions in our amended and restated certificate of incorporation and amended and restated bylaws, as well as provisions of Delaware law, could make it more difficult for a third party to acquire us or increase the cost of acquiring us, even if doing so would benefit our stockholders, and may prevent or frustrate attempts by our stockholders to replace or remove our current management.*

Some provisions of our charter documents and Delaware law may have anti-takeover effects that could discourage an acquisition of us by others, even if an acquisition would be beneficial to our stockholders, and may prevent attempts by our stockholders to replace or remove our current management. These provisions include:

- authorizing the issuance of “blank check” preferred stock, the terms of which may be established and shares of which may be issued without stockholder approval;
- limiting the removal of directors by the stockholders;
- creating a staggered board of directors;
- prohibiting stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of our stockholders;
- eliminating the ability of stockholders to call a special meeting of stockholders; and
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon at stockholder meetings.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, we are subject to Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with an interested stockholder of such corporation for a period of three years following the date on which the stockholder became an interested stockholder, unless such transactions are approved by our board of directors. This provision could have the effect of delaying or preventing a change of control, whether or not it is desired by or beneficial to our stockholders. Further, other provisions of Delaware law may also discourage, delay or prevent someone from acquiring us or merging with us.

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

Not applicable.

#### **Item 2. Properties**

Our offices are located in Burlington, Massachusetts at a leased facility used primarily for corporate functions. Due to increased headcount and future growth plans, during 2019, we amended the lease to expand the facility to approximately 42,000 square feet. The lease for the office space expires in April 2025. In addition, we lease approximately 5,300 square feet of laboratory space in Woburn, Massachusetts under a lease that expires in 2022.

#### **Item 3. Legal Proceedings**

We are not currently a party to any material legal proceedings.

#### **Item 4. Mine Safety Disclosures**

Not applicable.



## PART II

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

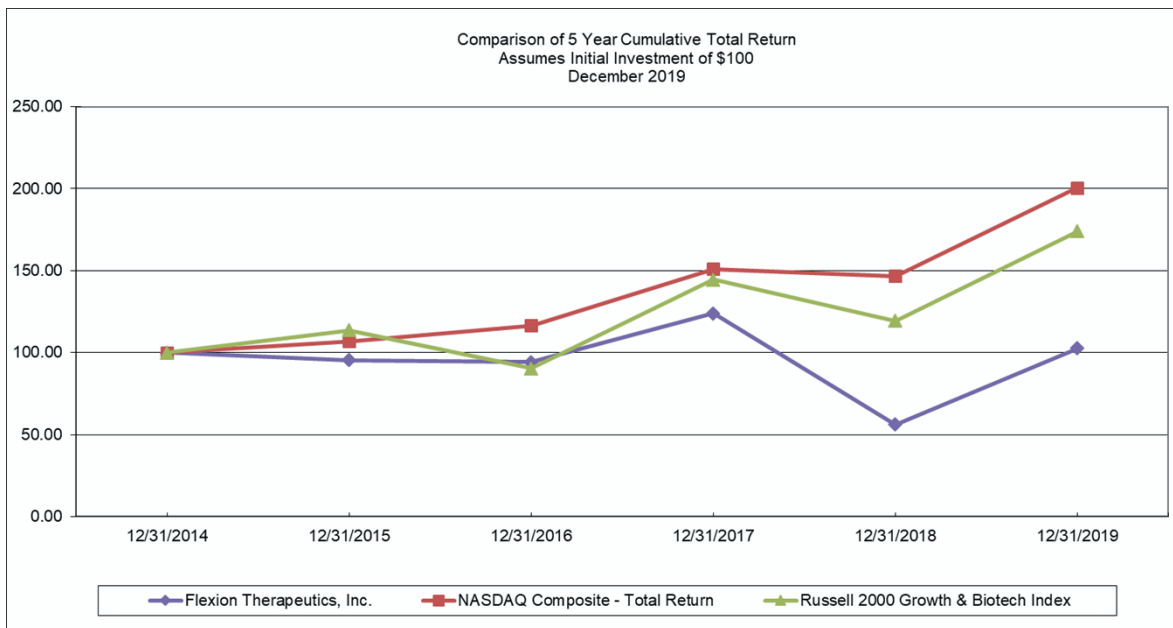
#### Market Information

Our common stock is listed on the Nasdaq Global Market and trades under the symbol “FLXN”.

#### Comparative Stock Performance Graph

The following performance graph and related information shall not be deemed “soliciting material” or to be “filed” with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or Exchange Act, except to the extent that we specifically incorporate it by reference into such filing.

The following graph shows a comparison from December 31, 2014 through December 31, 2019 of the cumulative total return for our common stock, the Russell 2000 Growth and Biotech index and the Nasdaq Composite Index. The graph assumes an initial investment of \$100 on December 31, 2014. The comparisons in the graph are not intended to forecast or be indicative of possible future performance of our common stock.



#### Holdings of Record

As of February 28, 2020, there were approximately 15 stockholders of record of our common stock. Certain shares are held in “street” name and accordingly, the number of beneficial owners of such shares is not known or included in the foregoing number.

#### Securities Authorized for Issuance under Equity Compensation Plans

Information about our equity compensation plans is incorporated herein by reference to Item 12 of Part III of this Annual Report.

#### Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities by us during the year ended December 31, 2019.

**Issuer Repurchases of Equity Securities**

None.

## Item 6. Selected Financial Data

The following selected financial data should be read together with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our consolidated financial statements and related notes included elsewhere in this Annual Report. The selected consolidated financial data in this section are not intended to replace our consolidated financial statements and the related notes. Our historical results are not necessarily indicative of the results that may be expected in the future.

We have derived the consolidated statements of operations data for the years ended December 31, 2019, 2018 and 2017 and the consolidated balance sheet data as of December 31, 2019 and December 31, 2018 from our audited consolidated financial statements appearing elsewhere in this Annual Report. The selected consolidated statement of operations data for the years ended December 31, 2016 and 2015 and the selected consolidated balance sheet data as of December 31, 2017, 2016 and 2015 are derived from our audited consolidated financial statements not included in this document.

	Year Ended December 31,				
	2019	2018	2017	2016	2015
	(in thousands, except per share amounts)				
<b>Consolidated Statement of Operations Data:</b>					
Revenues:					
Product revenue, net	\$ 72,957	\$ 22,524	\$ 355	\$ —	\$ —
Operating expenses:					
Cost of sales	9,960	7,336	4	—	—
Research and development	69,559	53,079	51,231	41,314	32,691
Selling, general and administrative	129,709	121,311	78,801	28,466	13,372
Total operating expenses	209,228	181,726	130,036	69,780	46,063
Loss from operations	(136,271)	(159,202)	(129,681)	(69,780)	(46,063)
Other (expense) income					
Interest income	3,212	4,567	3,718	1,521	1,246
Interest expense	(17,066)	(15,712)	(11,268)	(1,748)	(571)
Other income (expense)	352	688	(250)	(1,887)	(927)
Total other (expense) income	(13,502)	(10,457)	(7,800)	(2,114)	(252)
Net loss	\$ (149,773)	\$ (169,659)	\$ (137,481)	\$ (71,894)	\$ (46,315)
Net loss per share attributable to common stockholders, basic and diluted <sup>(1)</sup>	\$ (3.93)	\$ (4.49)	\$ (4.16)	\$ (2.84)	\$ (2.15)
Weighted average common shares outstanding, basic and diluted <sup>(1)</sup>	38,086	37,751	33,027	25,297	21,497

	As of December 31,				
	2019	2018	2017	2016	2015
	(in thousands)				
<b>Consolidated Balance Sheet Data:</b>					
Cash, cash equivalents, marketable securities, and long-term investments	\$ 136,660	\$ 258,784	\$ 423,916	\$ 210,329	\$ 118,604
Working capital <sup>(2)</sup>	159,456	248,425	367,418	191,853	104,044
Total assets	217,560	295,752	441,317	226,262	127,139
Total debt <sup>(3)</sup>	193,589	158,486	160,010	30,533	15,002
Total stockholders’ (deficit) equity	(20,108)	110,079	260,274	187,032	103,986

- (1) See Note 3 to our consolidated financial statements appearing elsewhere in this Annual Report for further details on the calculation of basic and diluted net loss per share attributable to common stockholders.
- (2) We define working capital as current assets less current liabilities.
- (3) Total debt includes the current and long-term portion of our term loan, net of debt issuance costs, and the 2024 Convertible Notes, net of the portion of the proceeds allocated to the conversion option and net of debt issuance costs.

## **Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion and analysis of financial condition and results of operations should be read in conjunction with “Item 6. Selected Financial Data” and our consolidated financial statements and related notes appearing elsewhere in this Annual Report. This discussion and analysis and other parts of this Annual Report contain forward-looking statements based upon current beliefs, plans and expectations that involve risks, uncertainties and assumptions, such as statements regarding our plans, objectives, expectations, intentions and projections. Our actual results and the timing of selected events could differ materially from those anticipated in these forward-looking statements as a result of several factors, including those set forth under “Item 1A. Risk Factors”. You should carefully read the “Risk Factors” section of this Annual Report to gain an understanding of the important factors that could cause actual results to differ materially from our forward-looking statements. Please also see the section entitled “Special Note Regarding Forward-Looking Statements.”*

### **Overview**

We are a biopharmaceutical company focused on the discovery, development and commercialization of novel, local therapies for the treatment of patients with musculoskeletal conditions, beginning with osteoarthritis, a type of degenerative arthritis referred to as OA.

On October 6, 2017, the U.S. Food and Drug Administration, or FDA, approved our product, ZILRETTA, for marketing in the United States. ZILRETTA is the first and only extended-release, intra-articular, or IA (meaning in the joint), injection indicated for the management of OA related knee pain. ZILRETTA is a non-opioid therapy that employs our proprietary microsphere technology to provide extended pain relief. The pivotal Phase 3 trial, on which the approval of ZILRETTA was based, showed that ZILRETTA met the primary endpoint of pain reduction at Week 12, with statistically significant pain relief extending through Week 16. On December 26, 2019, we announced that the FDA approved a revised product label for ZILRETTA. The new label removed language that previously stated ZILRETTA was “not intended for repeat administration” and replaced it with language stating that “the efficacy and safety of repeat administration of ZILRETTA have not been demonstrated.”

We have two pipeline programs focused on the local treatment of musculoskeletal conditions: FX201, which is an investigational IA gene therapy product candidate in clinical development for the treatment of OA, and FX301, a preclinical product candidate, which is being developed as a locally administered peripheral nerve block for management of post-operative pain.

We were incorporated in Delaware in November 2007, and to date we have devoted substantially all of our resources to developing our product candidates, including conducting clinical trials with our product candidates, preparing for and undertaking the commercialization of ZILRETTA, providing general and administrative support for these operations and protecting our intellectual property. From our inception through December 31, 2019, we have raised approximately \$796 million and funded our operations primarily through the sale of our common stock, convertible preferred stock, and convertible debt, as well as debt financing. Until such time, if ever, that we can generate sufficient product revenue, we expect to finance our cash needs through a combination of equity offerings, debt financings, government or third-party funding, and licensing or collaboration arrangements.

We have incurred net losses in each year since our inception in 2007. Our net losses were \$149.8 million, \$169.7 million, and \$137.5 million for the years ended December 31, 2019, 2018 and 2017, respectively. As of December 31, 2019, we had an accumulated deficit of \$668.6 million. Substantially all of our net losses resulted from costs incurred in connection with our development programs and from selling, general and administrative expenses associated with our operations.

We anticipate that we will incur losses over the next few years. We expect that our operating expenses will continue to increase in connection with our ongoing activities, as we:

- continue the development and commercialization of ZILRETTA, including our on-going and future clinical trials;
- continue to scale-up manufacturing activities including the supply of clinical trial materials and commercial batches;

- maintain a sales and marketing infrastructure for the commercialization of ZILRETTA;
- expand our development activities and advance additional product candidates;
- maintain, expand and protect our intellectual property portfolio; and
- add operational, financial and management information systems and personnel, including personnel to support our product development and commercialization efforts and operations as a public company.

ZILRETTA is a physician-administered product, and therefore physicians are required to purchase and manage the inventory of ZILRETTA, prior to administering the product to patients. Physicians obtain reimbursement for ZILRETTA from the applicable third-party payer, such as Medicare or a health insurance company, only after it has been administered to patients. This is called a “buy and bill” process. Because physicians are at financial risk for the cost of a “buy and bill” product until they have been reimbursed, concerns about reimbursement can impact a physician’s decision to use the product. CMS announced in November 2018, that ZILRETTA had been recommended for a product-specific J code (J3304), which took effect on January 1, 2019. We believe that the product-specific J code, J3304, provides prescribers with confidence in the reimbursement of ZILRETTA, as product-specific J codes are universally recognized by Medicare, as well as by commercial payers.

Our promotional and marketing activities have increased since launch, as our field sales representatives, known as Musculoskeletal Business Managers, or MBMs, have expanded prescriber awareness and utilization of ZILRETTA. Furthermore, our Field Access Managers have been working with physician practices to navigate any reimbursement challenges and to support their awareness of the product-specific Healthcare Common Procedures Coding System (HCPCS) reimbursement code for ZILRETTA (J3304), which became effective on January 1, 2019.

We closely track and provide updates on several uptake metrics to provide perspective on the progress of the ZILRETTA launch. Since the launch in November 2017 through December 31, 2019:

- 3,488 of our approximately 4,972 target accounts had purchased ZILRETTA. This compares to the 3,130 purchasing accounts over the period from launch through September 30, 2019
- 76% of purchasing accounts (2,642) had placed at least one reorder
- 794 accounts had made ZILRETTA purchases of more than 50 units; 1,028 accounts had purchased 11-50 units; and 1,666 accounts had purchased between 1-10 units
- Accounts purchasing more than 50 ZILRETTA units have been responsible for 81% of the total ZILRETTA units purchased (142,789 units)

On August 2, 2019, we entered into the Amended and Restated Credit and Security Agreement with Silicon Valley Bank as agent, MidCap Financial Trust, Flexpoint MCLS Holdings, LLC, and the other lenders from time to time party thereto (collectively, the Lenders), providing for a term loan of \$40.0 million and a revolving credit facility of up to \$20.0 million, both of which mature on January 1, 2024. We concurrently drew down the \$40.0 million term loan and used \$7.7 million of the proceeds to repay the remaining amount owed on our existing term loan with Silicon Valley Bank and MidCap Funding XIII Trust. The revolving credit facility became available to us beginning January 1, 2020, and in February 2020, we drew down the \$20.0 million available. The Amended and Restated Credit and Security Agreement also contains a minimum revenue covenant that will be in effect at any time our liquidity (defined as cash and cash equivalents held with Silicon Valley Bank) is below \$80.0 million. If the revenue covenant becomes applicable and we fail to comply with it, the amounts due under the Amended and Restated Credit and Security Agreement could be declared immediately due and payable. The revenue covenant is set annually and is based on the greater of a conservative percentage of that year’s approved forecast and modest growth over the trailing twelve months of actual sales.

We may need to raise additional capital for the commercialization of ZILRETTA and completing clinical development of any of our other product candidates. Until such time that we can generate sufficient product revenue, we expect to finance our cash needs through a combination of equity offerings, debt financings, including convertible debt financings, government or other third-party funding and collaborations, and licensing arrangements. However, we may be unable to raise additional funds or enter into such arrangements when needed on favorable terms, or at all, which would have a negative impact on our financial condition and could force us to delay, limit, reduce or terminate our development programs or commercialization efforts or grant to others, rights to develop or

market product candidates that we would otherwise prefer to develop and market ourselves. Failure to receive additional funding could cause us to cease operations, in part or in full.

## **Financial Overview**

### ***Revenue***

Net product sales consist of sales of ZILRETTA, which was approved by the FDA on October 6, 2017 and launched in the United States shortly thereafter. We had not generated any revenue prior to the launch of ZILRETTA.

### ***Cost of Sales***

Cost of sales consists of third-party manufacturing costs, freight and indirect overhead costs associated with sales of ZILRETTA. Cost of sales also includes period costs related to certain inventory manufacturing services, inventory adjustment charges, and unabsorbed manufacturing and overhead costs, as well as any write-offs of inventory that fails to meet specification or is otherwise no longer suitable for commercial manufacture. Based on our policy to expense costs associated with the manufacture of our products prior to regulatory approval, the vast majority of the costs to manufacture ZILRETTA that was recognized as revenue during the year ended December 31, 2017 were expensed prior to the October 2017 FDA approval and, therefore, are not included in cost of sales during the period. In addition, the majority of product sold during the year ended December 31, 2018 was manufactured and previously charged to research and development expense prior to FDA approval of ZILRETTA and therefore is not included in cost of sales during the period. As of December 31, 2018, all of the finished goods inventory that was previously expensed had been sold to customers.

### ***Research and Development Expenses***

Our research and development activities include: preclinical studies, clinical trials, and chemistry, manufacturing, and controls, or CMC activities. Our research and development expenses consist primarily of:

- expenses incurred under agreements with consultants, contract research organizations, or CROs, and investigative sites that conduct our preclinical studies and clinical trials;
- costs of acquiring, developing and manufacturing clinical trial materials;
- personnel costs, including salaries, benefits, stock-based compensation and travel expenses for employees engaged in scientific research and development functions;
- costs related to compliance with certain regulatory requirements;
- expenses related to the in-license of certain technologies; and
- allocated expenses for rent and maintenance of facilities, insurance and other general overhead.

We expense research and development costs as incurred. Our direct research and development expenses consist primarily of external-based costs, such as fees paid to investigators, consultants, investigative sites, CROs and companies that manufacture our clinical trial materials and potential future commercial supplies, and are tracked on a program-by-program basis. We do not allocate personnel costs, facilities or other indirect expenses to specific research and development programs. These indirect expenses are included within the amounts designated as “Personnel and other costs” in the Results of Operations section below. Inventory acquired prior to receipt of the marketing approval of ZILRETTA was recorded as research and development expense as incurred. We began capitalizing the costs associated with the production of ZILRETTA after the FDA approval on October 6, 2017.

Our research and development expenses are expected to increase in the foreseeable future. Specifically, our costs will increase as we conduct additional clinical trials for ZILRETTA and conduct further developmental activities for our pipeline programs.

We cannot determine with certainty the duration of and completion costs associated with ongoing and future clinical trials or the associated regulatory approval process, post-marketing development of ZILRETTA or

development of any product candidates in our pipeline. The duration, costs and timing associated with the further development of ZILRETTA or the development of other product candidates will depend on a variety of factors, including uncertainties associated with the results of our clinical trials. As a result of these uncertainties, we are currently unable to estimate with any precision our future research and development expenses for expanded indications for ZILRETTA or any product candidates in our pipeline, or when we may generate sufficient revenue to achieve a positive cash flow position.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses consist primarily of personnel costs, including salaries, related benefits, travel expenses and stock-based compensation of our executive, finance, business development, commercial, information technology, legal and human resources functions. Other selling, general and administrative expenses include an allocation of facility-related costs, patent filing expenses, and professional fees for legal, consulting, auditing and tax services.

We anticipate that our selling, general and administrative expenses will increase in the future as we continue to build our corporate and commercial infrastructure to support the continued development and commercialization of ZILRETTA or any other product candidates. In particular, we expect to incur ongoing increases in selling, general and administrative expenses related to the commercialization of ZILRETTA, including external marketing expenses and the operation of our field sales force. Additionally, we anticipate increased expenses related to the audit, legal and compliance, regulatory, investor relations and tax-related services associated with maintaining compliance with the SEC and Nasdaq requirements and healthcare laws and compliance requirements, director and officer insurance premiums and other costs associated with operating as a publicly-traded company.

### ***Other Income (Expense)***

***Interest income.*** Interest income consists of interest earned on our cash and cash equivalents balances and our marketable securities. The primary objective of our investment policy is capital preservation.

***Interest expense.*** Interest expense consists of contractual interest on our 2024 Convertible Notes, which accrue interest at a rate of 3.375% per annum, payable semi-annually, our former term loan facility, which accrued interest at a fixed rate of 6.25% per annum and our new term loan facility, which accrues interest at a floating interest rate equal to the greater of the Prime Rate (as reported in the Wall Street Journal) plus 1.50%, or 6.50% per annum. Also included in interest expense is the amortization of the final payment on the term loan and the debt discount related to the convertible notes, which is being amortized to interest expense using the effective interest method over the expected life of the debt.

***Foreign currency gain (loss).*** We maintain a bank account denominated in British Pounds. All foreign currency payables and cash balances are measured at the applicable exchange rate at the end of the reporting period. All associated gains and losses from foreign currency transactions are reflected in the consolidated statements of operations, within other income and expense.

***Other income (expense).*** Other income (expense) consists of the net accretion of premiums and discounts related to our marketable securities, and our realized gains (losses) on redemptions of our marketable securities. We will continue to record either income or expense related to accretion of discounts or amortization of premiums on marketable securities for as long as we hold these investments. Also included in other income (expense) is the amortization of debt issuance costs on our term loan facility and the 2024 Convertible Notes, which are being amortized over the respective terms of the loans.

### ***Income Taxes***

As of December 31, 2019, we had \$404.3 million and \$300.0 million of federal and state net operating loss carryforwards, respectively, and \$8.6 million and \$4.3 million of federal and state research and development tax credit carryforwards, respectively, available to offset our future taxable income, if any. These federal net operating loss carryforwards and research and development tax credit carryforwards expire at various dates beginning in 2029,

if not utilized and are subject to review and possible adjustment by the Internal Revenue Service. Approximately \$214.8 million of the federal net operating losses have an indefinite carryforward. The state net operating loss carryforwards and research and development tax credit carryforwards expire at various dates beginning in 2030 and 2025, respectively, if not utilized and are subject to review and possible adjustment by the state tax authorities. At December 31, 2019, a full valuation allowance was recorded against our net operating loss carryforwards and our research and development tax credit carryforwards.

If we experience a greater than 50% aggregate change in ownership of certain stockholders over a three-year period, utilization of our then-existing net operating loss carryforwards and research and development tax credit carryforwards will be subject to an annual limitation.

### **Critical Accounting Policies and Significant Judgments and Estimates**

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which we have prepared in accordance with generally accepted accounting principles in the United States, or GAAP. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of our financial statements, and the reported revenue and expenses during the reported periods. We evaluate these estimates and judgments, including those described below, on an ongoing basis. We base our estimates on historical experience, known trends and events, contractual milestones and various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in Note 3 to our consolidated financial statements appearing elsewhere in this Form 10-K, we believe that the estimates and assumptions involved in the following accounting policies may have the greatest potential impact on our financial statements and, therefore, consider these to be critical for fully understanding and evaluating our financial condition and results of operations.

#### ***Revenue Recognition***

On October 6, 2017, U.S. Food and Drug Administration, of FDA, approved ZILRETTA. We entered into a limited number of arrangements with specialty distributors and a specialty pharmacy in the U.S. to distribute ZILRETTA. We recognize revenue in accordance with Accounting Standards Codification ("ASC") Topic 606 - Revenue from Contracts with Customers ("Topic 606"). Under Topic 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to be entitled to in exchange for those goods or services.

To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the entity performs the following five steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. We only apply the five-step model to arrangements that meet the definition of a contract with a customer under Topic 606, including when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, we assess the goods or services promised within each contract, determine those that are performance obligations, and assess whether each promised good or service is distinct. We then recognize as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied. For a complete discussion of accounting for product revenue, see Product Revenue, Net (below).



*Product Revenue, Net*— We primarily sell ZILRETTA to specialty distributors and a specialty pharmacy, who then subsequently resell ZILRETTA to physicians, clinics and certain medical centers or hospitals. We also contract directly with healthcare providers and intermediaries such as Group Purchasing Organizations (“GPOs”). In addition, we enter into arrangements with government payers that provide for government mandated rebates and chargebacks with respect to the purchase of ZILRETTA.

We recognize revenue on product sales when the customer obtains control of ZILRETTA, which occurs at a point in time (upon delivery to the customer). We have determined that the delivery of ZILRETTA to our customers constitutes a single performance obligation. There are no other promises to deliver goods or services beyond what is specified in each accepted customer order. Management has assessed the existence of a significant financing component in the agreements with our customers. The trade payment terms with our customers do not exceed one year and therefore management has elected to apply the practical expedient and no amount of consideration has been allocated as a financing component. Product revenues are recorded net of applicable reserves for variable consideration, including discounts and allowances.

*Transaction Price, including Variable Consideration*— Revenues from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for which reserves are established. Components of variable consideration include trade discounts and allowances, product returns, government chargebacks, discounts and rebates, and other incentives, such as voluntary patient assistance, and other fee for service amounts that are detailed within our contracts with our customers relating to the sale of ZILRETTA. These reserves, as detailed below, are based on the amounts earned, or to be claimed on the related sales, and are classified as reductions of accounts receivable (if the amount is payable to the customer) or a current liability (if the amount is payable to a party other than a customer). These estimates take into consideration a range of possible outcomes which are probability-weighted in accordance with the expected value method in Topic 606 for relevant factors such as current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect our best estimates of the amount of consideration to which we are entitled based on the terms of the respective underlying contracts.

The amount of variable consideration which is included in the transaction price may be constrained and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized under the contract will not occur in a future period. Actual amounts of consideration ultimately received may differ from our estimates. If actual results in the future vary from our original estimates, we will adjust these estimates, which would affect net product revenue and earnings in the period such variances become known.

*Service Fees and Allowances*—We compensate our customers and GPOs for sales order management, data, and distribution services. However, we have determined such services received to date are not distinct from our sale of products to the customer and, therefore, these payments have been recorded as a reduction of revenue within the statement of operations and comprehensive loss through December 31, 2019, as well as a reduction to trade receivables, net on the consolidated balance sheets.

*Product Returns*— Consistent with industry practice, we generally offer our customers a limited right of return for product that has been purchased from us based on the product’s expiration date. We estimate the amount of our product sales that may be returned by our customers and record this estimate as a reduction of revenue in the period the related product revenue is recognized, as well as within accrued expenses and other current liabilities, net on the consolidated balance sheets. We currently estimate product return liabilities using available industry data and our own sales information, including our visibility into the inventory remaining in the distribution channel. We have received an immaterial amount of returns to date and we believe that returns of ZILRETTA will be minimal.

*Chargebacks*— Chargebacks for fees and discounts to qualified government healthcare providers represent the estimated obligations resulting from contractual commitments to sell products to qualified VA hospitals and 340b entities at prices lower than the list prices charged to customers who directly purchase the product from us. The 340b Drug Discount Program is a US federal government program created in 1992 that requires drug manufacturers

to provide outpatient drugs to eligible health care organizations and covered entities at significantly reduced prices. Customers charge us for the difference between what they pay for the product and the statutory selling price to the qualified government entity. These reserves are established in the same period that the related revenue is recognized, resulting in a reduction of product revenue and trade receivables, net. Chargeback amounts are generally determined at the time of resale to the qualified government healthcare provider by customers, and we generally issue credits for such amounts within a few weeks of the customer's notification to us of the resale. Reserves for chargebacks consist of credits that we expect to issue for units that remain in the distribution channel inventories at each reporting period-end that we expect will be sold to qualified healthcare providers, and chargebacks that customers have claimed, but for which we have not yet issued a credit.

*Government Rebates*— We are subject to discount obligations under state Medicaid programs and Medicare. These reserves are recorded in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability which is included in accrued expenses and other current liabilities on the consolidated balance sheets. For Medicare, we also estimate the number of patients in the prescription drug coverage gap for whom we will owe an additional liability under the Medicare Part D program. We anticipate our exposure to utilization from the Medicare Part D coverage gap discount program to be immaterial. For Medicaid programs, we estimate the portion of sales attributed to Medicaid patients and record a liability for the rebates to be paid to the respective state Medicaid programs. Our liability for these rebates consists of invoices received for claims from prior quarters that have not been paid or for which an invoice has not yet been received, estimates of claims for the current quarter, and estimated future claims that will be made for product that has been recognized as revenue, but which remains in the distribution channel inventories at the end of each reporting period.

*Purchaser/Provider Discounts and Rebates*—Beginning in the third quarter of 2019, we began offering rebates to eligible purchasers and healthcare providers that are variable based on volume of product purchased. Rebates are based on actual purchase levels during the rebate purchase period. We estimate these rebates and record such estimates in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability.

*Other Incentives*— Other incentives which we offer include voluntary patient assistance programs, such as the co-pay assistance program, which are intended to provide financial assistance to qualified commercially-insured patients with prescription drug co-payments required by payers. The calculation of the accrual for co-pay assistance is based on an estimate of claims and the cost per claim that we expect to receive associated with product that has been recognized as revenue but remains in the distribution channel inventories at the end of each reporting period. The adjustments are recorded in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability which is included as a component of accrued expenses and other current liabilities on the consolidated balance sheets.

To date, our only source of product revenue has been from the U.S. sales of ZILRETTA, which we began shipping to customers in October 2017.

The following table summarizes activity in each of the product revenue allowance and reserve categories for the years ended December 31, 2019, 2018 and 2017:

<i>(In thousands)</i>	<b>Service Fees, Allowances and Chargebacks</b>	<b>Government Rebates and Other Incentives</b>	<b>Product Returns</b>	<b>Purchaser/Provider Discounts and Rebates</b>	<b>Total</b>
Balance as of January 1, 2017	\$ —	\$ —	\$ —	\$ —	\$ —
Provision related to sales in the current year	100	15	2	—	117
Credit or payments made during the period	(40)	—	—	—	(40)
Balance as of December 31, 2017	60	15	2	—	77
Provision related to sales in the current year	1,688	502	124	—	2,314
Credit or payments made during the period	(1,147)	(26)	(1)	—	(1,174)
Balance as of December 31, 2018	601	491	125	—	1,217
Provision related to sales in the current year	5,527	261	334	2,685	8,807
Credit or payments made during the period	(4,281)	(375)	(57)	(1,029)	(5,742)
Adjustments related to prior period sales	—	(129)	—	—	(129)
Balance as of December 31, 2019	<u>\$ 1,847</u>	<u>\$ 248</u>	<u>\$ 402</u>	<u>\$ 1,656</u>	<u>\$ 4,153</u>

### ***Research and Development Expenses***

As part of the process of preparing our financial statements, we are required to estimate our accrued expenses. This process involves reviewing open contracts and purchase orders, communicating with applicable internal and vendor personnel to identify services that have been performed on our behalf and estimating the level of service performed and the associated cost incurred for the service when we have not yet been invoiced or otherwise notified of the actual cost. The majority of our service providers invoice us monthly in arrears for services performed or when contractual milestones are met. We make estimates of our accrued expenses as of each balance sheet date in our financial statements based on facts and circumstances known to us at that time. We periodically confirm the accuracy of our estimates with the service providers and make adjustments if necessary. Examples of estimated accrued research and development expenses include fees paid to:

- CROs in connection with clinical studies;
- investigative sites in connection with clinical studies;
- vendors related to product manufacturing, development and distribution of clinical supplies; and
- vendors in connection with preclinical development activities.

We record expenses related to clinical studies and manufacturing development activities based on our estimates of the services received and efforts expended pursuant to contracts with multiple CROs and manufacturing vendors that conduct and manage these activities on our behalf. The financial terms of these agreements are subject to negotiation, vary from contract to contract, and may result in uneven payment flows.

We make estimates of our accrued expenses as of each balance sheet date in our financial statements based on facts and circumstances known to us. If timelines or contracts are modified based upon changes in the clinical trial protocol or scope of work to be performed, we modify our estimates of accrued expenses accordingly on a prospective basis. If we do not identify costs that we have begun to incur, or if we underestimate or overestimate the level of services performed or the costs of these services, our actual expenses could differ from our estimates. To date, we have not adjusted our estimates at any particular balance sheet date in any material amount.

## RESULTS OF OPERATIONS

### Year Ended December 31, 2019 Compared to Year Ended December 31, 2018

The following table summarizes our results of operations for the years ended December 31, 2019 and 2018:

<i>(In thousands)</i>	Year Ended December 31,			
	2019	2018	\$ Change	% Change
<b>Revenues</b>				
Product revenue, net	\$ 72,957	\$ 22,524	\$ 50,433	223.9%
<b>Operating expenses</b>				
Cost of sales	9,960	7,336	2,624	35.8%
Research and development	69,559	53,079	16,480	31.0%
Selling, general and administrative	129,709	121,311	8,398	6.9%
Total operating expenses	209,228	181,726	27,502	15.1%
Loss from operations	(136,271)	(159,202)	22,931	(14.4)%
<b>Other (expense) income</b>				
Interest income	3,212	4,567	(1,355)	(29.7)%
Interest expense	(17,066)	(15,712)	(1,354)	8.6%
Other income (expense)	352	688	(336)	48.8%
Total other (expense) income	(13,502)	(10,457)	(3,045)	29.1%
Net loss	\$ (149,773)	\$ (169,659)	\$ 19,886	(11.7)%

#### **Product Revenue**

We began commercially selling ZILRETTA within the United States in October 2017, following FDA approval on October 6, 2017. For the years ended December 31, 2019 and 2018, we recorded \$73.0 million and \$22.5 million, respectively, of net product revenue. For further discussion regarding our revenue recognition policy, see Note 3 to our consolidated financial statements appearing elsewhere in this Annual Report.

#### **Cost of Sales**

Cost of sales was \$10.0 million and \$7.3 million for the years ended December 31, 2019 and 2018, respectively. For the years ended December 31, 2019 and 2018, cost of sales consisted of \$8.4 million and \$2.3 million, respectively, related to the actual cost of units sold and \$0.9 million and \$5.0 million, respectively, as a result of unabsorbed manufacturing and overhead costs related to the operation of the facility at Patheon. Cost of sales for the year ended December 31, 2019 also included \$0.7 million of period costs and other adjustments. Based on our policy to expense costs associated with the manufacture of our products prior to regulatory approval, the vast majority of the costs to manufacture ZILRETTA that were recognized as revenue during the year ended December 31, 2018 were expensed prior to the October 2017 FDA approval and, therefore, are not included in cost of sales during the period. As of December 31, 2018, all of the finished goods inventory that was previously expensed had been sold to customers.

#### **Research and Development Expenses**

<i>(In thousands)</i>	Year Ended December 31,			
	2019	2018	\$ Change	% Change
<b>Direct research and development expenses by program:</b>				
ZILRETTA	\$ 22,847	\$ 16,244	\$ 6,603	40.6%
Portfolio expansion	11,384	6,713	4,671	69.6%
Other	3,120	2,345	775	33.0%
Total direct research and development expenses	37,351	25,302	12,049	47.6%
Personnel and other costs	32,208	27,777	4,431	16.0%
Total research and development expenses	\$ 69,559	\$ 53,079	\$ 16,480	31.0%

Research and development expenses were \$69.6 million and \$53.1 million for the years ended December 31, 2019 and 2018, respectively. The increase in research and development expenses year-over-year of \$16.5 million was primarily due to an increase of \$4.4 million in salary and other employee-related costs for additional headcount and stock-based compensation expense, an increase of \$5.5 million in preclinical expenses related to our portfolio expansion and other programs costs, primarily related to the completion of toxicology studies and ongoing manufacturing of GMP batches to start clinical testing for our gene therapy product candidate, FX201, as well as the upfront payment of \$3.0 million to Xenon Pharmaceuticals for the acquisition of the global rights to funapide, and an increase of \$6.6 million in development expenses for ZILRETTA, including CMC and clinical trial costs.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses were \$129.7 million and \$121.3 million for the years ended December 31, 2019 and 2018, respectively. Selling expenses were \$96.3 million and \$87.3 million for the years ended December 31, 2019 and 2018. The year-over-year increase in selling expenses of \$9.0 million was primarily due to salary and other employee-related costs and external costs related to marketing and reimbursement support activities. General and administrative expenses were \$33.4 million and \$34.0 million for the years ended December 31, 2019 and 2018, respectively, which represents a decrease of \$0.6 million year over year.

### ***Other Income (Expense)***

Interest income was \$3.2 million and \$4.6 million for the years ended December 31, 2019 and 2018, respectively. The decrease in interest income was primarily due to a decrease in the average investment balance.

Interest expense was \$17.1 million and \$15.7 million for the years ended December 31, 2019 and 2018, respectively. The increase in interest expense is primarily due to the write-off of unamortized costs associated with the 2015 term loan facility which was extinguished in the third quarter of 2019 and the establishment of the new term loan facility in August 2019 related to the increased outstanding balance.

We recorded other income of \$0.4 million for the year ended December 31, 2019, compared to other income of \$0.7 million for the year ended December 31, 2018. The decrease in other income, was primarily due to the debt issuance costs related to the term loan facility that was extinguished in the third quarter of 2019 and an increase in losses related to foreign currency exchange rates, partially offset by an increase in accretion related to our investments

### **Year Ended December 31, 2018 Compared to Year Ended December 31, 2017**

The following table summarizes our results of operations for the years ended December 31, 2018 and 2017:

<i>(In thousands)</i>	<b>Year Ended December 31,</b>			
	<b>2018</b>	<b>2017</b>	<b>\$ Change</b>	<b>% Change</b>
<b>Revenues</b>				
Product revenues, net	\$ 22,524	\$ 355	\$ 22,169	NM
<b>Operating expenses</b>				
Cost of sales	7,336	4	7,332	NM
Research and development	53,079	51,231	1,848	3.6%
Selling, general and administrative	121,311	78,801	42,510	53.9%
Total operating expenses	181,726	130,036	51,690	39.8%
Loss from operations	(159,202)	(129,681)	(29,521)	22.8%
<b>Other (expense) income</b>				
Interest income	4,567	3,718	849	22.8%
Interest expense	(15,712)	(11,268)	(4,444)	39.4%
Other income (expense)	688	(250)	938	(375.2)%
Total other (expense) income	(10,457)	(7,800)	(2,657)	34.1%
Net loss	<u>\$ (169,659)</u>	<u>\$ (137,481)</u>	<u>\$ (32,178)</u>	<u>23.4%</u>

### ***Product Revenue***

We began commercially selling ZILRETTA within the United States in October 2017, following FDA approval on October 6, 2017. For the years ended December 31, 2018 and 2017, we recorded \$22.5 million and \$0.4 million, respectfully, of net product revenue. For further discussion regarding our revenue recognition policy, see Note 3 to our consolidated financial statements appearing elsewhere in this Form 10-K.

### ***Cost of Sales***

Cost of sales was approximately \$7.3 million and \$4 thousand for the years ended December 31, 2018 and 2017, of which \$5.0 million relates to unabsorbed manufacturing and overhead related to the operation of the facility at Patheon for the year ended December 31, 2018. Based on our policy to expense costs associated with the manufacture of our products prior to regulatory approval, the vast majority of the costs to manufacture ZILRETTA that was recognized as revenue during the year ended December 31, 2018 were expensed prior to the October 2017 FDA approval of ZILRETTA and, therefore, are not included in cost of sales during the period. We expect cost of sales to increase in relation to product revenues as we deplete these inventories.

### ***Research and Development Expenses***

<i>(In thousands)</i>	<b>Year Ended December 31,</b>			
	<b>2018</b>	<b>2017</b>	<b>\$ Change</b>	<b>% Change</b>
Direct research and development expenses by program:				
ZILRETTA	\$ 16,244	\$ 20,040	\$ (3,796)	(18.9)%
Portfolio expansion	6,713	5,043	1,670	33.1%
Other	2,345	1,080	1,265	117.1%
Total direct research and development expenses	25,302	26,163	(861)	(3.3)%
Personnel and other costs	27,777	25,068	2,709	10.8%
Total research and development expenses	<u>\$ 53,079</u>	<u>\$ 51,231</u>	<u>\$ 1,848</u>	<u>3.6%</u>

Research and development expenses were \$53.1 million and \$51.2 million for the years ended December 31, 2018 and 2017, respectively. The increase in research and development expenses year over year of \$1.8 million was primarily due to an increase of \$2.7 million in salary and other employee-related costs for additional headcount and stock-based compensation expense, as well as a \$2.9 million increase in expenses related to our pipeline program and other program costs, offset by a decrease of \$3.8 million in ZILRETTA clinical development expenses primarily due to the marketing approval of ZILRETTA in the fourth quarter of 2017 and timing of clinical trial costs.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses were \$121.3 million and \$78.8 million for the years ended December 31, 2018 and 2017, respectively, for a year-over-year increase of \$42.5 million. Selling expenses were \$87.3 million and \$45.9 million for the years ended December 31, 2018 and 2017, respectively. The increase in selling expenses year over year of \$41.4 million was primarily due to salary and related costs associated with additional headcount and costs related to the creation of commercial marketing and sales capabilities. General and administrative expenses were \$34.0 million and \$32.9 million for the years ended December 31, 2018 and 2017, respectively, which represents an increase of \$1.1 million year over year.

### ***Other Income (Expense)***

Interest income was \$4.6 million and \$3.7 million for the years ended December 31, 2018 and 2017, respectively. The increase in interest income was primarily due to increasing interest rates throughout 2018.

Interest expense was \$15.7 million and \$11.3 million for the years ended December 31, 2018 and 2017, respectively. The increase in interest expense was primarily due to interest incurred on the 2024 Convertible Notes.

We recorded other income of \$0.7 million for the year ended December 31, 2018, compared to other expense of \$0.3 million for the year ended December 31, 2017. Other income, net increased primarily due to the accretion of discounts on marketable securities; whereas in 2017 more securities were purchased at a premium.

### Liquidity and Capital Resources

During the year ended December 31, 2019, we generated \$73.0 million in net product revenue. We have incurred significant net losses in each year since our inception in 2007, including net losses of \$149.8 million, \$169.7 million, and \$137.5 million for fiscal years 2019, 2018, and 2017, respectively. As of December 31, 2019, we had an accumulated deficit of \$668.6 million. We anticipate that we will continue to incur losses over the next few years. We expect that our research and development and selling, general and administrative expenses will continue to increase and, as a result, we may need additional capital to fund our operations, which we may seek to obtain through one or more equity offerings, debt and convertible debt financings, government or other third-party funding, and licensing or collaboration arrangements.

Since our inception through December 31, 2019, we have funded our operations primarily through the sale of our common stock and convertible preferred stock and convertible debt, and through venture debt financing. From our inception through December 31, 2019, we had raised approximately \$796.0 million from such transactions, including amounts from our initial and follow-on public offerings during 2014, 2016 and 2017 as well as our term loan facility entered into in 2015 and 2019 and our 2024 Convertible Notes issuance in 2017. As of December 31, 2019, we had cash, cash equivalents and marketable securities of \$136.7 million. Based on our current operating plan we anticipate that our existing cash, cash equivalents and marketable securities will fund our operations and debt obligations for at least the next twelve months from the date of issuance of the financial statements included in this report. Cash in excess of immediate requirements is invested in accordance with our investment policy, primarily with a view to capital preservation.

In connection with the Term Loan described in Note 10 of our accompanying consolidated financial statements, if our future cash balance decreases below \$80 million, we will need to remain in compliance with a minimum monthly net revenue covenant (determined in accordance with U.S. GAAP), measured on a trailing twelve month basis. The lender also has the ability to call debt based on a material adverse change clause, which is subjectively defined. If we are not in compliance with the monthly net revenue covenants or the subjective acceleration clauses are triggered under the agreement, then the lender may call our debt obligation resulting in the us immediately needing additional funds. As of December 31, 2019, we are in compliance with all covenants.

The following table shows a summary of our cash flows for each of the years ended December 31, 2019, 2018 and 2017:

<i>(In thousands)</i>	<b>Year Ended December 31,</b>		
	<b>2019</b>	<b>2018</b>	<b>2017</b>
Cash flows used in operating activities	\$ (148,758)	\$ (160,419)	\$ (107,831)
Cash flows provided by (used in) investing activities	114,764	125,584	(118,672)
Cash flows provided by (used in) financing activities	29,018	(6,325)	323,497
Net (decrease) increase in cash and cash equivalents	<u>\$ (4,976)</u>	<u>\$ (41,160)</u>	<u>\$ 96,994</u>

#### *Net Cash Used in Operating Activities*

Operating activities used \$148.8 million of cash in the year ended December 31, 2019. Cash used in operating activities resulted primarily from our net loss of \$149.8 million and changes in our operating assets and liabilities of \$25.6 million, partially offset by non-cash charges of \$26.6 million. Changes in our operating assets and liabilities consisted primarily of a \$24.0 million increase in accounts receivable, a \$7.7 million increase in inventory, partially offset by a \$0.1 million decrease in prepaid expenses and other current assets, an increase of \$7.0 million in accounts payable and accrued expenses and a \$1.0 million decrease in lease liabilities and other long-term liabilities. Non-cash charges consisted primarily of \$15.9 million of stock-based compensation expense, \$8.7 million related to the amortization of the debt discount and debt issuance costs related to the 2024 Convertible Notes, \$1.3 million

related to the amortization of right-of-use assets -\$1.1 million of depreciation and \$0.9 million related to non-cash interest expense and loss from debt extinguishment related to our 2015 term loan, partially offset by \$1.3 of net accretion of discounts related to our investments.

Operating activities used \$160.4 million of cash in the year ended December 31, 2018. Cash used in operating activities resulted primarily from our net loss of \$169.7 million offset by changes in our operating assets and liabilities of \$14.2 million and non-cash charges of \$23.4 million. Changes in our operating assets and liabilities consisted primarily of a \$12.7 million increase in accounts receivable, a \$5.2 million increase in inventory, and a \$2.1 million increase in prepaid expenses and other current assets, partially offset by an increase of \$5.8 million in accounts payable and accrued expenses. Non-cash charges consisted primarily of \$15.5 million of stock-based compensation expense, \$7.8 million related to the amortization of the debt discount and debt issuance costs related to the 2024 Convertible Notes, and \$1.7 million of depreciation, partially offset by \$1.3 million of net accretion of discounts related to our investments.

Operating activities used \$107.8 million of cash in the year ended December 31, 2017. The cash used in operating activities in the year ended December 31, 2017 resulted primarily from our 2017 net loss of \$137.5 million offset by changes in our operating assets and liabilities of \$11.8 million and non-cash charges of \$17.9 million. Changes in our operating assets and liabilities consisted primarily of a \$2.2 million increase in accounts receivable and inventory, offset by a \$0.4 million decrease in prepaid expenses, an increase of \$9.4 million in accrued expenses and other current liabilities and an increase of \$4.1 million in accounts payable. The increase in accrued expenses and other current liabilities was primarily attributable to increased expenses related to payroll and other employee related expenses, professional service fees and interest expense on loans. Non-cash charges consisted primarily of \$11.5 million of stock-based compensation expense, \$2.0 million in depreciation expense, \$4.8 million related to the amortization of the debt discount and issuance costs related to the 2024 Convertible Notes, and \$0.3 million amortization and accretion related to our investments, offset by \$0.9 million of premiums paid on securities purchased.

#### *Net Cash Provided by (Used in) Investing Activities*

Net cash provided by investing activities was \$114.7 million in the year ended December 31, 2019. Net cash provided by investing activities consisted primarily of cash received for the redemption and sale of marketable securities of \$234.1 million, partially offset by cash used to purchase marketable securities of \$115.5 million. In addition, \$3.9 million of cash was used for capital expenditures, including \$3.4 million for manufacturing equipment, \$0.2 million for lab equipment and \$0.3 million for leasehold improvements related to an expansion of our Burlington, Massachusetts headquarters.

Net cash provided by investing activities was \$125.6 million in the year ended December 31, 2018. Net cash provided by investing activities consisted primarily of cash received for the redemption and sale of marketable securities of \$348.9 million, partially offset by cash used to purchase marketable securities of \$222.5 million. In addition, \$0.8 million of cash was used for capital expenditures including \$0.2 million for manufacturing equipment, \$0.2 million for lab equipment and \$0.4 million for leasehold improvements related to an expansion of our Burlington, Massachusetts headquarters.

Net cash used in investing activities was \$118.7 million in the year ended December 31, 2017. Net cash used in investing activities consisted primarily of cash used to purchase marketable securities of \$356.8 million, partially offset by cash received from the redemption and sale of marketable securities of \$240.2 million. In addition, \$2.1 million of cash was used to purchase property and equipment, primarily computer equipment relating to the creation of commercial sales capabilities and further developing our manufacturing capabilities at our contract manufacturer, Patheon U.K. Limited.

#### *Net Cash Provided by (Used in) Financing Activities*

Net cash provided by financing activities was \$29.0 million for the year ended December 31, 2019. Net cash provided by financing activities in the year ended December 31, 2019 consisted primarily \$40.0 million of gross proceeds received from the 2019 term loan facility and \$3.5 million received from the exercise of stock options and



employee stock purchases through our employee stock purchase plan, partially offset by \$14.4 million related to the payment of principal on our 2015 term loan and \$0.1 million of debt issuance costs related to the 2019 term loan facility.

Net cash used in financing activities was \$6.3 million for the year ended December 31, 2018. Net cash used in financing activities in the year ended December 31, 2018 consisted primarily of \$10.0 related to the payment of our principal on our 2015 term loan, partially offset by \$3.7 million received from the exercise of stock options and employee stock purchases through our employee stock purchase plan.

Net cash provided by financing activities was \$323.5 million for the year ended December 31, 2017. Net cash provided by financing activities in the year ended December 31, 2017 consisted of \$194.8 million of proceeds received from the issuance of the 2024 Convertible Notes, \$132.7 million in proceeds from the follow-on offering of our common stock, and \$4.9 million in proceeds from the exercise of stock options and the issuance of common stock related to our employee stock purchase plan that was partially offset by \$8.3 million of principal payments on our 2015 term loan and \$0.5 million in financing costs associated with our follow-on financing in 2017.

### *Contractual Obligations*

The following table discloses aggregate information about our contractual obligations and the periods in which payments are due as of December 31, 2019:

	Payments Due By Period				
	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	More Than 5 Years
	(in thousands)				
Long-term debt obligation (including interest) <sup>(1)</sup>	\$ 49,084	\$ 2,736	\$ 29,427	\$ 16,921	—
Operating lease obligations <sup>(2)</sup>	8,408	1,987	3,914	2,507	—
Monthly base fee to Patheon <sup>(3)</sup>	66,011	8,518	17,036	17,036	23,421
2024 Convertible notes obligations <sup>(4)</sup>	231,248	6,792	13,584	210,872	—
Supply Agreement with Evonik <sup>(5)</sup>	847	847	—	—	—
<b>Total</b>	<u>\$ 355,598</u>	<u>\$ 20,880</u>	<u>\$ 63,961</u>	<u>\$ 247,336</u>	<u>\$ 23,421</u>

- (1) Represents the contractually required principal and interest payments on our credit facility in accordance with the required payment schedule and the 4.75% final payment to the lender on January 1, 2024. Amounts associated with future interest payments to be made were calculated using a floating interest rate equal to the greater of the prime rate plus 1.5% or 6.5% per annum.
- (2) Represents the contractually required payments under our operating lease obligations in existence as of December 31, 2019 in accordance with the required payment schedule. No assumptions were made with respect to renewing the lease terms at the expiration date of their initial terms.
- (3) Represents the contractually required monthly base fee to Patheon for the operation of the manufacturing suite.
- (4) Represents the contractually required interest payments in accordance with the required payment schedule and the final principal payment of \$201.3 million due on May 1, 2024.
- (5) Represents contractually required purchases of PLGA for clinical and commercial supply of ZILRETTA. The required purchases are based upon a 24-month rolling forecast of 100% of our total volume requirements for the PLGA product. Only the first 12 months of the 24-month rolling forecast are binding. Beginning in July 2019, the required purchases reduce to 50% of our total volume requirements for the PLGA product. Since the current required binding forecast does not go beyond December 2020, any potential minimum purchase in the year 2021 and beyond are not fixed or determinable and therefore no amounts are presented in the table above.

The table above reflects only payment obligations that are fixed or determinable. We enter into contracts in the normal course of business with CROs for clinical trials, with contract manufacturers for clinical and commercial supply manufacturing, and with vendors for preclinical research studies, research supplies and other services and

products for operating purposes. These contracts generally provide for termination on notice, and therefore we believe that our non-cancelable obligations under these agreements are not material.

In July 2015, we amended the lease for our primary office space to add approximately 4,700 square feet of additional office space, with the option to lease an additional 5,400 square feet in the same building in Burlington, Massachusetts. In addition, at the time, we leased approximately 6,700 square feet of temporary space for use prior to delivery of the additional space. This amendment extended the lease term through October 31, 2019. On September 30, 2015, we exercised our option for the additional 5,400 square feet of office space. On September 21, 2016, we entered into a second amendment to extend the lease for the 6,700 square feet of temporary space until October 31, 2017.

On April 7, 2017, we further amended the Lease to extend the term to October 31, 2023 on the then-existing office space, including the temporary space, consisting of approximately 28,600 square feet of office space in Burlington, Massachusetts. From November 2016 through October 2017, our lease payment for this space was approximately \$80,000 per month. Also, as part of this amendment to the Lease, we leased an additional 1,471 square feet of office space beginning in 2018. The lease payment for the 1,471 square feet of office space is approximately \$4,100 per month.

On October 6, 2017, we exercised our option for an additional 6,450 square feet of space, and the term for the space commenced in April 2018. We have approximately 36,500 square feet of office space in Burlington, Massachusetts under a lease term expiring on October 31, 2023. Starting in December 2017, our minimum monthly lease payment is approximately \$87,000 and it increases over the life of the amended Lease. In addition to the base rent for the office space, which increases over the term of the amended Lease, we are responsible for our share of operating expenses and real estate taxes.

In June 2019, we amended the Lease to add approximately 5,330 square feet of additional office space and extend the term of the Lease through April 30, 2025 (“the Amended Lease”). As a result of the Amended Lease, the total rentable floor area is 41,873 square feet. Starting in August 2019, our minimum monthly lease payment is approximately \$108,000, which increases over the term of the Amended Lease. In addition to the base rent for the office space, we are responsible for our share of operating expenses and real estate taxes. The lease commencement date for the additional space, which represents the date we first had access to the space, was July 1, 2019.

In February 2017, we entered into a five-year lease for laboratory space located in Woburn, Massachusetts with a monthly lease payment of approximately \$15,000, which increases over the term of the lease, plus a share of operating expenses. The total cash obligations for the term of the lease are approximately \$0.9 million.

In July 2015, we and Patheon U.K. Limited, or Patheon, entered into a Manufacturing and Supply Agreement, or the Manufacturing Agreement and Technical Transfer and Service Agreement, or the Technical Transfer Agreement, for the manufacture of clinical and commercial supplies of ZILRETTA.

Patheon agreed in the Technical Transfer Agreement to undertake certain technical transfer activities and construction services needed to prepare Patheon’s United Kingdom facility for the manufacture of ZILRETTA in dedicated manufacturing suites. We provided Patheon with certain equipment and materials necessary to manufacture ZILRETTA and pay Patheon a monthly fee for such activities and reimburse Patheon for certain material, equipment, and miscellaneous expenses and additional services.

The initial term of the Manufacturing Agreement is 10 years from approval by the FDA of the Patheon manufacturing suites for ZILRETTA, or until October 6, 2027. We pay a monthly base fee to Patheon for the operation of the manufacturing suites and a per product fee for each vial based upon a forecast of commercial demand. We also reimburse Patheon for purchases of materials and equipment made on its behalf, certain nominal expenses and additional services. The Manufacturing Agreement will remain in full effect unless and until it is terminated. Upon termination of the Manufacturing Agreement (other than termination by us in the event that Patheon does not meet the construction and manufacturing milestones or for a breach by Patheon), we will be obligated to pay for the costs incurred by Patheon associated with the removal of our manufacturing equipment and for Patheon’s termination costs up to a capped amount.

In June 2019, we and Patheon amended the Manufacturing Agreement and Technical Transfer Agreement. The amendment primarily modifies the compensation structure, which is comprised of base fees and per product fees we pay to Patheon.

In December 2017, we entered into a definitive agreement with GeneQuine to acquire the global rights to FX201. As part of the asset purchase transaction with GeneQuine, we made an upfront payment to GeneQuine of \$2.0 million. In 2018, we paid GeneQuine \$750,000 for the milestone of initiating a GLP toxicology study of FX201. In addition, we paid GeneQuine a \$750,000 payment in November 2019 following the FDA acceptance of the IND application for FX201. This milestone was recognized as research and development expense in the fourth quarter of 2019. The next milestone of \$2.5 million was achieved in March 2020 when the first patient was treated in the Phase 1 clinical trial. We may also be required to make additional milestone payments during the development of FX201, including up to \$4.5 million through the Phase 2 PoC, clinical trial and, following successful PoC, up to an additional \$51.5 million in development and global regulatory approval milestone payments. The transaction was accounted for as an asset acquisition, as it did not qualify as a business combination. The upfront fee was attributed to the intellectual property acquired and recognized as research and development expense in December 2017 as the FX201 rights had not been commercially approved and have no alternative future use. The milestone payment for the GLP toxicology study was also recorded to research and development expense in the fourth quarter of 2018. Future milestone payments earned prior to regulatory approval of FX201 would be recognized as research and development expense in the period when the milestone events become probable of being achieved. Future milestones earned upon regulatory approval would be recognized as an intangible asset and amortized to expense over its estimated life. As part of the transaction with GeneQuine, we became the direct licensee of certain underlying Baylor College of Medicine (Baylor) patents and other proprietary rights related to FX201 for human applications. The Baylor license agreement grants us an exclusive, royalty-bearing, world-wide right and license (with a right to sublicense) for human applications under its patent and other proprietary rights directly related to FX201, with a similar non-exclusive license to certain Baylor intellectual property rights that are not specific to FX201. The license agreement with Baylor includes a low single-digit royalty on net sales of FX201 and requires us to use reasonable efforts to develop FX201 according to timelines set out in the license agreement. In December 2017, we also entered into a Master Production Services Agreement with SAFC Carlsbad, Inc., a part of MilliporeSigma, for the manufacturing of preclinical and initial clinical supplies of FX201.

In September 2019, we acquired the global rights to develop and commercialize Xenon's NaV1.7 inhibitor, funapide, formulated for extended release using our novel, proprietary thermosensitive hydrogel. The preclinical program is known as FX301. As part of the asset purchase transaction with Xenon, we made an upfront payment to Xenon of \$3.0 million. We may also be required to make additional milestone payments during the development of FX301, including up to \$9.0 million through initiation of a Phase 2 proof of concept (PoC) clinical trial and, following successful PoC, up to \$40.8 million in development and global regulatory approval milestone payments and up to an additional \$75.0 million in sales-related milestone payments. As of December 31, 2019, no milestones under the arrangement had been achieved. As part of the transaction, we became the direct licensee of certain underlying Xenon patents and other proprietary rights related to funapide for human applications. The Xenon agreement grants us an exclusive, royalty-bearing, world-wide right and license (with a right to sublicense) for human applications under its patents directly related to funapide, with a similar royalty-free license to other Xenon proprietary rights directly related to funapide. The agreement with Xenon includes a tiered royalty ranging from mid-single digits to low double digits that is based on aggregate annual net sales of FX301 and requires us to use reasonable efforts to develop FX301 according to timelines set out in the agreement.

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

During the periods presented, we did not have, nor do we currently have, any off-balance sheet arrangements that are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

### **Recent Accounting Pronouncements**

A discussion of recent accounting pronouncements is included in Note 3 to the consolidated financial statements in this Annual Report on Form 10-K.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of U.S. interest rates. Due to the short-term duration of our investment portfolio and the low risk profile of our investments, an immediate 10% change in interest rates would not have a material effect on the fair market value of our portfolio. Accordingly, we would not expect our operating results or cash flows to be affected to any significant degree by a sudden change in market interest rates on our investment portfolio.

- We have borrowed \$40.0 million under our credit facility. Amounts outstanding under the credit facility bear interest at a floating interest rate equal to the greater of the prime rate plus 1.5% or 6.5% per annum.
- Our 2024 Convertible Notes carry a fixed interest rate and, thus we are not subject to interest rate risk in connection with the 2024 Convertible Notes.
- We have borrowed \$201.3 million under the 2024 Convertible Notes. Amounts outstanding bear interest at a fixed rate of 3.375% per annum.
- We do not believe that our cash, cash equivalents and marketable securities have significant risk of default or illiquidity. While we believe our cash and cash equivalents and certificates of deposit do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits.

Most of our transactions are conducted in U.S. dollars. We do have certain material agreements with vendors located outside the United States, which have transactions conducted primarily in British Pounds and Euros. As of December 31, 2019, we had approximately \$4.3 million in payables to vendors denominated in British pounds. A hypothetical 10% change in foreign exchange rates would result in a \$0.4 million change in the value of our liabilities. No other payables to vendors were denominated in currencies other than in U.S. dollars. As of December 31, 2019, we also had approximately \$0.7 million in cash denominated in British pounds. A hypothetical 10% change in foreign exchange rates would result a \$0.1 million change in the amount of cash denominated in British Pounds.

**Item 8. Financial Statements and Supplementary Data**

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders  
of Flexion Therapeutics, Inc.

### ***Opinions on the Financial Statements and Internal Control over Financial Reporting***

We have audited the accompanying consolidated balance sheets of Flexion Therapeutics, Inc. and its subsidiary (the “Company”) as of December 31, 2019 and 2018, and the related consolidated statements of operations and comprehensive loss, of changes in stockholders’ (deficit) equity and of cash flows for each of the three years in the period ended December 31, 2019, including the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of 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 accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the COSO.

### ***Change in Accounting Principle***

As discussed in Note 3 to the consolidated financial statements, the Company changed the manner in which it accounts for leases in 2019.

### ***Basis for Opinions***

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on the Company’s consolidated financial statements and on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (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 audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### ***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 (i) pertain to the maintenance of records that, in reasonable detail,

accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) 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 (iii) 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.

***Emphasis of Matter***

As discussed in Note 1 to the consolidated financial statements, the Company will require additional financing to fund future operations if the Company cannot generate sufficient cash flows from operations in the future. Also as discussed in Note 1 to the consolidated financial statements, the Company's debt facility includes financial and nonfinancial covenants. If the Company cannot generate sufficient revenues in the future, the Company may not be in compliance with these covenants and the debt may be called by the lender. Management's plans in regard to these matters are described in Note 1.

/s/ PricewaterhouseCoopers LLP  
Boston, Massachusetts  
March 12, 2020

We have served as the Company's auditor since 2010.

**Flexion Therapeutics, Inc.**  
**Consolidated Balance Sheets**  
(In thousands, except share amounts)

	December 31, 2019	December 31, 2018
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 82,253	\$ 87,229
Marketable securities	54,407	171,555
Accounts receivable, net	37,115	13,121
Inventories	16,529	7,637
Prepaid expenses and other current assets	5,371	5,500
Total current assets	195,675	285,042
Property and equipment, net	13,662	10,710
Right-of-use assets	8,223	—
Total assets	<u>\$ 217,560</u>	<u>\$ 295,752</u>
<b>Liabilities and Stockholders' (Deficit) Equity</b>		
Current liabilities		
Accounts payable	\$ 15,258	\$ 12,340
Accrued expenses and other current liabilities	19,610	14,310
Operating lease liabilities	1,351	—
Current portion of long-term debt	—	9,967
Total current liabilities	36,219	36,617
Long-term operating lease liability, net	7,609	—
Long-term debt, net	40,176	3,640
2024 convertible notes, net	153,413	144,879
Other long-term liabilities	251	537
Total liabilities	<u>237,668</u>	<u>185,673</u>
Commitments and contingencies		
Preferred Stock, \$0.001 par value; 10,000,000 shares authorized at December 31, 2019 and December 31, 2018 and 0 shares issued and outstanding at December 31, 2019 and December 31, 2018	—	—
Stockholders' (deficit) equity		
Common stock, \$0.001 par value; 100,000,000 shares authorized; 38,361,476 and 37,946,341 shares issued and outstanding, at December 31, 2019 and December 31, 2018, respectively	38	38
Additional paid-in capital	648,391	628,944
Accumulated other comprehensive loss	62	(77)
Accumulated deficit	(668,599)	(518,826)
Total stockholders' (deficit) equity	<u>(20,108)</u>	<u>110,079</u>
Total liabilities and stockholders' (deficit) equity	<u>\$ 217,560</u>	<u>\$ 295,752</u>

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



**Flexion Therapeutics, Inc.**  
**Consolidated Statements of Operations and Comprehensive Loss**  
(In thousands, except per share amounts)

	Year Ended December 31,		
	2019	2018	2017
<b>Revenues</b>			
Product revenue, net	\$ 72,957	\$ 22,524	\$ 355
<b>Operating expenses</b>			
Cost of sales	9,960	7,336	4
Research and development	69,559	53,079	51,231
Selling, general and administrative	129,709	121,311	78,801
Total operating expenses	209,228	181,726	130,036
<b>Loss from operations</b>	(136,271)	(159,202)	(129,681)
<b>Other (expense) income</b>			
Interest income	3,212	4,567	3,718
Interest expense	(17,066)	(15,712)	(11,268)
Other income (expense)	352	688	(250)
Total other (expense) income	(13,502)	(10,457)	(7,800)
<b>Net loss</b>	\$ (149,773)	\$ (169,659)	\$ (137,481)
Net loss per common share, basic and diluted	\$ (3.93)	\$ (4.49)	\$ (4.16)
Weighted average common shares outstanding, basic and diluted	38,086	37,751	33,027
<b>Other comprehensive income (loss)</b>			
Unrealized gains (losses) from available-for-sale securities, net of tax of \$0	139	330	(336)
Total other comprehensive income (loss)	139	330	(336)
<b>Comprehensive loss</b>	\$ (149,634)	\$ (169,329)	\$ (137,817)

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

**Flexion Therapeutics, Inc.**  
**Consolidated Statements of Changes in Stockholders' (Deficit) Equity**  
(In thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' (Deficit) Equity
	Shares	Par Value				
<b>Balance at December 31, 2016</b>	31,667	\$ 32	\$ 398,757	\$ (71)	\$ (211,686)	\$ 187,032
Issuance of common stock net of issuance costs	5,520	6	132,171			132,177
Issuance of common stock for equity awards	334		3,858			3,858
Employee stock purchase plan	90		1,016			1,016
Stock-based compensation expense			11,542			11,542
Portion of convertible debt proceeds allocated to equity component			62,466			62,466
Net loss					(137,481)	(137,481)
Other comprehensive loss				(336)		(336)
<b>Balance at December 31, 2017</b>	37,611	\$ 38	\$ 609,810	\$ (407)	\$ (349,167)	\$ 260,274
Issuance of common stock for equity awards, net of shares withheld for taxes	197		1,653			1,653
Employee stock purchase plan	138		2,022			2,022
Stock-based compensation expense			15,459			15,459
Net loss					(169,659)	(169,659)
Other comprehensive income				330		330
<b>Balance at December 31, 2018</b>	37,946	\$ 38	\$ 628,944	\$ (77)	\$ (518,826)	\$ 110,079
Issuance of common stock for equity awards, net of shares withheld for taxes	230		1,726			1,726
Employee stock purchase plan	185		1,820			1,820
Stock-based compensation expense			15,901			15,901
Net loss					(149,773)	(149,773)
Other comprehensive income				139		139
<b>Balance at December 31, 2019</b>	38,361	\$ 38	\$ 648,391	\$ 62	\$ (668,599)	\$ (20,108)

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

**Flexion Therapeutics, Inc.**  
**Consolidated Statements of Cash Flows**  
(In thousands)

	Year Ended December 31,		
	2019	2018	2017
<b>Cash flows from operating activities</b>			
Net loss	\$ (149,773)	\$ (169,659)	\$ (137,481)
Adjustments to reconcile net loss to cash used in operating activities:			
Depreciation	1,059	1,714	2,008
Amortization of right-of-use assets	1,337	—	—
Stock-based compensation expense	15,901	15,459	11,542
Non-cash interest expense	564	—	—
(Accretion) Amortization of (discount) premium on marketable securities	(1,337)	(1,320)	333
Loss from debt extinguishment	352	—	—
Amortization of debt discount and debt issuance costs	8,714	7,805	4,826
Premium paid on securities purchased	(34)	(214)	(857)
Changes in operating assets and liabilities:			
Accounts receivable	(23,994)	(12,711)	(410)
Inventory	(7,674)	(5,244)	(1,799)
Prepaid expenses and other current assets	126	(2,097)	387
Accounts payable	1,702	5,141	4,188
Accrued expenses and other current liabilities	5,326	707	9,432
Lease liabilities	(1,027)	—	—
Net cash used in operating activities	(148,758)	(160,419)	(107,831)
<b>Cash flows from investing activities</b>			
Purchases of property and equipment	(3,894)	(852)	(2,146)
Purchases of marketable securities	(115,466)	(222,482)	(356,754)
Sale and redemption of marketable securities	234,124	348,918	240,228
Net cash provided by (used in) investing activities	114,764	125,584	(118,672)
<b>Cash flows from financing activities</b>			
Proceeds from the issuance of 2024 convertible notes	—	—	201,250
Proceeds from borrowings under term loan	40,000	—	—
Payment of debt issuance costs	(161)	—	(6,470)
Proceeds from the offering of common stock	—	—	132,666
Payments on notes payable	(14,367)	(10,000)	(8,333)
Payments of public offering costs	—	—	(490)
Proceeds from the exercise of stock options	1,726	1,653	3,858
Proceeds from employee stock purchase plan	1,820	2,022	1,016
Net cash provided by (used in) financing activities	29,018	(6,325)	323,497
<b>Net (decrease) increase in cash, cash equivalents, and restricted cash</b>	(4,976)	(41,160)	96,994
Cash, cash equivalents, and restricted cash at beginning of period	87,229	128,389	31,395
Cash, cash equivalents, and restricted cash at end of period	<u>\$ 82,253</u>	<u>\$ 87,229</u>	<u>\$ 128,389</u>
<b>Supplemental disclosures of cash flow information</b>			
Cash paid for interest	\$ 8,049	\$ 7,874	\$ 5,080
<b>Non-cash investing and financing activities</b>			
Right-of-use asset obtained in exchange for operating lease obligation	\$ 9,560	\$ —	\$ —
Portion of debt proceeds allocated to equity component	\$ —	\$ —	\$ 62,466
Purchases of property and equipment in accounts payable and accrued expenses	\$ 2,202	\$ 986	\$ 9

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

**Flexion Therapeutics, Inc.**  
**Notes to Consolidated Financial Statements**

**1. Nature of the Business**

Flexion Therapeutics, Inc. (“Flexion” or the “Company”) was incorporated under the laws of the state of Delaware on November 5, 2007. Flexion is a biopharmaceutical company focused on the discovery, development and commercialization of novel, local therapies for the treatment of patients with musculoskeletal conditions, beginning with osteoarthritis, (“OA”), a type of degenerative arthritis. The Company has an approved product, ZILRETTA®, which it markets in the United States. ZILRETTA is the first and only extended-release, intra-articular, or IA (meaning in the joint), injection indicated for the management of OA knee pain. ZILRETTA is a non-opioid therapy that employs Flexion’s proprietary microsphere technology to provide effective pain relief. The pivotal Phase 3 trial, on which the approval of ZILRETTA was based, showed that ZILRETTA met the primary endpoint of pain reduction at Week 12, with statistically significant pain relief extending through Week 16. The Company also has two pipeline programs focused on the local treatment of musculoskeletal conditions: FX201, which is an investigational IA gene therapy product candidate in clinical development for the treatment of OA, and FX301, a preclinical product candidate, which is being developed as a locally administered peripheral nerve block for control of post-operative pain.

The Company is subject to risks and uncertainties common to companies in the biopharmaceutical industry, including, but not limited to, new technological innovations, dependence on key personnel, protection of proprietary technology, compliance with government regulations, and the ability to secure additional capital to fund operations. Successfully commercializing ZILRETTA requires significant sales and marketing efforts and the Company’s pipeline programs may require significant additional research and development efforts, including extensive preclinical and clinical testing. These activities will in turn require significant amounts of capital, qualified personnel and adequate infrastructure. There can be no assurance when, if ever, the Company will realize significant revenue from the sales of ZILRETTA or if the development efforts supporting the Company’s pipeline, including future clinical trials, will be successful.

The accompanying consolidated financial statements have been prepared on a basis which assumes that the Company will continue as a going concern and which contemplates the realization of assets and satisfaction of liabilities and commitments in the normal course of business. The Company has incurred recurring losses and negative cash flows from operations. As of December 31, 2019, the Company had cash, cash equivalents, and marketable securities of approximately \$136.7 million. Management believes that current cash, cash equivalents and marketable securities on hand at December 31, 2019 should be sufficient to fund operations and debt obligations for at least the next 12 months beyond the date of issuance of these financial statements. The future viability of the Company is dependent on its ability to fund its operations through sales of ZILRETTA, or the Company will need to raise additional capital, such as debt or equity offerings, as needed. This funding is necessary for the Company to support the commercialization of ZILRETTA and to perform the research and development activities required to develop the Company’s other product candidates in order to generate future revenue streams. The Company may not be able to obtain financing on acceptable terms, or at all. If the Company is unable to obtain funding on a timely basis, the Company may need to curtail its operations, including the commercialization of ZILRETTA and its research and development activities, which could adversely affect its prospects.

In connection with the Term Loan described in Note 10, if the Company’s cash balance in the future decreases below \$80 million, the Company will need to remain in compliance with a minimum monthly net revenue covenant (determined in accordance with U.S. GAAP), measured on a trailing twelve month basis. The lender also has the ability to call debt based on a material adverse change clause, which is subjectively defined. If the Company is not in compliance with the monthly net revenue covenants or the subjective acceleration clauses are triggered under the agreement, then the lender may call the debt resulting in the Company immediately needing additional funds. As of December 31, 2019, the Company was in compliance with all covenants.

## **2. Financing Transactions**

On August 2, 2019, the Company entered into an amended and restated credit and security agreement (the “amended and restated credit and security agreement”) with Silicon Valley Bank as agent, MidCap Financial Trust, Flexpoint MCLS Holdings, LLC, and the other lenders from time to time party thereto (collectively, the “Lenders”), providing for a term loan of \$40.0 million and a revolving credit facility of up to \$20.0 million, both of which mature on January 1, 2024 (the “Maturity Date”). The Company concurrently borrowed the \$40.0 million term loan and used \$7.7 million of the proceeds to repay the remaining amount owed on the 2015 term loan.

On October 16, 2017, the Company completed a follow-on public offering of its common stock, which resulted in the sale of 5,520,000 shares of the Company’s common stock at a price to the public of \$25.50 per share including shares sold pursuant to the exercise in full of the underwriters’ option to purchase additional shares. The Company received net proceeds from the follow-on financing of \$132.2 million after deducting underwriting discounts, commissions, and offering costs paid by the Company

On May 2, 2017, the Company issued an aggregate of \$201.3 million principal amount of the 2024 Convertible Notes. The 2024 Convertible Notes have a maturity date of May 1, 2024 are unsecured and accrue interest at a rate of 3.375% per annum, payable semi-annually on May 1 and November 1 of each year, beginning November 1, 2017. The Company received \$194.8 million for the sale of the 2024 Convertible Notes, after deducting fees and expenses of \$6.5 million.

The Company’s total issued common stock as of December 31, 2019 was 38,361,476 shares.

## **3. Summary of Significant Accounting Policies**

### **Basis of Presentation**

The accompanying consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission (the “SEC”) and Generally Accepted Accounting Principles (“GAAP”) for financial information, including the accounts of the Company and its wholly owned subsidiary after elimination of all significant intercompany accounts and transactions.

### **Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and judgments that may affect the reported amounts of assets and liabilities, revenues and expenses and related disclosures. The Company bases estimates and judgments on historical experience and on various other factors that it believes to be reasonable under the circumstances. The most significant estimates in these consolidated financial statements include estimates related to revenue and accrued expenses related to preclinical and clinical development costs. The Company’s actual results may differ from these estimates under different assumptions or conditions. The Company evaluates its estimates on an ongoing basis. Changes in estimates are reflected in reported results in the period in which they become known by the Company’s management.

### **Revenue Recognition**

On October 6, 2017, U.S. Food and Drug Administration, (the FDA), approved ZILRETTA. The Company entered into a limited number of arrangements with specialty distributors and a specialty pharmacy in the U.S. to distribute ZILRETTA. The Company recognizes revenue in accordance with Accounting Standards Codification (“ASC”) Topic 606 - Revenue from Contracts with Customers (“Topic 606”). Under Topic 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to be entitled to in exchange for those goods or services.

To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the entity performs the following five steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the

performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The Company only applies the five-step model to arrangements that meet the definition of a contract with a customer under Topic 606, including when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services promised within each contract, determines those that are performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

*Product Revenue, Net*— The Company primarily sells ZILRETTA to specialty distributors and a specialty pharmacy, who then subsequently resell ZILRETTA to physicians, clinics and certain medical centers or hospitals. The Company also contracts directly with healthcare providers and intermediaries such as Group Purchasing Organizations (“GPOs”). In addition, the Company enters into arrangements with government payers that provide for government mandated rebates and chargebacks with respect to the purchase of ZILRETTA.

The Company recognizes revenue on product sales when the customer obtains control of the Company's product, which occurs at a point in time (upon delivery to the customer). The Company has determined that the delivery of ZILRETTA to its customers constitutes a single performance obligation. There are no other promises to deliver goods or services beyond what is specified in each accepted customer order. The Company has assessed the existence of a significant financing component in the agreements with its customers. The trade payment terms with our customers do not exceed one year and therefore the Company has elected to apply the practical expedient and no amount of consideration has been allocated as a financing component. Product revenues are recorded net of applicable reserves for variable consideration, including discounts and allowances.

*Transaction Price, including Variable Consideration*— Revenues from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for which reserves are established. Components of variable consideration include trade discounts and allowances, product returns, government chargebacks, discounts and rebates, and other incentives, such as voluntary patient assistance, and other fee for service amounts that are detailed within contracts between the Company and its customers relating to the Company's sale of its products. These reserves, as detailed below, are based on the amounts earned, or to be claimed on the related sales, and are classified as reductions of accounts receivable (if the amount is payable to the customer) or a current liability (if the amount is payable to a party other than a customer). These estimates take into consideration a range of possible outcomes which are probability-weighted in accordance with the expected value method in Topic 606 for relevant factors such as current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect the Company's best estimates of the amount of consideration to which it is entitled based on the terms of the respective underlying contracts.

The amount of variable consideration which is included in the transaction price may be constrained and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized under the contract will not occur in a future period. Actual amounts of consideration ultimately received may differ from the Company's estimates. If actual results in the future vary from the Company's original estimates, the Company will adjust these estimates, which would affect net product revenue and earnings in the period such variances become known.

*Service Fees and Allowances*—The Company compensates its customers and GPOs for sales order management, data, and distribution services. However, the Company has determined such services received to date are not distinct from the Company's sale of products to the customer and, therefore, these payments have been recorded as a reduction of revenue within the statement of operations and comprehensive loss through December 31, 2019, as well as a reduction to trade receivables, net on the consolidated balance sheets.

*Product Returns*— Consistent with industry practice, the Company generally offers customers a limited right of return for product that has been purchased from the Company based on the product's expiration date. 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, as well as within accrued expenses and other current liabilities, net, on the consolidated balance sheets. The Company currently estimates product return liabilities using available industry data and its own sales information, including its visibility into the inventory remaining in the distribution channel. The Company has received an immaterial amount of returns to date and believes that returns of ZILRETTA will be minimal.

*Chargebacks*— Chargebacks for fees and discounts to qualified government healthcare providers represent the estimated obligations resulting from contractual commitments to sell products to qualified VA hospitals and 340b entities at prices lower than the list prices charged to customers who directly purchase the product from the Company. The 340b Drug Discount Program is a US federal government program created in 1992 that requires drug manufacturers to provide outpatient drugs to eligible health care organizations and covered entities at significantly reduced prices. Customers charge the Company for the difference between what they pay for the product and the statutory selling price to the qualified government entity. These reserves are established in the same period that the related revenue is recognized, resulting in a reduction of product revenue and trade receivables, net. Chargeback amounts are generally determined at the time of resale to the qualified government healthcare provider by customers, and the Company generally issues credits for such amounts within a few weeks of the Customer's notification to the Company of the resale. Reserves for chargebacks consist of credits that the Company expects to issue for units that remain in the distribution channel inventories at each reporting period-end that the Company expects will be sold to qualified healthcare providers, and chargebacks that customers have claimed, but for which the Company has not yet issued a credit.

*Government Rebates*— The Company is subject to discount obligations under state Medicaid programs and Medicare. These reserves are recorded in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability which is included in accrued expenses and other current liabilities on the consolidated balance sheets. For Medicare, the Company also estimates the number of patients in the prescription drug coverage gap for whom the Company will owe an additional liability under the Medicare Part D program. The Company anticipates its exposure to utilization from the Medicare Part D coverage gap discount program to be immaterial. For Medicaid programs, the Company estimates the portion of sales attributed to Medicaid patients and records a liability for the rebates to be paid to the respective state Medicaid programs. The Company's liability for these rebates consists of invoices received for claims from prior quarters that have not been paid or for which an invoice has not yet been received, estimates of claims for the current quarter, and estimated future claims that will be made for product that has been recognized as revenue, but which remains in the distribution channel inventories at the end of each reporting period.

*Purchaser/Provider Discounts and Rebates*—Beginning in the third quarter of 2019, the Company began offering rebates to eligible purchasers and healthcare providers that are variable based on the volume of product purchased. Rebates are based on actual purchase levels during the rebate purchase period. The Company estimates these rebates and records such estimate in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability.

*Other Incentives*— Other incentives which the Company offers include voluntary patient assistance programs, such as the co-pay assistance program, which are intended to provide financial assistance to qualified commercially-insured patients with prescription drug co-payments required by payers. The calculation of the accrual for co-pay assistance is based on an estimate of claims and the cost per claim that the Company expects to receive associated with product that has been recognized as revenue, but remains in the distribution channel inventories at the end of each reporting period. The adjustments are recorded in the same period the related revenue is recognized, resulting in a reduction of product revenue and the establishment of a current liability which is included as a component of accrued expenses and other current liabilities on the consolidated balance sheets.

To date, the Company's only source of product revenue has been from the U.S. sales of ZILRETTA, which it began shipping to customers in October 2017.

The following table summarizes activity in each of the product revenue allowance and reserve categories for the years ended December 31, 2019, 2018 and 2017:

<i>(In thousands)</i>	Service Fees, Allowances and Chargebacks	Government Rebates and Other Incentives	Product Returns	Purchaser/Provider Discounts and Rebates	Total
Balance as of January 1, 2017	\$ —	\$ —	\$ —	\$ —	\$ —
Provision related to sales in the current year	100	15	2	—	117
Credit or payments made during the period	(40)	—	—	—	(40)
Balance as of December 31, 2017	60	15	2	—	77
Provision related to sales in the current year	1,688	502	124	—	2,314
Credit or payments made during the period	(1,147)	(26)	(1)	—	(1,174)
Balance as of December 31, 2018	601	491	125	—	1,217
Provision related to sales in the current year	5,527	261	334	2,685	8,807
Credit or payments made during the period	(4,281)	(375)	(57)	(1,029)	(5,742)
Adjustments related to prior period sales	—	(129)	—	—	(129)
Balance as of December 31, 2019	<u>\$ 1,847</u>	<u>\$ 248</u>	<u>\$ 402</u>	<u>\$ 1,656</u>	<u>\$ 4,153</u>

## Inventory

The Company values its inventories at the lower of cost or estimated net realizable value. The Company determines the cost of its inventories, which includes amounts related to materials and manufacturing overhead, on a first-in, first-out basis. The Company performs an assessment of the recoverability of capitalized inventory during each reporting period, and it writes down any excess and obsolete inventories to their estimated realizable value in the period in which the impairment is first identified. Such impairment charges, should they occur, are recorded within cost of sales. The determination of whether inventory costs will be realizable requires estimates by management. If actual market conditions are less favorable than projected by management, additional write-downs of inventory may be required, which would be recorded as a cost of sales in the consolidated statements of operations and comprehensive loss.

The Company capitalizes inventory costs associated with the Company's products after regulatory approval when, based on management's judgment, future commercialization is considered probable and the future economic benefit is expected to be realized. Inventory acquired prior to receipt of marketing approval of a product candidate is expensed as research and development expense as incurred. Inventory that can be used in either the production of clinical or commercial product is expensed as research and development expense when selected for use in a clinical manufacturing campaign. Inventory produced that will be used in promotional marketing campaigns is expensed to selling, general and administrative expense when it is selected for use in a marketing program.

## Consolidation

The accompanying consolidated financial statements include the Company and its wholly-owned subsidiary, Flexion Therapeutics Securities Corporation. The Company has eliminated all intercompany transactions for the years ended December 31, 2019, 2018 and 2017. In addition, Flexion Therapeutics, Inc. is registered to do business in the United Kingdom through its branch office located in Swindon, United Kingdom.

## Accounts Receivable

Accounts receivable are recorded net of customer allowances for distribution fees and chargebacks, and doubtful accounts. Allowances for distribution fees and chargebacks are based on contractual terms. The Company estimates the allowance for doubtful accounts based on existing contractual payment terms, actual payment patterns of its customers and individual customer circumstances. At December 31, 2019 and 2018, respectively, the Company determined that an allowance for doubtful accounts was not required. No accounts were written off during the years ended December 31, 2019 and 2018, respectively.



## Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents. The Company currently invests available cash in money market funds of a major financial institution, corporate bonds, government obligations and commercial paper.

## Marketable Securities

Marketable securities consist of investments with original maturities greater than ninety days and less than one year from the balance sheet date. Long-term investments consist of investments with maturities of greater than one year. The Company classifies all of its investments, which consist solely of debt securities, as available-for-sale. Accordingly, these investments are recorded at fair value, which is based on quoted market prices. Unrealized gains and losses are recorded as a component of other comprehensive income (loss). Realized gains and losses are determined on a specific identification basis and are included in other income (loss). Amortization and accretion of discounts and premiums is recorded in other income.

## Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation and amortization expense is recognized using the straight-line method over the following estimated useful lives:

	Estimated Useful Life (Years)
Computers, office equipment, and minor computer software	3
Computer software	7
Manufacturing equipment	7-10
Furniture and fixtures	5

Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the related asset. Costs of major additions and betterments are capitalized and depreciated on a straight-line basis over their useful lives. Repairs and maintenance costs are expensed as incurred. Upon retirement or sale, the cost of assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to income. Property and equipment includes construction-in-progress, that is not yet in service.

## Foreign Currencies

The Company maintains a bank account designated in British Pounds. All foreign currency payables and cash balances are measured at the applicable exchange rate at the end of the reporting period. All associated gains and losses from foreign currency transactions are reflected in the consolidated statements of operations.

## Impairment of Long-Lived Assets

The Company reviews its long-lived assets, including property and equipment, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Factors that the Company considers in deciding when to perform an impairment review include significant underperformance of the business in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in the use of the assets. If an impairment review is performed to evaluate a long-lived asset for recoverability, the Company compares forecasts of undiscounted cash flows expected to result from the use and eventual disposition of the long-lived asset to its carrying value. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of an asset are less than its carrying amount. The impairment loss would be based on the excess of the carrying value of the impaired asset over its fair value, determined based on discounted cash flows.

## **Debt Issuance Costs, net**

As of December 31, 2019 and 2018, the carrying value of debt issuance costs was \$2.9 million and \$3.5 million, respectively, and was presented as a direct deduction from the carrying amounts of long-term debt. In addition, \$0.6 million, \$0.6 million, and \$0.4 million, respectively, of debt issuance costs were amortized and recognized as other expense in the statement of operations for the years ended December 31, 2019, 2018 and 2017.

## **Research and Development**

Research and development expenses are comprised of costs incurred in performing research and development activities, including salaries and benefits, facilities costs, overhead costs, depreciation, clinical trial and related clinical manufacturing costs, contract services and other related costs. Research and development costs are expensed to operations as the related obligation is incurred.

As part of the process of preparing its financial statements, the Company is required to estimate its accrued expenses. This process involves reviewing open contracts and purchase orders, communicating with applicable internal and vendor personnel to identify services that have been performed on the Company's behalf and estimating the level of service performed and the associated cost incurred for the service when the Company has not yet been invoiced or otherwise notified of the actual cost. The majority of the Company's service providers invoice it monthly in arrears for services performed or when contractual milestones are met. The Company makes estimates of its accrued expenses as of each balance sheet date in its financial statements based on facts and circumstances known to it at that time. The Company periodically confirms the accuracy of its estimates with the service providers and makes adjustments if necessary. Examples of estimated accrued research and development expenses include fees paid to:

- CROs in connection with clinical studies;
- investigative sites in connection with clinical studies;
- vendors related to product manufacturing, development and distribution of clinical supplies; and
- vendors in connection with preclinical development activities.

The Company records expenses related to clinical studies and manufacturing development activities based on its estimates of the services received and efforts expended pursuant to contracts with multiple CROs and manufacturing vendors that conduct and manage these activities on the Company's behalf. The financial terms of these agreements are subject to negotiation, vary from contract to contract, and may result in uneven payment flows.

The Company makes estimates of its accrued expenses as of each balance sheet date in its financial statements based on facts and circumstances known to it. If timelines or contracts are modified based upon changes in the clinical trial protocol or scope of work to be performed, the Company modifies its estimates of accrued expenses accordingly on a prospective basis. If the Company does not identify costs that it has begun to incur, or if it underestimates or overestimates the level of services performed or the costs of these services, the Company's actual expenses could differ from its estimates. To date, the Company has not adjusted its estimates at any particular balance sheet date in any material amount.

## **Patent Costs**

All patent-related costs incurred in connection with filing and prosecuting patent applications are recorded as general and administrative expenses as incurred, as recoverability of such expenditures is uncertain.

## **Accounting for Stock-Based Compensation**

The Company measures all stock options and other stock based-awards granted to employees at the fair value at the date of grant using the Black-Scholes option-pricing model. The fair value of the awards is recognized as expense over the requisite service period, which is generally the vesting period of the respective award. The straight-line method of expense recognition is applied to all awards with service-only conditions. The Company accounts for forfeitures as they occur and does not estimate future forfeitures. As such, previously recognized compensation expense for an award is reversed in the period that the award is forfeited. For stock awards that have a performance condition, the Company recognizes compensation expense based on its assessment of the probability that the

performance condition will be achieved, using an accelerated attribution model, over the explicit or implicit service period.

As a result of our adoption of “ASU 2018-07”, stock-based awards granted to non-employees are accounted for the same way as awards granted to employees, and such awards will not be re-measured at fair value each reporting period. We adopted this standard prospectively and there was no impact on previously issued financial statements.

The Company classifies stock-based compensation expense in the consolidated statements of operations in the same manner in which the award recipient’s payroll costs are classified, or in the case of a non-employee, in the same manner as the award recipient’s service costs are classified.

### **Concentration of Credit Risk and Significant Suppliers**

Financial instruments that potentially expose the Company to concentration of credit risk consist primarily of commercial paper and corporate bonds. The Company generally invests its cash in money market funds, government and corporate bonds, and commercial paper at one financial institution. The Company does not believe that it is subject to unusual credit risk beyond the normal credit risk associated with commercial banking relationships.

The Company is completely dependent on third-party manufacturers and product suppliers for research and commercial activities. In particular, the Company relies on a limited number of manufacturers and relies on them to purchase from third-party suppliers the materials necessary to produce its product candidates for its clinical trials and for commercial supply. These programs would be adversely affected by a significant interruption in the supply of active pharmaceutical ingredients.

Three individual customers accounted for 44%, 25% and 15% for a total 84% of product revenues for the year ended 2019, and two individual customers accounted for 49% and 32% for a total of 81% for the year ended December 31, 2018. Four individual customers accounted for 42%, 11%, 20%, and 20% for a total of 93% of accounts receivable from product sales for the year ended December 31, 2019, and two individual customers accounted for 52% and 30% for a total of 82% for the year ended December 31, 2018. No other customers accounted for more than 10% of product revenue or accounts receivable for the years ended December 31, 2019 and 2018, respectively.

### **Comprehensive Loss**

Comprehensive loss includes net loss as well as other changes in stockholders’ equity that result from transactions and economic events other than those with stockholders. The Company’s only element of other comprehensive income (loss) in all periods presented was unrealized gains (losses) on available-for-sale securities.

### **Income Taxes**

The Company accounts for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences of events that have been recognized in the financial statements or in the Company’s tax returns. Deferred taxes are determined based on the differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted rates in effect for the year in which these temporary differences are expected to be recovered or settled. Changes in deferred tax assets and liabilities are recorded in the provision for income taxes. The Company assesses the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent it believes, based upon the weight of available evidence, that it is more likely than not that all or a portion of deferred tax assets will not be realized, a valuation allowance is established through a charge to income tax expense. Potential recovery of deferred tax assets is evaluated by estimating the future taxable profits expected and considering prudent and feasible tax planning strategies.

The Company accounts for uncertainty in income taxes recognized in the financial statements by applying a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to

determine the likelihood that it will be sustained upon external examination by the taxing authorities. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. The provision for income taxes includes the effects of any resulting tax reserves, or unrecognized tax benefits, that are considered appropriate as well as the related net interest and penalties.

### **Fair Value Measurements**

Fair value is defined as the exchange price that would be received to sell 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 at the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Financial assets and liabilities carried at fair value are to be classified and disclosed in one of the following three levels of the fair value hierarchy, of which the first two are considered observable and the last is considered unobservable:

- Level 1 — Quoted market prices in active markets for identical assets or liabilities. Level 1 consists primarily of financial instruments whose value is based on quoted market prices, such as exchange-traded instruments and listed equities.
- Level 2 — Observable inputs (other than Level 1 quoted prices) such as quoted prices in active markets for similar assets or liabilities, quoted prices in markets that are not active for identical or similar assets or liabilities, or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to determining the fair value of the assets or liabilities, including pricing models, discounted cash flow methodologies and similar techniques.

The Company's financial instruments consist of cash equivalents, marketable securities, accounts payable and accrued expenses, its term loan and 2024 Convertible Notes (Note 10). The estimated fair value of the Company's financial instruments, with the exception of the 2024 Convertible Notes, approximates their carrying values.

The fair value of the 2024 Convertible Notes, which differs from their carrying value, is influenced by interest rates, stock price and stock price volatility and is determined by prices for the 2024 Convertible Notes observed in market trading. The market for trading of the 2024 Convertible Notes is not considered to be an active market and therefore the estimate of fair value is based on Level 2 inputs. The estimated fair value of the 2024 Convertible Notes, face value of \$201.3 million, was \$215.7 million at December 31, 2019.

### **Net Loss Per Share**

The Company follows the two-class method when computing net loss per share as the Company has issued shares that meet the definition of participating securities. The two-class method determines net loss per share for each class of common and participating securities according to dividends declared or accumulated and participation rights in undistributed earnings. The two-class method requires income available to common stockholders for the period to be allocated between common and participating securities based on their respective rights to receive dividends as if all income for the period had been distributed.

Basic net loss per share attributable to common stockholders is computed by dividing the net loss attributable to common stockholders by the weighted average number of shares of common stock outstanding for the period. Diluted net loss attributable to common stockholders is computed by adjusting net loss attributable to common stockholders to reallocate undistributed earnings based on the potential impact of dilutive securities, including the assumed conversion of our 2024 Convertible Notes, outstanding stock options and unvested restricted common stock, except where the result would be anti-dilutive. Diluted net loss per share attributable to common stockholders is computed by dividing the diluted net loss attributable to common stockholders by the weighted average number of common shares outstanding for the period, including potential dilutive common shares assuming the dilutive effect of the conversion of the 2024 Convertible Notes, the exercise of outstanding stock options and the vesting unvested restricted common stock. In the diluted net loss per share calculation, net loss would also be adjusted for the

elimination of interest expense on the 2024 Convertible Notes, if the impact was not anti-dilutive. For periods in which the Company has reported net losses, diluted net loss per share attributable to common stockholders is the same as basic net loss per share attributable to common stockholders, since dilutive common shares are not assumed to have been issued if their effect is anti-dilutive. Potential common shares will always be anti-dilutive for periods in which the Company has reported a net loss. Diluted net loss per share attributable to common stockholders is the same as basic net loss per share attributable to common stockholders for the years ended December 31, 2019, 2018 and 2017.

## **Segment Data**

The Company manages its operations as a single operating segment for the purposes of assessing performance and making operating decisions. The Company is a biopharmaceutical company focused on the development and commercialization of novel, local therapies. All revenues for the years ended December 31, 2019, 2018 and 2017 were generated in the United States.

## **Recent Accounting Pronouncements**

### ***Accounting Standards Recently Adopted***

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASU 2016-02, *Leases* (“ASU 2016-02”), to increase transparency and comparability among organizations by recognizing lease assets and liabilities, including operating leases, on the balance sheet and disclosing key information about leasing arrangements. The Company adopted ASU 2016-02 on January 1, 2019 using the “Comparatives under 840” approach, which was approved by the FASB in July 2018 as part of ASU 2018-11. Under this method, the consolidated financial statements as of the year ended December 31, 2019 are presented applying the new requirements under ASC 842, while the consolidated financial statements as of the year ended December 31, 2018 are presented under ASC 840.

As part of its adoption of ASU 2016-02, the Company elected the package of practical expedients which allows it to not reassess (1) whether existing contracts contain leases, (2) the lease classification for existing leases, and (3) whether existing initial direct costs meet the new definition. Consequently, on adoption, the Company recognized lease liabilities of \$7.0 million and corresponding right-of-use (“ROU”) assets of \$6.6 million based on the present value of the remaining minimum rental payments under current leasing standards for existing operating leases. These lease liabilities and ROU assets relate to operating leases only, as the Company concluded that it does not have any finance leases. The difference between the lease liability and the ROU assets upon adoption relates to the deferred rent balance that had been recorded prior to adoption. The Company determined that no cumulative adjustment to retained earnings was required.

In June 2018, the FASB issued ASU No. 2018-07, *Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting* (“ASU 2018-07”). The new standard expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. Equity-based payments to nonemployees were previously covered under ASC 505-50 and required companies to measure the awards based on the fair value of the consideration received or the fair value of the equity instruments issued and remeasure the fair value of such awards at each reporting date. The Company adopted ASU 2018-07 prospectively and there was no impact on previously issued financial statements.

### ***Accounting Standards Recently Issued***

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“ASU 2016-13”). The new standard requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. ASU 2016-13 is effective for fiscal years, and the interim periods within those years, beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact of ASU 2016-13 on the Company’s consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement* (“ASU 2018-13”). The new standard modifies the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, as part of the FASB’s disclosure framework project. ASU 2018-13 is effective for fiscal years, and the interim periods within those years, beginning after December 15, 2019, and early adoption is permitted. Additionally, the new standard permits an entity to early adopt any removed or modified disclosures upon issuance of the ASU and delay adoption of the additional disclosures until their effective date. ASU 2018-13 removes the requirement to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy. The Company early adopted this portion of the standard as of the quarter ended September 30, 2018. The Company does not expect the adoption of the remainder of ASU 2018-13 to have any impact on its consolidated financial statements, as the changes to the disclosures are primarily relevant for companies with Level 3 assets and liabilities, which the Company does not have.

#### 4. Fair Value of Financial Assets and Liabilities

The following tables present information about the Company’s assets that are measured at fair value on a recurring basis as of December 31, 2019 and 2018 and indicate the level of the fair value hierarchy utilized to determine such fair value:

<i>(In thousands)</i>	Fair Value Measurements as of December 31, 2019			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Cash equivalents	\$ —	\$ 69,733	\$ —	\$ 69,733
Marketable securities	—	54,407	—	54,407
	<u>\$ —</u>	<u>\$ 124,140</u>	<u>\$ —</u>	<u>\$ 124,140</u>

<i>(In thousands)</i>	Fair Value Measurements as of December 31, 2018			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Cash equivalents	\$ —	\$ 57,739	\$ —	\$ 57,739
Marketable securities	—	171,555	—	171,555
	<u>\$ —</u>	<u>\$ 229,294</u>	<u>\$ —</u>	<u>\$ 229,294</u>

As of December 31, 2019 and 2018, the Company’s cash equivalents that are invested in money market funds and overnight repurchase contracts are valued based on Level 2 inputs. The Company measures the fair value of marketable securities using Level 2 inputs and primarily relies on quoted prices in active markets for similar marketable securities. Amortization and accretion of discounts and premiums are recorded in other income.

The Company had a term loan outstanding under its 2015 credit facility with MidCap Financial Funding XIII Trust and Silicon Valley Bank (the “2015 term loan”). On August 2, 2019, the Company entered into an amended and restated credit and security agreement with Silicon Valley Bank as agent, MidCap Financial Trust, and Flexpoint MCLS Holdings, LLC (collectively, the “Lenders”), providing for a term loan of \$40.0 million (the “2019 term loan”). The Company concurrently borrowed the \$40.0 million term loan and used \$7.7 million of the proceeds to repay the remaining amount owed on the 2015 term loan. The amount outstanding on the 2019 term loan is reported at its carrying value in the accompanying balance sheet as of December 31, 2019. The Company determined the fair value of the 2019 term loan using an income approach that utilizes a discounted cash flow analysis based on current market interest rates for debt issuances with similar remaining years to maturity, adjusted for credit risk. The 2019 term loan was valued using Level 2 inputs as of December 31, 2019.

On May 2, 2017 the Company issued 3.375% convertible senior notes due 2024 (the “2024 Convertible Notes”) with embedded conversion features. The Company estimated the fair value of the 2024 Convertible Notes using a discounted cash flow approach to derive the value of a debt instrument using the expected cash flows and the estimated yield related to the convertible notes. The significant assumptions used in estimating the expected cash flows were: the estimated market yield based on an implied yield and credit quality analysis of a term loan with similar attributes, and the average implied volatility of the Company’s traded and quoted options available as of May 2, 2017. The Company recorded approximately \$136.7 million as the fair value of the liability on May 2, 2017,

with a corresponding amount recorded as a discount on the initial issuance of the 2024 Convertible Notes of approximately \$64.5 million. The debt discount was recorded to equity and is being amortized to the debt liability over the life of the 2024 Convertible Notes using the effective interest method.

The fair value of the 2024 Convertible Notes, which differs from their carrying value, is influenced by interest rates, stock price and stock price volatility and is determined by prices for the 2024 Convertible Notes observed in market trading. The market for trading of the 2024 Convertible Notes is not considered to be an active market and therefore the estimate of fair value is based on Level 2 inputs. The estimated fair value of the 2024 Convertible Notes, face value of \$201.3 million, was \$215.7 million at December 31, 2019.

## 5. Marketable Securities

As of December 31, 2019 and 2018, the fair value of available-for-sale marketable securities by type of security was as follows:

<i>(In thousands)</i>	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	\$ 6,189	\$ —	\$ —	\$ 6,189
U.S. government obligations	29,950	24	—	29,974
Corporate bonds	18,206	38	—	18,244
	<u>\$ 54,345</u>	<u>\$ 62</u>	<u>\$ —</u>	<u>\$ 54,407</u>

<i>(In thousands)</i>	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Commercial paper	\$ 36,723	\$ —	\$ —	\$ 36,723
U.S. government obligations	39,910	—	(12)	39,898
Corporate bonds	94,999	20	(85)	94,934
	<u>\$ 171,632</u>	<u>\$ 20</u>	<u>\$ (97)</u>	<u>\$ 171,555</u>

As of December 31, 2019 and 2018, marketable securities consisted of approximately \$54.4 million and \$171.6 million, respectively, of investments that mature within 12 months. There were no investments with maturities greater than 12 months as of December 31, 2019 and December 31, 2018

## 6. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consisted of the following as of December 31, 2019 and 2018:

<i>(in thousands)</i>	December 31,	
	2019	2018
Prepaid expenses	\$ 5,072	\$ 4,717
Deposits	61	66
Interest receivable on marketable securities	238	717
Total prepaid expenses and other current assets	<u>\$ 5,371</u>	<u>\$ 5,500</u>

## 7. Inventory

Inventory consisted of the following as of December 31, 2019 and 2018 :

<i>(In thousands)</i>	December 31,	
	2019	2018
Raw materials	\$ 2,846	\$ 2,367
Work in process	7,575	3,553
Finished goods	6,108	1,717
Total inventories	<u>\$ 16,529</u>	<u>\$ 7,637</u>

Finished goods manufactured by the Company have a shelf life of approximately 24 months from the date of manufacture.

The Company reduces its inventory to net realizable value for potentially excess, dated or obsolete inventory based on an analysis of forecasted demand compared to quantities on hand and any firm purchase orders, as well as product shelf life. During the year ended December 31, 2019, the Company expensed \$0.9 million to cost of sales for unabsorbed manufacturing and overhead costs related to the operation of the United Kingdom facility at Patheon UK Limited. At December 31, 2019, the Company determined that no write-downs to inventory for potentially excess, dated or obsolete inventory were required.

## 8. Property and Equipment, Net

Property and equipment, net, as of December 31, 2019 and 2018 consisted of the following:

<i>(In thousands)</i>	December 31,	
	2019	2018
Computer and office equipment	\$ 1,184	\$ 1,133
Manufacturing equipment	12,147	12,000
Furniture and fixtures	609	604
Software	455	434
Leasehold improvements	1,157	815
Construction—in progress	6,077	1,416
	<u>21,629</u>	<u>16,402</u>
Less: Accumulated depreciation	<u>(7,967)</u>	<u>(5,692)</u>
Total property and equipment, net	<u>\$ 13,662</u>	<u>\$ 10,710</u>

Depreciation expense for the years ended December 31, 2019, 2018 and 2017 was \$1.1 million, \$1.7 million, and \$2.0 million, respectively. No property or equipment was disposed of during the years ended December 31, 2019 and 2018. As of December 31, 2019, construction in progress consists primarily of equipment purchases related to the expansion of the Company's manufacturing capabilities at its contract manufacturer, Patheon U.K. Limited.



## 9. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following as of December 31, 2019 and 2018:

<i>(In thousands)</i>	December 31,	
	2019	2018
Research and development	\$ 1,924	\$ 1,216
Payroll and other employee-related expenses	8,748	8,207
Professional services fees	4,888	2,544
Accrued interest	1,356	1,195
Product revenue reserves	2,306	616
Accrual for employee stock purchase plan	183	251
Other	205	281
Total accrued expenses and other current liabilities	<u>\$ 19,610</u>	<u>\$ 14,310</u>

## 10. Debt

### *Amended and Restated Credit and Security Agreement*

#### *Term Loan*

On August 4, 2015, the Company entered into a credit and security agreement with MidCap Financial Trust, as agent, and MidCap Financial Funding XIII Trust and Silicon Valley Bank, as lenders, to borrow up to \$30.0 million in term loans. In August 2019 the Company terminated the credit and security agreement and paid off the remaining outstanding balance of principal and accrued and unpaid interest on the 2015 term loan, as well as the \$2.7 million final payment. As a result, the Company recorded a debt extinguishment loss of \$0.4 million primarily related to the write-off of the unamortized portion of the final payment and unamortized debt issuance costs, which have been recorded as a component of interest expense and other expense, respectively, on the statement of operations for the year ended December 31, 2019.

On August 2, 2019, the Company entered into an amended and restated credit and security agreement (the “amended and restated credit and security agreement”) with Silicon Valley Bank as agent, MidCap Financial Trust, Flexpoint MCLS Holdings, LLC, and the other lenders from time to time party thereto (collectively, the “Lenders”), providing for a term loan of \$40.0 million and a revolving credit facility of up to \$20.0 million, both of which mature on January 1, 2024 (the “Maturity Date”). The Company concurrently borrowed the \$40.0 million term loan and used \$7.7 million of the proceeds to repay the remaining amount owed on the 2015 term loan. The revolving credit facility became available to us beginning January 1, 2020, and in February 2020, we drew down the \$20.0 million available.

The Company granted the Lenders a security interest in substantially all of its personal property, rights and assets, other than intellectual property, to secure the payment of all amounts owed under the amended and restated credit and security agreement. The Company agreed not to encumber any of its intellectual property without the Lender’s prior written consent.

The amended and restated credit and security agreement contains certain representations, warranties, and covenants of the Company, including a minimum revenue covenant that will be in effect at any time the Company’s liquidity (defined as cash and cash equivalents held with Silicon Valley Bank) is below \$80.0 million. The revenue covenant is set annually and is based on the greater of a conservative percentage of that year’s approved forecast and modest growth over the trailing twelve months of actual. The amended and restated credit and security agreement also has a material adverse event clause. If the revenue covenant becomes applicable and the Company fails to comply with it, or a material adverse change as defined in the agreement occurs, the amounts due under the amended and restated credit and security agreement could be declared immediately due and payable. As of December 31, 2019, the Company was compliant with all covenants.

Borrowings under the 2019 term loan accrue interest monthly at a floating interest rate equal to the greater of the prime rate plus 1.5% or 6.5% per annum. Following an interest-only period of 18 months, principal is due in 36 equal monthly installments commencing February 1, 2021 and ending on the Maturity Date. Upon the Maturity

Date, the Company will be obligated to pay a final payment equal to 4.75% of the total principal amounts borrowed under the facility. The final payment amount is being accreted to the carrying value of the debt using the straight-line method, which approximates the effective interest method. As of December 31, 2019, the carrying value of the term loan was approximately \$40.2 million, all of which is presented as long-term debt in the Company’s condensed consolidated balance sheet as of December 31, 2019.

The Company may prepay the term loan at any time by paying the outstanding principle balance, a final payment equal to 4.75% of the term loan amount, all accrued interest and a prepayment fee of 3% of the outstanding term loan amount if repaid in the first year, 2% of the outstanding term loan amount if repaid in the second year, and 1% of the outstanding term loan amount if repaid in the third year of the loan; no prepayment fee is required thereafter.

#### *Revolving Credit Facility*

Borrowings under the revolving credit facility accrue interest monthly at a floating interest rate equal to the greater of the prime rate or 5.50% per annum. In addition to paying interest on any amounts borrowed under the revolving credit facility, the Company owes an unused revolving line facility fee equal to 0.25% per annum of the average unused portion of the revolving line multiplied by the difference between the total amount available to be borrowed (the “Revolver Commitment Amount”) of \$20.0 million and the greater of the average outstanding revolver balance and 25% of the Commitment Amount. The revolving credit facility and any related fees or interest payments was made available to the Company beginning January 1, 2020, after certain conditions imposed by the Lenders, were met, including an initial borrowing limitation of up to \$10.0 million until the Lenders completed an audit of certain collateral accounts.

Beginning on January 1, 2020, if the interest payment on the revolving credit facility is less than the amount of interest that would have been payable had the Company borrowed 25% of the Revolver Commitment Amount, then the Company will be required to pay the difference.

The Company may retire the revolving credit facility early, at any time, by paying the outstanding principal balance, all accrued interest and a termination fee equal to 2% of the Revolving Commitment Amount if repaid in the first year, and 1% of the Revolving Commitment Amount if repaid in the second year; with no termination fee thereafter.

As of December 31, 2019, annual principal and interest payments due under the 2019 term loan are as follows:

<b>Year</b>	<b>Aggregate Minimum Payments (in thousands)</b>
2020	2,736
2021	14,611
2022	14,816
2023	13,903
2024	3,018
Total	\$ 49,084
Less interest	(7,182)
Less unamortized portion of final payment	(1,726)
Total	<u>\$ 40,176</u>

#### **2024 Convertible Notes**

On May 2, 2017 the Company issued an aggregate of \$201.3 million principal amount of the 2024 Convertible Notes. The 2024 Convertible Notes have a maturity date of May 1, 2024, are unsecured and accrue interest at a rate of 3.375% per annum, payable semi-annually on May 1 and November 1 of each year, beginning November 1, 2017.

The Company received \$194.8 million in proceeds for the sale of the 2024 Convertible Notes, after deducting fees and expenses of \$6.5 million.

Upon conversion of the 2024 Convertible Notes, at the election of each holder of a 2024 Convertible Note (the “Holder”), the note will be convertible into cash, shares of the Company’s common stock, or a combination thereof, at the Company’s election (subject to certain limitations in the 2015 term loan), at a conversion rate of approximately 37.3413 shares of common stock per \$1,000 principal amount of the 2024 Convertible Notes, which corresponds to an initial conversion price of approximately \$26.78 per share of the Company’s common stock.

The conversion rate is subject to adjustment from time to time upon the occurrence of certain events, including, but not limited to, fundamental change events and certain corporate events that occur prior to the maturity date of the notes. In addition, if the Company delivers a notice of redemption, the Company will increase, in certain circumstances, the conversion rate for a Holder who elects to convert its notes in connection with such a corporate event or notice of redemption, as the case may be. At any time prior to the close of business on the business day immediately preceding February 1, 2024, Holders may convert all, or any portion, of the 2024 Convertible Notes at their option only under the following circumstances:

- (1) during any calendar quarter commencing after the calendar quarter ending on June 30, 2017 (and only during such calendar quarter), if the last reported sale price of the Company’s common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- (2) during the five business day period after any ten consecutive trading day period (the “measurement period”) in which the trading price per \$1,000 principal amount of notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company’s common stock and the conversion rate on each such trading day;
- (3) if the Company calls any or all of the notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; and
- (4) upon the occurrence of specified corporate events.

On or after February 1, 2024, until the close of business on the business day immediately preceding the maturity date, Holders may convert their notes at any time, regardless of the foregoing circumstances. The Company may redeem, for cash, all or any portion of the 2024 Convertible Notes, at its option, on or after May 6, 2020 if the last reported sale price of the Company’s common stock has been at least 130% of the conversion price for at least 20 trading days during any 30 consecutive day trading period, at a redemption price equal to 100% of the principal amount of the 2024 Convertible Notes to be redeemed, plus accrued and unpaid interest, subject to the Holders’ right to convert as described above.

The 2024 Convertible Notes are considered convertible debt with a cash conversion feature. Per ASC 470-20, Debt with Conversion and Other Options, the Company has separated the convertible debt into liability and equity components based on the fair value of a similar debt instrument excluding the embedded conversion option. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The allocation was performed in a manner that reflected our non-convertible debt borrowing rate for similar debt. The equity component of the 2024 Convertible Notes was recognized as a debt discount and represents the difference between the proceeds from the issuance of the 2024 Convertible Notes and the fair value of the liability of the 2024 Convertible Notes on their respective dates of issuance. The excess of the principal amount of the liability component over its carrying amount (“debt discount”) is amortized to interest expense using the effective interest method over seven years. The equity component is not re-measured as long as it continues to meet the conditions for equity classification. The liability component of \$136.7 million was recorded as long-term debt at May 2, 2017 with the remaining equity component of \$64.5 million recorded as additional paid-in capital.

In connection with the issuance of the 2024 Convertible Notes, the Company incurred approximately \$6.5 million of debt issuance costs, which primarily consisted of underwriting, legal and other professional fees, and allocated these costs to the liability and equity components based on the allocation of the proceeds. Of the total debt

issuance costs, \$4.4 million were allocated to the liability component and are recorded as a reduction of the 2024 Convertible Notes in our consolidated balance sheets. The remaining \$2.1 million was allocated to the equity component and is recorded as a reduction to additional paid-in capital.

Debt discount and issuance costs of \$68.9 million are being amortized to interest expense over the life of the 2024 Convertible Notes using the effective interest rate method. As of December 31, 2019, the stated interest rate was 3.375%, and the effective interest rate was 9.71%. Interest expense related to the 2024 Convertible Notes for the year ended December 31, 2019 was \$14.7 million, including \$8.0 million related to amortization of the debt discount.

The table below summarizes the carrying value of the 2024 Convertible Notes as of December 31, 2019:

	<i>(in thousands)</i>	
Gross proceeds	\$	201,250
Portion of proceeds allocated to equity component (additional paid-in capital)		(64,541)
Debt issuance costs		(6,470)
Portion of issuance costs allocated to equity component (additional paid-in capital)		2,075
Amortization of debt discount and debt issuance costs		21,099
Carrying value 2024 Convertible Notes	\$	153,413

## 11. Stockholders' Equity

On February 17, 2014, the Company filed an amended and restated Certificate of Incorporation (the "Restated Certificate") in connection with the closing of the Company's initial public offering. As of December 31, 2019, under the Restated Certificate, the Company is authorized to issue 10,000,000 shares of preferred stock with a par value of \$0.001 per share.

On June 7, 2016, the Company completed a follow-on public offering of its common stock, which resulted in the sale of 5,900,000 shares of the Company's common stock at a price to the public of \$14.00 per share including shares sold pursuant to the exercise in full of the underwriters' option to purchase additional shares.

On November 15, 2016, the Company completed a follow-on public offering of its common stock, which resulted in the sale of 4,140,000 shares of the Company's common stock at a price to the public of \$18.00 per share including shares sold pursuant to the exercise in full of the underwriters' option to purchase additional shares.

On October 16, 2017, the Company completed a follow-on public offering of its common stock, which resulted in the sale of 5,520,000 shares of the Company's common stock at a price to the public of \$25.50 per share including shares sold pursuant to the exercise in full of the underwriters' option to purchase additional shares.

Each share of common stock entitles the holder to one vote on all matters submitted to a vote of the Company's stockholders. Common stockholders are entitled to receive dividends, as may be declared by the board of directors, if any, subject to the preferential dividend rights of any holders of Preferred Stock. As of December 31, 2019, no dividends have been declared.

## 12. Stock Plans

### 2013 Equity Incentive Plan

On January 27, 2014, the Company's stockholders approved the 2013 Equity Incentive Plan (the "2013 Plan"), which became effective on February 11, 2014, the date of execution of the underwriting agreement pursuant to which the Company's common stock was priced for its initial public offering. Prior to the effective date of the 2013 Plan, the Company granted stock-based awards pursuant to the 2009 Stock Incentive Plan (the "2009 Plan"), which had similar features to the 2013 Plan. The 2013 Plan provides for the grant of incentive stock options ("ISOs"), non-statutory stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards, performance-based stock awards, and other forms of equity compensation. Initially, the maximum number of shares of the Company's common stock that may be issued pursuant to stock awards under the 2013 Plan was 2,337,616,

which is the sum of (i) 1,230,012 shares, plus (ii) the number of shares remaining available for grant under the 2009 Plan, plus (iii) any shares subject to outstanding stock options or other stock awards that would have otherwise returned to the 2009 Plan (such as upon the expiration or termination of a stock award prior to vesting).

Additionally, the number of shares of common stock reserved for issuance under the 2013 Plan automatically increases on January 1 of each year, beginning on January 1, 2015 and continuing through and including January 1, 2023, by 4% of the total number of shares of the Company's capital stock outstanding on December 31 of the preceding calendar year, or a lesser number of shares determined by the board of directors. The maximum number of shares that may be issued upon the exercise of ISOs under the 2013 Plan is 4,684,989 shares.

On September 11, 2017, the Company's compensation committee approved an amendment to the 2013 Plan to reserve an additional 1,500,000 of the Company's common stock to be used exclusively for grants of inducement awards to individuals who were not previously employees or non-employee directors of the Company (or following a bona fide period of non-employment with the Company).

As of December 31, 2019, 3,073,933 shares were available for future issuance under the 2013 Plan. As of December 31, 2019, there were 236,187 options outstanding under the 2009 Plan and 4,531,754 options outstanding under the 2013 Plan, including 839,560 shares underlying outstanding stock options granted as inducement awards under the 2013 Plan.

### **Employee Stock Purchase Plan**

On January 27, 2014, the Company's stockholders approved the Employee Stock Purchase Plan. A total of 209,102 shares of common stock were reserved for issuance under this plan. The Employee Stock Purchase Plan became effective on February 11, 2014, the date of execution of the underwriting agreement pursuant to which the Company's common stock was priced for its initial public offering. During the years ended December 31, 2019 and 2018, 184,860 and 138,405 shares, respectively, were purchased by employees under the plan. Additionally, the number of shares of common stock reserved for issuance under the Employee Stock Purchase Plan automatically increases on January 1 of each year, beginning on January 1, 2015 and continuing through and including January 1, 2023, by 1% of the total number of shares of the Company's capital stock outstanding on December 31 of the preceding calendar year, or a lesser number of shares determined by the board of directors.

## **13. Stock-Based Compensation**

### ***Stock Options***

During the years ended December 31, 2019, 2018 and 2017, the Company granted stock options for the purchase of 1,099,450, 1,127,263, and 1,448,100 shares of common stock, respectively, to certain employees, two non-employees and directors. The vesting conditions for most of these awards are time-based, and the awards vest 25% after one year and monthly thereafter for the next 36 months, except for annual option grants to non-employee directors of the Company whose initial grants vest 25% after one year and monthly thereafter for the next 24 months and whose annual grants vest in equal monthly installments during the 12-month period following the grant date, pursuant to the Company's Non-Employee Director Compensation Policy. Options granted have a maximum term of up to 10 years.

### **Stock Option Valuation**

The fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model. Prior to February 2014, the Company was privately held with a limited operating history and accordingly it utilized data from representative peer companies to estimate expected stock price volatility from its inception to its initial public offering. The Company selected peer companies from the biopharmaceutical industry with similar characteristics as the Company, including stage of product development, market capitalization and therapeutic focus. Since its initial public offering in February 2014, the Company has continued to use volatility data from a representative peer group to estimate expected stock price volatility and expects to continue to do so until such time as it has adequate historical data regarding the volatility of its own traded stock price for a period of time that is commensurate with the expected term (in years) of the Company's stock options. Starting in 2020, we will

use our own volatility as it will have been six years since our IPO. The expected term of the Company's stock options has been determined utilizing the "simplified" method for awards that qualify as "plain vanilla" options. The expected term of stock options granted to non-employees is equal to the contractual term of the option award. The risk-free interest rate is determined by reference to the U.S. Treasury yield curve in effect at the time of grant of the award for time periods approximately equal to the expected term of the award. Expected dividend yield is based on the fact that the Company has never paid cash dividends and does not expect to pay any cash dividends in the foreseeable future. The relevant data used to determine the value of the stock option grants for the years ended December 31, 2019, 2018 and 2017 is as follows:

	December 31,		
	2019	2018	2017
Risk-free interest rates	1.42% - 2.67%	2.67% - 3.06%	1.97% - 2.29%
Expected dividend yield	0.00%	0.00%	0.00%
Expected term (in years)	6.0	6.0	6.0
Expected volatility	66.2% - 69.5%	69.8% - 75.3%	69.9% - 72.8%

The following table summarizes stock option activity for the year ended December 31, 2019:

<i>(In thousands, except per share amounts)</i>	Shares Issuable Under Options	Weighted Average Exercise Price
<b>Outstanding as of December 31, 2018</b>	4,435	\$ 19.21
Granted	1,099	\$ 13.53
Exercised	(154)	\$ 12.09
Cancelled	(605)	\$ 20.31
<b>Outstanding as of December 31, 2019</b>	<u>4,775</u>	<u>\$ 17.99</u>
<b>Options vested and expected to vest at December 31, 2019</b>	<u>4,775</u>	<u>\$ 17.99</u>
<b>Options exercisable at December 31, 2019</b>	<u>2,973</u>	<u>\$ 18.34</u>

The aggregate intrinsic value of options is calculated as the difference between the exercise price of the options and the fair value of the Company's common stock for those options that had exercise prices lower than the fair value of the Company's common stock. A total of 153,754, 165,684, and 308,011 options were exercised during the years ended December 31, 2019, 2018 and 2017, respectively. The aggregate intrinsic value of stock options exercised was \$0.9 million, \$2.3 million, and \$2.9 million for the years ended December 31, 2019, 2018 and 2017, respectively.

At December 31, 2019, 2018 and 2017, the Company had options for the purchase of 4,774,691, 4,435,056, and 3,799,965 shares of common stock outstanding, with a weighted average remaining contractual term of 6.9, 7.6, and 8.0 years, respectively, and with a weighted average exercise price of \$17.99, \$19.21, and \$17.75 per share, respectively. At December 31, 2019, 2018 and 2017 there were options for the purchase of 2,973,000, 2,368,955, and 1,688,652 shares of common stock exercisable under these stock option awards, with a weighted average remaining contractual life of 6.1, 6.6, and 6.8 years, respectively, and an aggregate intrinsic value of \$9.8 million, \$2.6 million, and \$17.0 million, respectively.

The weighted average grant date fair value of options granted during the years ended December 31, 2019, 2018 and 2017 was \$8.55, \$15.12, and \$14.33, respectively.

### Restricted Stock Units

On January 4, 2016, the Company granted 189,300 restricted stock units, ("RSUs"), with performance and time-based vesting conditions to certain executives. These RSUs began vesting, and the underlying shares of common stock became deliverable, beginning when ZILRETTA was approved (the "Milestone"). The number of shares eligible for vesting varied based on the timing of achieving the Milestone. As a result of the Milestone being achieved on October 6, 2017, the number of shares of the Company's common stock earned under these awards was 122,800, subject to ongoing employment with the Company for a period of two years. The 122,800 shares had an approximate value of \$2.2 million as of the original grant date of which \$1.6 million was recognized in the fourth quarter of 2017 upon achieving the Milestone and the remaining \$0.6 million will be recognized over a period of two years.

During the year ended December 31, 2019, the Company awarded 873,481 RSUs to employees at an average grant date fair value of \$14.51 per share. The RSUs vest in four substantially equal installments on each of the first four anniversaries of the vesting commencement date, subject to the employee's continued employment with, or services to, the Company on each vesting date. Compensation expense is recognized on a straight-line basis.

The following table summarizes the RSU activity for the year ended December 31, 2019:

<i>(In thousands, except per share amounts)</i>	Number of Shares	Weighted Average Grant Date Fair Value Per Share
<b>Nonvested balance as of December 31, 2018</b>	252	\$ 22.25
Granted	873	14.51
Cancelled	(186)	21.07
Vested/Released	(86)	15.86
<b>Nonvested balance as of December 31, 2019</b>	<b>853</b>	<b>\$ 15.84</b>

### Stock-based Compensation

The Company recorded stock-based compensation expense related to stock options, restricted stock and shares purchased under the Employee Stock Purchase Plan for the years ended December 31, 2019, 2018 and 2017 as follows:

<i>(In thousands)</i>	Year Ended December 31,		
	2019	2018	2017
Research and development	\$ 5,211	\$ 4,728	\$ 3,979
Selling, general and administrative	10,690	10,731	7,563
<b>Total</b>	<b>\$ 15,901</b>	<b>\$ 15,459</b>	<b>\$ 11,542</b>

As of December 31, 2019, unrecognized stock-based compensation expense for stock options outstanding was \$18.4 million which is expected to be recognized over a weighted average period of 2.2 years. As of December 31, 2019, unrecognized stock-based compensation expense for RSUs outstanding was \$10.5 million which is expected to be recognized over a period of 2.9 years.

## 14. Commitments and Contingencies

### Operating Leases

#### Burlington Lease

In May 2013, the Company entered into a lease for office space in Burlington, Massachusetts (the "Lease"). The term of the Lease was for 42-months with minimum monthly lease payments beginning at \$17,588 per month and escalating over the term of the Lease. In July 2015, the Company amended the Lease to add approximately 4,700 square feet of additional office space, with the option to lease an additional 5,400 square feet in the same building in Burlington, Massachusetts. In addition, at the time, the Company leased approximately 6,700 square feet of temporary space for use prior to delivery of the additional space. This amendment also extended the term of the Lease through October 31, 2019. On September 30, 2015, the Company exercised its option for the additional 5,400 square feet of office space. On September 21, 2016, the Company entered into another amendment to extend the Lease for the 6,700 square feet of temporary space until October 31, 2017.

On April 7, 2017, the Company further amended the Lease to extend the term to October 31, 2023 on the then-existing office space, including the temporary space, consisting of approximately 28,600 square feet of office space in Burlington, Massachusetts. From November 2016 through October 2017, the Company's lease payment for this space was approximately \$80,000 per month. Also, as part of this amendment to the Lease, the Company leased an additional 1,471 square feet of office space beginning in 2018. The lease payment for the 1,471 square feet of office space is approximately \$4,100 per month.

On October 6, 2017, the Company exercised its option for an additional 6,450 square feet of space, and the term for the space commenced in April 2018. The Company had approximately 36,500 square feet of office space in Burlington, Massachusetts under a lease term expiring on October 31, 2023. Starting in December 2017, the Company's minimum monthly lease payment is approximately \$87,000 and it increases over the life of the amended Lease. In addition to the base rent for the office space, which increases over the term of the amended Lease, the Company is responsible for its share of operating expenses and real estate taxes.

In June 2019, the Company amended the Lease to add approximately 5,330 square feet of additional office space and extend the term of the Lease through April 30, 2025 (the "Amended Lease"). As a result of the Amended Lease, the total rentable floor area is 41,873 square feet. Starting in August 2019, the Company's minimum monthly lease payment is approximately \$108,000, which increases over the term of the Amended Lease. In addition to the base rent for the office space, the Company is responsible for its share of operating expenses and real estate taxes. The lease commencement date for the additional space, which represents the date the Company first had access to the space, was July 1, 2019. The Company accounted for the Amended Lease as a lease modification that is a separate contract from the original lease and recorded an incremental right-of-use asset and lease liability of \$2.5 million, which represents the present value of the lease payments relating to the new space, as well as the lease payments relating to the 18-month extension of the existing space, as of the modification date, discounted at 6.8%.

The straight-line lease cost for the Amended Lease (including the expense relating to the original Lease) amounted to \$1.6 million for the year ended December 31, 2019, respectively, and was included in operating expenses. As of December 31, 2019, the remaining lease term on the Amended Lease was 5.3 years, which includes the 18-month extension resulting from the amendment signed in June 2019.

### **Woburn Lease**

In February 2017, the Company entered into a five-year lease for laboratory space located in Woburn, Massachusetts with a monthly lease payment of approximately \$15,000, which increases over the term of the lease, plus a share of operating expenses. The total cash obligations for the term of the lease are approximately \$0.9 million.

Upon adoption of ASU 2016-02, the Company recorded a right-of-use asset and corresponding lease liability for the Lease on January 1, 2019, by calculating the present value of lease payments, discounted at 8.4%, the Company's estimated incremental borrowing rate, over the 3.2-year remaining term. The Woburn lease includes an option to extend the term of the lease for two years. Since the Company adopted ASU 2016-02 using the Comparatives under 840 approach, it did not reassess the determination of its operating leases as leases, and therefore no options to extend the lease were included in the calculation of the lease liability as of December 31, 2019. The straight-line lease cost for the Woburn lease amounted to \$0.2 million for the year ended December 31, 2019, respectively, and was included in operating expenses. As of December 31, 2019, the remaining lease term on the Woburn lease was 2.2 years.

The Company incurred operating lease costs of \$2.0 million, \$1.1 million, and \$1.0 million for the years ended December 31, 2019, 2018 and 2017, respectively.

### **Manufacturing and Supply Agreement with Patheon U.K. Limited**

In July 2015, the Company and Patheon U.K. Limited ("Patheon") entered into a Manufacturing and Supply Agreement (the "Manufacturing Agreement") and Technical Transfer and Service Agreement (the "Technical Transfer Agreement") for the manufacture of ZILRETTA.

Patheon agreed in the Technical Transfer Agreement to undertake certain transfer activities and construction services needed to prepare Patheon's United Kingdom facility for the commercial manufacture of ZILRETTA in dedicated manufacturing suites. The Company provided Patheon with certain equipment and materials necessary to manufacture ZILRETTA and pays Patheon a monthly fee for such activities and reimburses Patheon for certain material, equipment and miscellaneous expenses and additional services.



The initial term of the Manufacturing Agreement is 10 years from approval by the FDA of the Patheon manufacturing suites for ZILRETTA, or until October 6, 2027. The Company pays a monthly base fee to Patheon for the operation of the manufacturing suites and a per product fee for each vial based upon a forecast of commercial demand. The Company also reimburses Patheon for purchases of materials and equipment made on its behalf, certain nominal expenses and additional services. The Manufacturing Agreement will remain in full effect unless and until it expires or is terminated. Upon termination of the Manufacturing Agreement (other than termination by Flexion in the event that Patheon does not meet the construction and manufacturing milestones or for a breach by Patheon), Flexion will be obligated to pay for the costs incurred by Patheon associated with the removal of our manufacturing equipment and for Patheon's termination costs up to a capped amount.

The Manufacturing Agreement with Patheon contains an operating lease for the use of dedicated manufacturing suites. With the adoption of ASU 2016-02, the Company recorded a right-of-use asset and corresponding lease liability for the operating lease.

In June 2019, the Company and Patheon amended the Manufacturing Agreement and the Technical Transfer Agreement. The amendment primarily modifies the compensation structure, which is comprised of base fees and per product fees the Company pays to Patheon and does not result in any additional rights of use. The Company accounted for the amendment as a lease modification that is not a separate contract from the original lease. As part of the modification, the Company reassessed whether the contract is or contains a lease and determined that there is an operating lease component for the use of dedicated manufacturing suites. The remainder of the consideration is allocated to the service component. The Company also reassessed the lease liability by calculating the present value of the remaining lease payments as of the modification date, discounted at 6.1%. The modification resulted in an increase to each of the lease liability and right of use asset of \$0.5 million.

As of December 31, 2019, the remaining lease term on the Patheon lease was 7.8 years. The straight-line lease cost amounted to \$204 thousand for the year ended December 31, 2019, respectively, and is included in inventory as part of manufacturing overhead.

The components of lease expense and related cash flows were as follows:

*(In thousands)*

<b>Operating lease cost</b>	<b>Year ended December 31, 2019</b>	
Operating lease cost included in operating expenses	\$	1,765
Operating lease cost included in inventory		204
<b>Total operating lease cost</b>		<b>1,969</b>
Operating cash flows from operating leases		2,363

Maturities of lease liability due under these lease agreements as of December 31, 2019 were as follows:

<b>Year</b>	<b>Aggregate Minimum Payments (in thousands)</b>
2020	1,987
2021	2,035
2022	1,879
2023	1,888
2024	1,929
Thereafter	1,221
Present value imputed interest	(2,531)
Present value of lease payments	<u>\$ 8,408</u>

As of December 31, 2018, future minimum lease payments under the Company's lease obligations under ASC 840 were as follows:

<b>Year</b>	<b>Aggregate Minimum Payments (in thousands)</b>
2019	1,491
2020	1,533
2021	1,576
2022	1,447
2023	1,203
Total	<u>\$ 7,250</u>

As of December 31, 2018, future minimum payments under the Company's agreed obligations under the Manufacturing Agreement with Patheon are as follows:

<b>Year</b>	<b>Aggregate Minimum Payments (in thousands)</b>
2019	8,027
2020	8,027
2021	8,027
2022	8,027
2023	8,027
2024 and thereafter	30,102
Total	<u>\$ 70,237</u>

## **Other Commitments and Contingencies**

### **Evonik Supply Agreement**

In November 2016, the Company entered into a Supply Agreement with Evonik Corporation (“Evonik”) for the purchase of PLGA which is used in the manufacturing of potential clinical and commercial supply of ZILRETTA. Pursuant to the Supply Agreement, Flexion is obligated to submit rolling monthly forecasts to Evonik for PLGA supply, a portion of which will constitute binding orders. In addition, Flexion agreed to certain minimum purchase requirements and which do not apply (i) during periods in which Evonik is in material breach of the Supply Agreement or is unable to perform its obligations due to a force majeure event, (ii) with respect to orders that Evonik is unable to supply in excess of binding orders, (iii) for orders Evonik is unable to timely deliver or does not deliver conforming product and provides a credit for such order, or (iv) during an uncured material quality failure by Evonik. Flexion agreed to purchase PLGA batches at a specified price per gram in U.S. dollars, subject to adjustment from time to time, including due to changes in price indices and in the event the initial term of the Supply Agreement is extended. The total term of the agreement is five years. Upon termination of the Supply Agreement (other than termination due to the expiration of the term of the agreement or due to bankruptcy of either Evonik or Flexion), Flexion is obligated to pay the costs associated with the binding supply forecast provided to Evonik. The Supply Agreement will renew for two successive two-year terms upon mutual written consent by both parties.

### **Southwest Research Institute License Agreement**

On July 25, 2014, the Company entered into an exclusive worldwide license agreement with Southwest Research Institute (“SwRI”) with respect to the use of SwRI’s proprietary microsphere manufacturing technologies for certain steroids formulated with PLGA, including ZILRETTA. Under the agreement, the Company paid an upfront fee of \$120,000 to SwRI. In February 2017, Flexion executed an agreement with SwRI to transfer manufacturing equipment to SwRI in consideration for SwRI deeming the additional milestone payment to have been fully paid by Flexion.

### **FX201 Related Agreement**

In December 2017, we entered into a definitive agreement with GeneQuine to acquire the global rights to FX201. As part of the asset purchase transaction with GeneQuine, we made an upfront payment to GeneQuine of \$2.0 million. In 2018, we paid GeneQuine \$750,000 for the milestone of initiating a GLP toxicology study of FX201. In addition, we paid GeneQuine a \$750,000 payment in November 2019 following the FDA acceptance of the IND application for FX201. This milestone was recognized as research and development expense in the fourth quarter of 2019. The next milestone of \$2.5 million was achieved in March 2020 when the first patient was treated in the Phase 1 clinical trial. We may also be required to make additional milestone payments during the development of FX201, including up to \$4.5 million through the Phase 2 PoC, clinical trial and, following successful PoC, up to an additional \$51.5 million in development and global regulatory approval milestone payments. The transaction was accounted for as an asset acquisition, as it did not qualify as a business combination. The upfront fee was attributed to the intellectual property acquired and recognized as research and development expense in December 2017 as the FX201 rights had not been commercially approved and have no alternative future use. The milestone payment for the GLP toxicology study was also recorded to research and development expense in the fourth quarter of 2018. Future milestone payments earned prior to regulatory approval of FX201 would be recognized as research and development expense in the period when the milestone events become probable of being achieved. Future milestones earned upon regulatory approval would be recognized as an intangible asset and amortized to expense over its estimated life. As part of the transaction with GeneQuine, we became the direct licensee of certain underlying Baylor College of Medicine (Baylor) patents and other proprietary rights related to FX201 for human applications. The Baylor license agreement grants us an exclusive, royalty-bearing, world-wide right and license (with a right to sublicense) for human applications under its patent and other proprietary rights directly related to FX201, with a similar non-exclusive license to certain Baylor intellectual property rights that are not specific to FX201. The license agreement with Baylor includes a low single-digit royalty on net sales of FX201

and requires us to use reasonable efforts to develop FX201 according to timelines set out in the license agreement. In December 2017, we also entered into a Master Production Services Agreement with SAFC Carlsbad, Inc., a part of MilliporeSigma, for the manufacturing of preclinical and initial clinical supplies of FX201.

### FX301 Related Agreements

In September 2019, the Company acquired from Xenon, the global rights to develop and commercialize Xenon's NaV1.7 inhibitor, funapide, formulated for extended release with a novel, Flexion proprietary thermosensitive hydrogel under the Company's preclinical program known as FX301. As part of the asset purchase transaction with Xenon, the Company made an upfront payment to Xenon of \$3.0 million. The Company may also be required to make additional milestone payments during the development of FX301, including up to \$9.0 million through initiation of a Phase 2 proof of concept (PoC) clinical trial and, following successful PoC, up to \$40.8 million in development and global regulatory approval milestone payments and up to an additional \$75.0 million in sales-related milestone payments. The transaction was accounted for as an asset acquisition, as it did not qualify as a business combination. The upfront fee was attributed to the intellectual property acquired and recognized as research and development expense in September 2019 as the FX301 product candidate had not been commercially approved and had no alternative future use. Future milestone payments earned prior to regulatory approval of FX301 will be recognized as research and development expense in the period when the milestone events become probable of being achieved. Future milestones earned subsequent to regulatory approval will be recognized as an intangible asset and amortized to expense over the estimated life of FX301. As of December 31, 2019, no milestones under the arrangement had been achieved. As part of the transaction, the Company became the direct licensee of certain underlying Xenon patents and other proprietary rights related to funapide for human applications. The Xenon agreement grants the Company an exclusive, royalty-bearing, world-wide right and license (with a right to sublicense) for human applications under its patents directly related to funapide, with a similar royalty-free license to other Xenon proprietary rights directly related to funapide. The agreement with Xenon includes a tiered royalty ranging from mid-single digits to low double digits that is based on aggregate annual net sales of FX301 and requires the Company to use reasonable efforts to develop FX301 according to timelines set out in the agreement.

### 15. Net Loss Per Share

Basic and diluted net loss per share attributable to common stockholders was calculated as follows for the years ended December 31, 2019, 2018 and 2017:

<i>(In thousands)</i>	Year ended December 31,		
	2019	2018	2017
<b>Numerator:</b>			
Net loss	\$ (149,773)	\$ (169,659)	\$ (137,481)
Net loss:	<u>\$ (149,773)</u>	<u>\$ (169,659)</u>	<u>\$ (137,481)</u>
<b>Denominator:</b>			
Weighted average common shares outstanding, basic and diluted	<u>38,086</u>	<u>37,751</u>	<u>33,027</u>
Net loss per share, basic and diluted	<u>\$ (3.93)</u>	<u>\$ (4.49)</u>	<u>\$ (4.16)</u>

The following common stock equivalents were excluded from the calculation of diluted net loss per share as including them would have an anti-dilutive effect:

	Year ended December 31,		
	2019	2018	2017
Shares issuable upon conversion of the 2024 convertible notes	7,515	7,515	5,017
Stock Options	4,988	4,498	3,602
Restricted Stock Units	802	266	147
	<u>13,305</u>	<u>12,279</u>	<u>8,766</u>

## 16. Income Taxes

The Company has generated losses since inception. Accordingly, there is no US tax provision or benefit for the years ended December 31, 2019, 2018 and 2017, respectively.

A reconciliation of the U.S. federal statutory income tax rate to the Company's effective income tax rate is as follows:

	Year Ended December 31,		
	2019	2018	2017
Federal statutory income tax rate	21.0%	21.0%	34.0%
State taxes, net of federal benefit	(0.2)	8.0	3.0
Federal and state research and development tax credits	1.0	1.0	0.9
Change in deferred tax asset valuation allowance	(22.2)	(27.4)	(11.6)
Tax rate change	1.7	(1.9)	(25.1)
Other	(1.3)	(0.7)	(1.2)
Effective income tax rate	—%	—%	—%

The Company's net deferred tax assets consisted of the following:

	December 31,	
	2019	2018
Net operating loss carryforwards	\$ 101,356	\$ 76,723
Research and development tax credit carryforwards	12,096	9,965
Accruals and other temporary differences	10,873	7,808
Debt discount	(11,156)	(14,165)
Right of use asset	(2,042)	—
Capitalized research and development expenses, net	43,442	41,048
Total deferred tax assets	154,569	121,379
Valuation allowance	(154,569)	(121,379)
Net deferred tax asset	\$ —	\$ —

As of December 31, 2019, the Company had federal and state net operating loss ("NOL") carryforwards of approximately \$404.3 million and \$300.0 million, respectively, which begin to expire in 2029 for federal purposes and in 2030 for state purposes. Approximately \$214.8 million of the federal NOLs have an indefinite carryforward. In addition, the Company had federal and state research and development tax credit carryforwards of approximately \$8.6 million and \$4.3 million, respectively, available to reduce future tax liabilities, which begin to expire in 2029 for federal purposes and 2025 for state purposes. Management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets, which are comprised principally of NOL carryforwards and capitalized research and development expenses. Management has considered the Company's history of cumulative net losses incurred since inception and determined that it is more likely than not that the Company will not realize the benefits of its deferred tax assets. As a result, a full valuation allowance has been established at December 31, 2019, 2018 and 2017.

Section 382 of the Internal Revenue Code of 1986, as amended ("Section 382"), contains rules that limit the ability of a company that undergoes an ownership change to utilize its NOLs, and tax credits existing as of the date of such ownership change. Under the rules, such an ownership change is generally any change in ownership of more than 50% of a company's stock within a rolling three-year period. The rules generally operate by focusing on changes in ownership among stockholders considered by the rules as owning, directly or indirectly, 5% or more of the stock of a company and any change in ownership arising from new issuances of stock by the company. The Company has experienced multiple ownership changes since its inception, however, based on the annual limitations calculated at each ownership change date, substantially all NOL carryforwards will be available to offset future taxable income. Approximately \$0.3 million of NOLs will expire unused. Future ownership changes as defined by Section 382 may further limit the amount of NOL carryforwards that could be utilized annually to offset future taxable income.

Changes in the valuation allowance for deferred tax assets during the years ended December 31, 2019, 2018 and 2017 were as follows:

	Year Ended December 31,		
	2019	2018	2017
Valuation allowance as of beginning of year	\$ (121,379)	\$ (74,842)	\$ (83,434)
Decreases recorded as benefit to income tax provision	2,046	1,913	36,606
Decreases recorded as benefit to equity	0	0	24,537
Increases recorded to income tax provision	(35,236)	(48,450)	(52,551)
Valuation allowance as of end of year	<u>\$ (154,569)</u>	<u>\$ (121,379)</u>	<u>\$ (74,842)</u>

In each reporting period, the Company considers whether a tax position of the Company is more likely than not to be sustained upon examination, including resolution of any related appeals of litigation processes, based on the technical merits of the position. For tax positions meeting the more likely than not threshold, the tax amount recognized in the financial statements is reduced by the largest benefit that has a greater than fifty percent likelihood of being realized upon the ultimate settlement with the relevant taxing authority. No liabilities for unrecognized tax benefits were recorded as of as of December 31, 2019 and 2018.

The Company files tax returns as prescribed by the tax laws of the jurisdictions in which it operates. In the normal course of business, the Company is subject to examination by federal and state jurisdictions, where applicable. There are currently no pending tax examinations. The Company's tax years are still open under statute from 2013 to the present. Earlier years may be examined to the extent that tax credit or NOL carryforwards are used in future periods. The resolution of tax matters is not expected to have a material effect on the Company's consolidated financial statements.

## 17. Quarterly Financial Data (unaudited)

The following information has been derived from unaudited consolidated financial statements that, in the opinion of management, include all recurring adjustments necessary for a fair statement of such information.

(in thousands, except per share amounts)	Three Months Ended			
	March 31,	June 30,	September 30,	December 31,
	2019	2019	2019	2019
Revenues	\$ 10,564	\$ 16,953	\$ 21,786	\$ 23,653
Gross profit	8,802	15,555	18,914	19,725
Net loss	(41,538)	(36,487)	(38,232)	(33,516)
Net loss per common share—basic and diluted	\$ (1.09)	\$ (0.96)	\$ (1.00)	\$ (0.88)
Weighted average common shares—basic and diluted	37,992	38,010	38,125	38,176

(in thousands, except per share amounts)	Three Months Ended			
	March 31,	June 30,	September 30,	December 31,
	2018	2018	2018	2018
Revenues	\$ 2,194	\$ 3,797	\$ 6,990	\$ 9,543
Gross profit	(504)	2,851	5,371	7,470
Net loss	(41,569)	(43,875)	(43,640)	(40,575)
Net loss per common share—basic and diluted	\$ (1.10)	\$ (1.16)	\$ (1.15)	\$ (1.07)
Weighted average common shares—basic and diluted	37,620	37,697	37,818	37,867

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

None.

**Item 9A. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

We are responsible for maintaining disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Disclosure controls and procedures are controls and other procedures designed to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Based on our management's evaluation (with the participation of our principal executive officer and our principal financial officer) of our disclosure controls and procedures as defined by Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act, our principal executive officer and our principal financial officer have concluded that our disclosure controls and procedures were effective to achieve their stated purpose as of December 31, 2019, 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 Rule 13a-15(f) and Exchange Act Rule 15d-15(f). Internal control over financial reporting is a process designed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, 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.

As of December 31, 2019, our management assessed the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control-Integrated Framework* (2013 Framework). Based on this assessment, our management concluded that, as of December 31, 2019, our internal control over financial reporting was effective based on those criteria.

The effectiveness of our internal control over financial reporting as of December 31, 2019 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included in Item 8 in this report.

**Changes in Internal Control over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

## PART III

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

The information required by this item and not set forth below will be set forth in the section headed “Election of Directors” and “Executive Officers” in our Proxy Statement for our 2020 Annual Meeting of Stockholders, or Proxy Statement, to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2019, and is incorporated herein by reference.

We have adopted a written code of business conduct and ethics that applies to our directors, officers and employees, including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. A current copy of the code is available on the Corporate Governance section of our website, [www.flexiontherapeutics.com](http://www.flexiontherapeutics.com). We intend to disclose on our website any amendments to, or waivers from, our code of business conduct and ethics that are required to be disclosed pursuant to SEC rules.

#### Section 16(a) Compliance

The information concerning Section 16(a) beneficial ownership reporting compliance will be set forth in the section headed “Delinquent Section 16(a) Reports” in our Proxy Statement and is incorporated herein by reference.

### **Item 11. Executive Compensation**

The information required by this item will be set forth in the section headed “Executive Compensation” in our Proxy Statement and is incorporated herein by reference.

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

The information required by this item will be set forth in the section headed “Security Ownership of Certain Beneficial Owners and Management” in our Proxy Statement and is incorporated herein by reference.

The information required by Item 201(d) of Regulation S-K will be set forth in the section headed “Executive Compensation” in our Proxy Statement and is incorporated herein by reference.

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

The information required by this item will be set forth in the section headed “Transactions With Related Persons” in our Proxy Statement and is incorporated herein by reference.

### **Item 14. Principal Accounting Fees and Services**

The information required by this item will be set forth in the section headed “Ratification of Selection of Independent Registered Public Accounting Firm” in our Proxy Statement and is incorporated herein by reference.



**PART IV**

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

**(a) Documents filed as part of this report.**

**1. Financial Statements**

The financial statements of Flexion Therapeutics, Inc. listed below are set forth in Item 8 of this report for the year ended December 31, 2019:

	<u>Page</u>
Report of Independent Registered Public Accounting Firm .....	84
Consolidated Balance Sheets.....	86
Consolidated Statements of Operations and Comprehensive Loss .....	87
Consolidated Statements of Changes in Convertible Preferred Stock and Stockholders' (Deficit) Equity .....	88
Consolidated Statements of Cash Flows .....	89
Notes to Consolidated Financial Statements .....	90

**2. Financial Statement Schedules**

These schedules have been omitted because the required information is included in the consolidated financial statements or notes thereto or because they are not applicable or not required.

**3. Exhibits**

Unless otherwise indicated, all references to previously filed exhibits refer to Flexion’s filings with the SEC under File No. 001-36287. The following exhibits are filed as part of, or incorporated by reference, into this report. Each management contract or compensatory plan or arrangement required to be identified by this item is so designated in such list.

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Flexion (Exhibit 3.1, Current Report on Form 8-K filed on February 19, 2014)
3.2	Amended and Restated Bylaws of Flexion (Exhibit 3.2, Current Report on Form 8-K filed on February 19, 2014)
4.1	Form of Common Stock Certificate of Flexion (Exhibit 4.1, Registration Statement on Form S-1 (File No. 333-193233), as amended, filed on January 29, 2014)
4.2	Indenture, dated as of May 2, 2017, by and between Flexion and Wells Fargo Bank, National Association, as trustee (Exhibit 4.1, Current Report on Form 8-K filed on May 2, 2017)
4.3	Form of Note representing Flexion’s 3.375% Convertible Senior Notes due 2024 (included as Exhibit A to the Indenture filed as Exhibit 4.1, Current Report on Form 8-K filed on May 2, 2017)
4.4	Consent and Second Amendment to Credit and Security Agreement, dated April 24, 2017, between Flexion and MidCap Financial Trust, as administrative agent (Exhibit 4.3, Current Report on Form 8-K filed on May 2, 2017)
4.5	Description of Common Stock
<b>Management Contracts and Compensatory Plans</b>	
10.1	Form of Indemnity Agreement between Flexion and its directors and officers (Exhibit 10.1, Registration Statement on Form S-1 (File No. 333-193233) filed on January 8, 2014)
10.2	Flexion Therapeutics, Inc. 2009 Equity Incentive Plan and Forms of Stock Option Agreement, Notice of Exercise and Stock Option Grant Notice thereunder (Exhibit 10.2, Registration Statement on Form S-1 (File No. 333-193233) filed on January 8, 2014)
10.3	Flexion Therapeutics, Inc. 2013 Equity Incentive Plan, as amended, and Forms of Stock Option Agreement, Notice of Exercise and Stock Option Grant Notice thereunder (Exhibit 99.1, Current Report on Form 8-K, filed September 14, 2017)
10.4	Form of Restricted Stock Unit Award Agreement and Restricted Stock Unit Grant Notice under the Flexion Therapeutics, Inc. 2013 Equity Incentive Plan (Exhibit 99.1, Current Report on Form 8-K filed on December 22, 2015)
10.5	Flexion Therapeutics, Inc. 2013 Employee Stock Purchase Plan (Exhibit 10.4, Registration Statement on Form S-1 (File No. 333-193233), as amended, filed on January 29, 2014)
10.6	Flexion Therapeutics, Inc. Non-Employee Director Compensation Policy, as revised
10.7	Amended and Restated Offer Letter between Flexion and Michael D. Clayman, M.D. (Exhibit 10.6, Registration Statement on Form S-1 (File No. 333-193233) filed on January 8, 2014)
10.8	Amendment to Amended and Restated Offer Letter between Flexion and Michael D. Clayman, M.D. (Exhibit 10.7, Annual Report on Form 10-K filed on March 28, 2014)
10.9	Amended and Restated Offer Letter between Flexion and Scott Kelley, M.D. (Exhibit 10.11, Annual Report on Form 10-K filed on March 8, 2018)

Exhibit Number	Description
10.10	Amended and Restated Offer Letter between Flexion and Mark Levine (Exhibit 10.12, Annual Report on Form 10-K filed on March 8, 2018)
10.11	Amended and Restated Offer Letter between Flexion and Kerry Wentworth (Exhibit 10.13, Annual Report on Form 10-K filed on March 8, 2018)
10.12	Offer Letter between Flexion and David Arkowitz (Exhibit 10.1, Quarterly Report on Form 10-Q filed on May 8, 2018)
10.13	Amended and Restated Offer Letter between Flexion and Christina Willwerth (Exhibit 10.15, Annual Report on Form 10-K filed on February 28, 2019)
10.14	Flexion Therapeutics, Inc. Change in Control Severance Benefit Plan and Form of Participation Agreement (Exhibit 99.1, Current Report on Form 8-K filed on June 23, 2017)
10.15	Separation and Consulting Agreement between Flexion and Neil Bodick, dated December 9, 2019
	<b>Other Agreements</b>
10.17	Lease, dated February 22, 2013, between Flexion and The Trustees of Mall Road Trust (Exhibit 10.14, Registration Statement on Form S-1 (File No. 333-193233) filed on January 8, 2014)
10.18	First Amendment of Lease, dated July 13, 2015, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (as successor in interest to The Trustees of Mall Road Trust) (Exhibit 10.3, Quarterly Report on Form 10-Q filed on November 9, 2015)
10.19	Second Amendment of Lease, dated December 15, 2015, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.20, Annual Report on Form 10-K filed on March 11, 2016)
10.20*	Exclusive License Agreement, dated July 25, 2014, between Flexion and Southwest Research Institute (Exhibit 10.21, Annual Report on Form 10-K filed on March 11, 2016)
10.21*	Manufacturing and Supply Agreement, dated July 31, 2015, between Flexion and Patheon UK Limited (Exhibit 10.1, Quarterly Report on Form 10-Q filed on November 9, 2015)
10.22*	Technical Transfer and Service Agreement, dated July 31, 2015, between Flexion and Patheon UK Limited (Exhibit 10.2, Quarterly Report on Form 10-Q/A filed on January 26, 2016)
10.23	Credit and Security Agreement, dated August 4, 2015, between Flexion and MidCap Financial Trust, as administrative agent, and the Lenders listed on the Credit Facility Schedule attached thereto (Exhibit 10.4, Quarterly Report on Form 10-Q filed on November 9, 2015)
10.24	Third Amendment of Lease, dated May 8, 2016, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.1, Quarterly Report on Form 10-Q filed on August 3, 2016)
10.25	Fourth Amendment of Lease, dated June 29, 2016, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.2, Quarterly Report on Form 10-Q filed August 3, 2016)
10.26	Fifth Amendment of Lease, dated July 21, 2016, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.3, Quarterly Report on Form 10-Q filed August 3, 2016)
10.27	Sixth Amendment of Lease, dated September 21, 2016, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.1, Quarterly Report on Form 10-Q filed on November 7, 2016)
10.28	Seventh Amendment of Lease, dated September 21, 2016, between Flexion and CIP II/RJK 10-20 BMR Owner, LLC (Exhibit 10.1, Quarterly Report on Form 10-Q filed on August 8, 2017)
10.29	Supply Agreement, dated November 10, 2016, between Flexion and Evonik Corporation (Exhibit 10.29, Annual Report on Form 10-K filed on March 10, 2017)

Exhibit Number	Description
10.30	Amendment to Exclusive License Agreement, dated February 7, 2017, between Flexion and Southwest Research Institute (Exhibit 10.30, Annual Report on Form 10-K filed on March 10, 2017)
10.31	First Amendment to the Technical Transfer and Service Agreement, dated May 12, 2019, between Flexion and Patheon UK Limited (Exhibit 10.1, Quarterly Report on Form 10-Q filed on August 6, 2019)
10.32	First Amendment to the Manufacturing and Supply Agreement, dated May 12, 2019, between Flexion and Patheon UK Limited (Exhibit 10.2, Quarterly Report on Form 10-Q filed on August 6, 2019)
10.33	Second Amendment to the Manufacturing and Supply Agreement, dated June 21, 2019, between Flexion and Patheon UK Limited (Exhibit 10.3, Quarterly Report on Form 10-Q filed on August 6, 2019)
10.34	Eighth Amendment of Lease, dated June 21, 2019, between Flexion and CIP II/RJK 10-20 BMR Owner LLC (Exhibit 10.4, Quarterly Report on Form 10Q filed on August 6, 2019)
10.35	Amended and Restated Credit and Security Agreement, dated August 2, 2019, by and among Flexion, Silicon Valley Bank as agent, MidCap Financial Trust, Flexpoint MCLS Holdings, LLC and the other lenders from time to time party thereto (Exhibit 99.3, Current Report on Form 8-K filed on August 6, 2019)
21.1	Subsidiaries of Flexion Therapeutics, Inc.
23.1	Consent of PricewaterhouseCoopers LLP, Independent Registered Public Accounting Firm
24.1	Power of Attorney (reference is made to the signature page thereto)
31.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of the Principal Financial and Accounting Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(b) or 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350
32.2	Certification of Principal Financial and Accounting Officer pursuant to Rule 13a-14(b) or 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350
101.INS	Inline XBRL Instance Document – the instance document does not appear in the Interactive Data File because XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document
104	Cover Page Interactive Data File (embedded within the Inline XBRL document)

\* Confidential treatment has been granted with respect to certain portions of this exhibit. Omitted portions have been filed separately with the SEC.

**Item 16. 10-K Summary**

None.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on the 12<sup>th</sup> day of March, 2020.

### FLEXION THERAPEUTICS, INC.

By:           /s/ Michael D. Clayman, M.D.          

**Michael D. Clayman, M.D.**  
*President and Chief Executive Officer*

## POWER OF ATTORNEY

**KNOW ALL PERSONS BY THESE PRESENTS**, that each person whose signature appears below constitutes and appoints Michael D. Clayman, M.D. and Mark S. Levine, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or either of them, or their or his substitutes or substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
<u>          /s/ Michael D. Clayman, M.D.          </u> Michael D. Clayman, M.D.	President, Chief Executive Officer and Member of the Board of Directors <i>(Principal Executive Officer)</i>	March 12, 2020
<u>          /s/ David Arkowitz          </u> David Arkowitz	Chief Financial Officer <i>(Principal Financial and Accounting Officer)</i>	March 12, 2020
<u>          /s/ Patrick J. Mahaffy          </u> Patrick J. Mahaffy	Chairman of the Board of Directors	March 12, 2020
<u>          /s/ Scott Canute          </u> Scott Canute	Member of the Board of Directors	March 12, 2020
<u>          /s/ Samuel D. Colella          </u> Samuel D. Colella	Member of the Board of Directors	March 12, 2020
<u>          /s/ Heath Lukatch, Ph.D.          </u> Heath Lukatch, Ph.D.	Member of the Board of Directors	March 12, 2020
<u>          /s/ Sandesh Mahatme          </u> Sandesh Mahatme	Member of the Board of Directors	March 12, 2020
<u>          /s/ Ann Merrifield          </u> Ann Merrifield	Member of the Board of Directors	March 12, 2020
<u>          /s/ Alan Milinazzo          </u> Alan Milinazzo	Member of the Board of Directors	March 12, 2020
<u>          /s/Mark Stejbach          </u> Mark Stejbach	Member of the Board of Directors	March 12, 2020



## Corporate Headquarters

10 Mall Road, Suite 301  
Burlington, MA 01803

## Stock Information

The common stock of the company is traded on the Nasdaq Global Market under the symbol FLXN.

# Annual Meeting of Stockholders

**Wednesday, June 10, 2020  
12 p.m., ET**

To attend the Virtual Annual Meeting of Flexion Therapeutics, Inc., please visit [www.proxydocs.com/FLXN](http://www.proxydocs.com/FLXN) for digital meeting registration and deadline details.

## Legal Counsel

Cooley LLP  
San Diego, CA

## Independent Auditors

PricewaterhouseCoopers LLP  
Boston, MA

## Transfer Agent

Computershare Trust Company  
Louisville, KY  
[computershare.com/investor](http://computershare.com/investor)



## Executive Committee

### Michael Clayman, MD

*Chief Executive Officer & Co-Founder*

### David Arkowitz

*Chief Financial Officer*

### Scott Kelley, MD

*Chief Medical Officer*

### Melissa Layman

*Chief Commercial Officer*

### Dan Leblanc

*Senior Vice President, CMC Operations*

### Mark Levine

*General Counsel and Corporate Secretary*

### Adam Muzikant, PhD

*Senior Vice President, Business Development*

### Kerry Wentworth

*Chief Regulatory Officer*

### Christina Willwerth

*Chief Strategy Officer*

## Board of Directors

### Patrick Mahaffy, MA (Chairman of the Board)

*President and CEO, Clovis Oncology*

### Michael Clayman, MD

*Chief Executive Officer, Flexion Therapeutics*

### Scott A. Canute

*Founder and Principal, Magis Consulting*

### Sam Colella

*Managing Director, Versant Ventures*

### Heath Lukatch, PhD

*Red Tree Venture Capital*

### Sandy Mahatme, LLM

*Executive Vice President, CFO and CBO, Sarepta Therapeutics*

### Ann Merrifield

*Independent, Former CEO of PathoGenetix*

### Alan W. Milinazzo

*Partner, Heidrick & Struggles International*

### Mark P. Stejbach

*Independent Board Member*

We will provide stockholders without charge, upon written request, a copy of our Annual Report on Form 10-K, including the financial statements, schedules and list of exhibits. We will furnish stockholders a copy of any exhibit to such report upon written request and payment of reasonable expenses in furnishing the exhibit. Requests should be sent to Investor Relations at our corporate headquarters. In addition, our Annual Report on Form 10-K, other filings with the Securities and Exchange Commission, and press releases, along with general information about our business, are available through our website at [www.flexiontherapeutics.com](http://www.flexiontherapeutics.com).



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