XOMA LTD /DE/
Form 10-Q
November 09, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2011

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 No. 0-14710

XOMA Ltd.

(Exact name of registrant as specified in its charter)

Bermuda	52-2154066
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2910 Seventh Street, Berkeley, California 94710	(510) 204-7200
(Address of principal executive offices, including zip code)	(Telephone Number)

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

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

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

Large accelerated filer o	Accelerated filer x	Non-accelerated filer o (Do not check if a smaller	Smaller reporting company o

reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act of 1934). Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 7, 2011
Common Shares, U.S. $0.0075 par value	34,246,279

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

XOMA Ltd.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)

	September 30, 2011 (unaudited)	December 31, 2010 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,707	$ 37,304
Trade and other receivables, net	14,900	20,864
Prepaid expenses and other current assets	1,341	712
Total current assets	61,948	58,880
Property and equipment, net	13,357	14,869
Other assets	1,880	503
Total assets	$ 77,185	$ 74,252
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,083	$ 3,581
Accrued and other liabilities	10,434	10,658
Deferred revenue	6,006	17,044
Warrant liabilities	896	4,245
Total current liabilities	20,419	35,528
Deferred revenue – long-term	8,016	1,086
Interest bearing obligations – long-term	26,649	13,694
Other long-term liabilities	440	353
Total liabilities	55,524	50,661
Shareholders' equity:		
Preference shares, $0.05 par value, 1,000,000 shares authorized		
Series B, 8,000 designated, 0 and 2,959 shares issued and outstanding at September 30, 2011 and December 31, 2010, respectively	-	1
Common shares, $0.0075 par value, 92,666,666 shares authorized, 33,412,263 and 28,491,318 shares outstanding at September 30, 2011 and December 31, 2010, respectively	250	214
Additional paid-in capital	895,729	876,686
Accumulated deficit	(874,318)	(853,310)
Total shareholders' equity	21,661	23,591
Total liabilities and shareholders' equity	$ 77,185	$ 74,252

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

(Note 1) The condensed consolidated balance sheet as of December 31, 2010 has been derived from the audited financial statements as of that date included in the Company's Annual Report on Form 10-K for the year ended

December 31, 2010.

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XOMA Ltd.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2011	2010	2011	2010
Revenues:				
License and collaborative fees	$ 4,859	$ 1,410	$ 16,725	$ 1,749
Contract and other revenue	11,349	5,733	31,477	18,025
Royalties	21	3,754	147	4,267
Total revenues	16,229	10,897	48,349	24,041
Operating expenses:				
Research and development	15,851	21,345	51,479	58,278
Selling, general and administrative	7,296	6,197	18,779	16,776
Total operating expenses	23,147	27,542	70,258	75,054
Loss from operations	(6,918)	(16,645)	(21,909)	(51,013)
Other income (expense):				
Interest expense	(652)	(104)	(1,818)	(281)
Other income	1,027	3,117	2,734	313
Net loss before taxes	(6,543)	(13,632)	(20,993)	(50,981)
Provision for income tax expense	-	(1)	(15)	(17)
Net loss	$ (6,543)	$ (13,633)	$ (21,008)	$ (50,998)
Basic and diluted net loss per common share	$ (0.20)	$ (0.69)	$ (0.69)	$ (2.87)
Shares used in computing basic and diluted net loss per common share	32,761	19,802	30,623	17,742

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

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XOMA Ltd.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2011	2010
Cash flows from operating activities:		
Net loss	$ (21,008)	$ (50,998)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	4,052	4,349
Common shares contribution to 401(k)	1,046	905
Share-based compensation expense	5,598	3,743
Accrued interest on interest bearing obligations	762	260
Revaluation of warrant liabilities	(3,349)	(4,811)
Warrant modification expense	-	4,500
Amortization of discount on long-term debt	1,019	-
Unrealized loss on foreign currency exchange	1,136	-
Unrealized gain on foreign exchange options	(157)	-
Other non-cash adjustments	47	19
Changes in assets and liabilities affecting cash:		
Trade and other receivables, net	5,964	(713)
Prepaid expenses and other assets	(1,850)	(615)
Accounts payable and accrued liabilities	(1,305)	2,217
Deferred revenue	(13,008)	(1,510)
Other liabilities	78	(256)
Net cash used in operating activities	(20,975)	(42,910)
Cash flows from investing activities:		
Purchase of property and equipment	(2,586)	(277)
Net cash used in investing activities	(2,586)	(277)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	20,102	-
Proceeds from issuance of common shares	12,435	40,638
Payment for modification of warrants	-	(4,500)
Net cash provided by financing activities	32,537	36,138
Effect of exchange rate changes on cash	(573)	-
Net increase (decrease) in cash and cash equivalents	8,976	(7,049)
Cash and cash equivalents at the beginning of the period	37,304	23,909
Cash and cash equivalents at the end of the period	$ 45,707	$ 16,860
Supplemental Cash Flow Information:		
Cash paid for income taxes	$ 15	$ 16
Non-cash investing and financing activities:		
Discount on long-term debt	$ (8,899)	$ -
Issuance and extinguishment of warrant liabilities	$ -	$ 1,767

Interest added to principal balance on Novartis note	$ 170	$ 164
Interest added to principal balance on Servier loan	$ 330	$ -

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

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XOMA Ltd.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

XOMA Ltd. ("XOMA" or the "Company"), a Bermuda company, is a biopharmaceutical company focused on the discovery, development and manufacture of therapeutic antibodies designed to treat autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases. The Company's products are presently in various stages of development and are subject to regulatory approval before they can be commercially launched.

2. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements include the accounts of XOMA and its subsidiaries. All intercompany accounts and transactions were eliminated during consolidation. The unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q. These financial statements and related disclosures have been prepared with the assumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the U.S. Securities and Exchange Commission ("SEC") on March 10, 2011.

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which are necessary to present fairly the Company's consolidated financial position as of September 30, 2011, the consolidated results of the Company's operations for the three and nine months ended September 30, 2011 and 2010, and the Company's cash flows for the nine months ended September 30, 2011 and 2010. The interim results of operations are not necessarily indicative of the results that may occur for the full fiscal year or future periods.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures. On an on-going basis, management evaluates its estimates including, but not limited to, those related to revenue recognition, long-lived assets, warrant liabilities, derivative instruments and share-based compensation. The Company bases its estimates on historical experience and on various other market-specific and other relevant assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates, such as the Company's billing under government contracts. Under the Company's contracts with the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health ("NIH"), the Company bills using NIH provisional rates and thus are subject to future audits at the discretion of NIAID's contracting office. These audits can result in an adjustment to revenue previously reported.

Concentration of Risk

Cash equivalents and receivables are financial instruments, which potentially subject the Company to concentrations of credit risk, as well as liquidity risk for certain cash equivalents such as money market funds. The Company has not encountered such issues during 2011.

The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the nine months ended September 30, 2011, two customers represented 59% and 36% of total revenue and 45% and 52% of the accounts receivable balance.

For the nine months ended September 30, 2010, three customers represented 56%, 18%, and 14% of total revenues. As of December 31, 2010, there were receivables outstanding from two customers representing 72% and 23% of the accounts receivable balance.

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Recent Accounting Pronouncements

In June of 2011, Accounting Standards Codification Topic 220, Comprehensive Income was amended to increase the prominence of items reported in other comprehensive income. Accordingly, a company can present all nonowner changes in stockholders' equity either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company plans to adopt this guidance as of January 1, 2012 on a retrospective basis and does not expect the adoption thereof to have a material effect on the Company's consolidated financial statements. The Financial Accounting Standards Board has proposed deferral of the requirement and if finalized, the Company would not adopt this guidance until January 1, 2013.

In May of 2011, Accounting Standards Codification Topic 820, Fair Value Measurement was amended to develop common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. generally accepted accounting principles and International Financial Reporting Standards. The Company plans to adopt this guidance as of January 1, 2012 on a prospective basis and does not expect the adoption thereof to have a material effect on the Company's consolidated financial statements.

In March of 2010, Accounting Standards Codification Topic 605, Revenue Recognition was amended to define a milestone and clarify that the milestone method of revenue recognition is a valid application of the proportional performance model when applied to research or development arrangements. Accordingly, a company can make an accounting policy election to recognize a payment that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. This guidance was adopted effective January 1, 2011 on a prospective basis and did not have a material effect on the Company's consolidated financial statements.

3. Condensed Consolidated Financial Statement Detail

Comprehensive Loss

Comprehensive loss is equal to net loss for the three and nine months ended September 30, 2011 and 2010.

Net Loss Per Common Share

Basic and diluted net loss per common share is based on the weighted average number of common shares outstanding during the period.

Potentially dilutive securities are excluded from the calculation of earnings per share if their inclusion is anti-dilutive. The following table shows the weighted average outstanding securities considered anti-dilutive and therefore excluded from the computation of diluted net loss per share (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Options for common shares	4,036	2,332	3,837	2,138
Convertible preference shares	-	254	90	254
Warrants for common shares	1,608	1,608	1,608	1,677
Total	5,644	4,194	5,535	4,069

For the three and nine months ended September 30, 2011 and 2010, all of the above outstanding securities were considered anti-dilutive, and therefore the calculations of basic and diluted net losses per share were the same.

Cash and Cash Equivalents

At September 30, 2011, cash equivalents consisted of demand deposits and money market funds with maturities of less than 90 days at the date of purchase. At December 31, 2010, cash equivalents consisted of demand deposits, money market funds and repurchase agreements with maturities of less than 90 days at the date of purchase.

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Cash and cash equivalent balances were recorded at fair value as follows as of September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$15,062	$-	$-	$15,062
Cash equivalents	30,645	-	-	30,645
Total cash and cash equivalents	$45,707	$-	$-	$45,707

	December 31, 2010			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$29,536	$-	$-	$29,536
Cash equivalents	7,768	-	-	7,768
Total cash and cash equivalents	$37,304	$-	$-	$37,304

Foreign Exchange Options

The Company holds debt and may incur expenses denominated in foreign currencies, which exposes it to market risk associated with foreign currency exchange rate fluctuations between the U.S. dollar and the Euro. The Company is required to make principal and accrued interest payments in Euros on its €15.0 million loan from Les Laboratoires Servier ("Servier") (refer to Note 6 below). In order to manage its foreign currency exposure related to these payments, in May of 2011, the Company entered into two foreign exchange option contracts to buy €15.0 million and €1.5 million on January 2016 and January 2014, respectively. By having these option contracts in place, the Company's foreign exchange rate risk is reduced if the U.S. dollar weakens against the Euro. However, if the U.S. dollar strengthens against the Euro, the Company is not required to exercise these options, but will not receive any refund on premiums paid.

Upfront premiums paid on these foreign exchange option contracts totaled $1.5 million. The fair values of these option contracts are re-valued at each reporting period and are estimated based on pricing models using readily observable inputs from actively quoted markets. The fair values of these option contracts are included in other assets on the condensed consolidated balance sheet and changes in fair value on these contracts are included in other income (expense) on the condensed consolidated statements of operations. The foreign exchange options were revalued at September 30, 2011 and had an aggregate fair value of $1.4 million, and the Company recognized losses of $0.3 million and $0.1 million related to the revaluation for the three and nine months ended September 30, 2011, respectively.

Receivables

Receivables consisted of the following at September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011	December 31, 2010
Trade receivables, net	$ 14,107	$ 20,309
Other receivables	793	555

Total	$ 14,900	$ 20,864

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Property and Equipment

Property and equipment consisted of the following at September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011	December 31, 2010
Furniture and equipment	$ 33,483	$ 31,700
Buildings, leasehold and building improvements	21,490	21,463
Construction-in-progress	420	203
Land	310	310
	55,703	53,676
Less: Accumulated depreciation and amortization	(42,346)	(38,807)
Property and equipment, net	$ 13,357	$ 14,869

Depreciation expense was $1.4 million and $4.1 million for the three and nine months ended September 30, 2011, respectively, compared with $1.4 million and $4.4 million, respectively, for the same periods in 2010.

Accrued Liabilities

Accrued liabilities consisted of the following at September 30, 2011 and December 31, 2010 (in thousands):

	September 30, 2011	December 31, 2010
Accrued payroll and other benefits	$ 2,906	$ 2,752
Accrued management incentive compensation	2,864	4,982
Accrued clinical trial costs	1,349	1,020
Accrued severance payments	1,076	-
Accrued professional fees	816	1,020
Other	1,423	884
Total	$ 10,434	$ 10,658

4. Fair Value Measurements

Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, the Company considers the principal or most advantageous market in which it would transact and assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of nonperformance.

A fair value hierarchy was established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels of inputs that may be used to measure fair value are as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities;

- Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be

corroborated by readily observable market data for substantially the full term of the assets or liabilities; or

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

The following tables set forth the Company's fair value hierarchy for its financial assets (cash equivalents) and liabilities measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010.

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Financial assets and liabilities carried at fair value as of September 30, 2011 and December 31, 2010 were classified as follows (in thousands):

	Fair Value Measurements at September 30, 2011 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Money market funds (1)	$ 30,645	$ -	$ -	$30,645
Foreign exchange options	-	1,371	-	1,371
Total	$ 30,645	$ 1,371	$ -	$32,016
Liabilities:				
Warrant liabilities	$ -	$ -	$ 896	$896

	Fair Value Measurements at December 31, 2010 Using Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Repurchase agreements (1)	$ 1,428	$ -	$ -	$1,428
Money market funds (1)	6,340	-	-	6,340
Total	$ 7,768	$ -	$ -	$7,768
Liabilities:				
Warrant liabilities	$ -	$ -	$ 4,245	$4,245

(1) Included in cash and cash equivalents

The fair value of the foreign exchange options at September 30, 2011 was determined using readily observable market inputs from actively quoted markets obtained from various third party data providers. These inputs, such as spot rate, forward rate and volatility have been derived from readily observable market data, meeting the criteria for Level 2 in the fair value hierarchy.

The fair value of the warrant liabilities at September 30, 2011 and December 31, 2010 was determined using the Black-Scholes Model, which requires inputs such as the expected term of the warrants, share price volatility and risk-free interest rate. These inputs are subjective and generally require significant analysis and judgment to develop.

The fair value of the warrant liabilities was estimated using the following range of assumptions at September 30, 2011 and December 31, 2010:

	September 30, 2011	December 31, 2010
Expected volatility	105.4 - 106.8 %	93.5 - 94.9 %
Risk-free interest rate	0.4 %	2.0 %
Expected term	3.2 - 3.4 years	3.9 - 4.1 years

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The following table provides a summary of changes in the fair value of the Company's Level 3 financial liabilities for the nine months ended September 30, 2011 (in thousands):

	Warrant Liabilities at September 30, 2011
Balance at December 31, 2010	$ 4,245
Net decrease in fair value of warrant liabilities on revaluation	(3,349)
Balance at September 30, 2011	$ 896

For the three and nine months ended September 30, 2011, the Company recognized net decreases of $0.5 million and $3.3 million, respectively, in the estimated fair value of the warrant liabilities resulting in recognized gains in the other income (expense) line of the condensed consolidated statements of operations.

For the three and nine months ended September 30, 2010, the Company recognized net decreases of $3.1 million and $4.8 million, respectively, in the estimated fair value of the warrant liabilities resulting in recognized gains in the other income (expense) line of the condensed consolidated statements of operations.

5. Licensing, Collaborative and Other Arrangements

Servier

In December of 2010, the Company entered into a license and collaboration agreement with Servier, to jointly develop and commercialize gevokizumab (formerly referred to as XOMA 052) in multiple indications, which provided for a non-refundable upfront payment of $15.0 million that was received by the Company in January of 2011. The upfront payment was recognized over the eight month period that the initial group of deliverables were provided to Servier. The Company recognized $3.9 million and $14.9 million in revenue relating to this upfront payment during the three and nine months ended September 30, 2011, respectively. In addition, the Company received a loan of €15.0 million, which was fully funded in January of 2011, with the proceeds converting to $19.5 million at the date of funding (refer to Note 6 below). Also, the Company retains development and commercialization rights for Behcet's uveitis and other inflammatory and oncology indications in the U.S. and Japan, and an option to reacquire rights to diabetes and cardiovascular disease indications from Servier in those territories. Servier will fully fund activities to advance the global clinical development and future commercialization of gevokizumab in diabetes and cardiovascular related diseases, as well as the first $50.0 million of future gevokizumab global clinical development and chemistry and manufacturing controls expenses and 50% of further expenses for the Behcet's uveitis indication. For the three and nine months ended September 30, 2011, the Company recorded revenue of $9.8 million and $27.5 million, respectively, under this agreement, which included the revenue relating to the upfront payment.

In November of 2011, the Company announced plans for expanded gevokizumab clinical development. The plan includes a global Phase 3 trial in non-infectious uveitis involving the intermediate and/or posterior segments of the eye, including Behçet's uveitis ("NIU") and a Phase 3 trial outside the U.S. in Behçet's uveitis. Based on the timing of anticipated regulatory interactions to discuss the planned Phase 3 program, the Company anticipates initiating the NIU Phase 3 trial in the second quarter of 2012. Servier has agreed to provide funding for the NIU Phase 3 trial under the terms of the collaboration agreement discussed above for the Behçet's uveitis indication so long as input from the European Medicines Agency enables the results to be useful for the European commercialization of gevokizumab. In addition, the Company announced a proof-of-concept clinical program to identify additional conditions that may respond to treatment with gevokizumab.

Merck/Schering-Plough

In May of 2006, the Company entered into a fully funded collaboration agreement with Schering-Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck ("Merck/Schering-Plough") for therapeutic monoclonal antibody discovery and development. Under the agreement, Merck/Schering-Plough made up-front, annual maintenance and milestone payments to the Company, funded its research and development activities related to the agreement and would have paid royalties on sales of products resulting from the collaboration. During the collaboration, the Company discovered therapeutic antibodies against multiple targets selected by Merck/Schering-Plough using multiple human antibody phage display libraries, optimized antibodies through affinity maturation or other protein engineering, used the Company's proprietary HE™ technology to humanize antibody candidates generated by hybridoma techniques, performed preclinical studies to support regulatory filings, developed cell lines and production processes and produced antibodies for initial clinical trials. Merck/Schering-Plough selected the first target at the inception of the agreement and, in December of 2006, exercised its right to initiate the additional discovery and development programs. In January of 2011, the Company successfully completed the contract services it had agreed to perform under the collaboration agreement with Merck/Schering-Plough.

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6. Long-Term Debt and Other Financings

Long-Term Debt

Novartis Note

In May of 2005, the Company executed a secured note agreement with Novartis (then Chiron Corporation), which is due and payable in full in June of 2015. Under this note agreement, the Company borrowed semi-annually to fund up to 75% of the Company's research and development and commercialization costs under its collaboration arrangement with Novartis, not to exceed $50.0 million in aggregate principal amount. Interest on the principal amount of the loan accrues at six-month LIBOR plus 2%, which was equal to 2.39% at September 30, 2011, and is payable semi-annually in June and December of each year. At the Company's election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed $50.0 million. The Company has made this election for all interest payments thus far. Loans under the note agreement are secured by the Company's interest in the collaboration with Novartis, including any payments owed to it thereunder.

At September 30, 2011 and December 31, 2010, the outstanding principal balance under this note agreement was $13.9 million and $13.7 million, respectively. Pursuant to the terms of the arrangement as restructured in November of 2008, the Company will not make any additional borrowings under the Novartis note. Due to the structure of the secured note agreement with Novartis and since there is no liquid market for this obligation, there is no practical method to estimate fair value of this long-term debt.

Servier Loan

In December of 2010, in connection with the license and collaboration agreement entered into with Servier (see footnote 5), the Company executed a loan agreement with Servier, which provided for an advance of up to €15.0 million. The loan was fully funded in January of 2011, with the proceeds converting to approximately $19.5 million. The loan is secured by an interest in XOMA's intellectual property rights to all gevokizumab indications worldwide, excluding certain rights in the U.S. and Japan. Interest is calculated at a floating rate based on a Euro Inter-Bank Offered Rate ("EURIBOR") and subject to a cap. The interest rate is reset semi-annually in January and July of each year. The interest rate for the initial interest period was 3.22%. The interest rate has been reset to 3.83% for the six-month period from July 2011 through January 2012. Interest is payable semi-annually; however, the loan agreement provides for a deferral of interest payments over a period specified in the agreement. During the deferral period, accrued interest will be added to the outstanding principal amount for the purpose of interest calculation for the next six-month interest period. On the repayment commencement date, all unpaid and accrued interest shall be paid to Servier and thereafter, all accrued and unpaid interest shall be due and payable at the end of each six-month period. The loan matures in 2016; however, after a specified period prior to final maturity, the loan is to be repaid (i) at Servier's option, by applying up to a significant percentage of any milestone or royalty payments owed by Servier under the Company's collaboration agreement and (ii) using a significant percentage of any upfront, milestone or royalty payments the Company receives from any third party collaboration or development partner for rights to gevokizumab in the U.S. and/or Japan. In addition, the loan becomes immediately due and payable upon certain customary events of default. At September 30, 2011, the outstanding principal balance under this loan was $20.4 million. For the three and nine months ended September 30, 2011, the Company recorded an unrealized foreign exchange gain of $1.2 million and an unrealized foreign exchange loss of $0.9 million, respectively, related to the re-measurement of the loan as of September 30, 2011.

The loan has a stated interest rate lower than the market rate based on comparable loans held by similar companies, which represents additional value to the Company. The Company recorded this additional value as a discount to the

face value of the loan amount, at its fair value of $8.9 million. The fair value of this discount, which was determined using a discounted cash flow model, represents the differential between the stated terms and rates of the loan, and market rates. Based on the association of the loan with the collaboration arrangement, the Company recorded the offset to this discount as deferred revenue.

The loan discount is amortized under the effective interest method over the expected five-year life of the loan. The Company recorded non-cash interest expense of $0.3 million and $1.0 million during the three and nine months ended September 30, 2011, respectively, resulting from the amortization of the loan discount. At September 30, 2011, the net carrying value of the loan was $12.7 million. For the three and nine months ended September 30, 2011, the Company recorded unrealized foreign exchange losses of $0.2 million and $0.4 million, respectively, related to the re-measurement of the loan discount as of September 30, 2011.

The Company believes that realization of the benefit and the associated deferred revenue is contingent on the loan remaining outstanding over the five-year contractual term of the loan. If the Company were to stop providing service under the collaboration arrangement and the arrangement is terminated, the maturity date of the loan would be accelerated and a portion of measured benefit would not be realized. As the realization of the benefit is contingent, in part, on the provision of future services, the Company is recognizing the deferred revenue over the expected five-year life of the loan. The deferred revenue is amortized under the effective interest method, and the Company recorded $0.3 million and $1.0 million of related non-cash revenue during the three and nine months ended September 30, 2011, respectively.

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Interest Expense

Interest expense for the Novartis note and Servier loan are shown below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest expense				
Novartis note	$ 85	$ 95	$ 254	$ 260
Servier loan	564	-	1,544	-
Other	3	9	20	21
Total interest expense	$ 652	$ 104	$ 1,818	$ 281

Other Financings

ATM Agreements

In the third quarter of 2010, the Company entered into an At Market Issuance Sales Agreement (the "2010 ATM Agreement"), with Wm Smith & Co. and McNicoll, Lewis & Vlak LLC (the "Agents"), under which the Company could sell common shares from time to time through the Agents, as its agents for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that could be sold under its registration statement on Form S-3 (File No. 333-148342) filed with the SEC on December 26, 2007. The Agents could sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, as amended (the "Securities Act"), including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. The Agents could also sell the common shares in privately negotiated transactions, subject to the Company's prior approval. The Company paid the Agents, collectively, a commission equal to 3% of the gross proceeds of the sales price of all common shares sold through them as sales agents under the 2010 ATM Agreement. From the inception of the 2010 ATM Agreement through May of 2011, the Company sold a total of 7,560,862 common shares under this agreement for aggregate gross proceeds of $34.0 million, including 821,386 common shares sold in 2011 for aggregate gross proceeds of $4.4 million. Total offering expenses incurred related to sales under the 2010 ATM Agreement from inception to May of 2011 were $1.0 million, including $0.1 million incurred in 2011. In May of 2011, the 2010 ATM Agreement expired by its terms, and there will be no further issuances under this facility.

On February 4, 2011, the Company entered into an At Market Issuance Sales Agreement (the "2011 ATM Agreement"), with McNicoll, Lewis & Vlak LLC ("MLV"), under which the Company may sell common shares from time to time through MLV, as its agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under the Company's registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to the Company's prior approval. The Company will pay MLV a commission equal to 3% of the gross proceeds of the sales price of all common shares sold through them as sales agent under the 2011 ATM Agreement. From the inception of the 2011 ATM Agreement through September 30, 2011, the Company sold a total of 3,603,422 common shares under this agreement for aggregate gross proceeds of $8.5 million. Total offering expenses incurred related to sales under the 2011 ATM Agreement from inception to September 30, 2011 were $0.3 million.

7. Income Taxes

Income tax expense was not material for the three and nine months ended September 30, 2011 or the comparable periods in 2010. The Company's effective tax rate will fluctuate from period to period due to several factors inherent in the nature of the Company's operations and business transactions. The factors that most significantly impact this rate include the variability of licensing transactions in foreign jurisdictions.

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8. Share-Based Compensation

In December of 2010, the Board of Directors of the Company approved a company-wide grant of share options under the Company's 2010 Long Term Incentive and Share Award Plan ("LTIP") and, in the first quarter of 2011, the options for 1,430,840 shares became effective. 1,040,220 of these options were granted subject to shareholder approval of an increase in the number of shares available under the LTIP. On May 26, 2011, shareholder approval was obtained at the Company's annual general meeting of shareholders. A cumulative adjustment of $1.3 million was recorded in the second quarter of 2011 to reflect the share-based compensation expense that would have been recorded from the conditional grant date to the shareholder approval date. The adjustment was based on the fair value of these options at the date of shareholder approval and calculated using the closing share price and expected term on that date. The remaining assumptions included in the calculation were the same assumptions used for the second quarter option grants. A portion of the 2011 annual options granted include immediate vesting terms with the remainder of the options vesting monthly over two years for employees and one year for directors.

On August 31, 2011, the Company announced that Steven B. Engle resigned as Chief Executive Officer, President and Chairman of the Board of the Company. In the third quarter of 2011, the Company incurred a share-based compensation charge of approximately $0.7 million, related to Mr. Engle's resignation.

As of September 30, 2011, the Company had approximately 4,598,775 common shares reserved for future issuance under its share option plans and Employee Share Purchase Plan ("ESPP").

The following table shows total share-based compensation expense included in the condensed consolidated statements of operations for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Research and development	$ 458	$ 742	$ 2,404	$ 1,829
Selling, general and administrative	1,084	920	3,194	1,914
Total share-based compensation expense	$ 1,542	$ 1,662	$ 5,598	$ 3,743

The valuation of share-based compensation awards is determined at the date of grant using the Black-Scholes Model. This model requires inputs such as the expected term of the option, expected volatility and risk-free interest rate. Further, the forfeiture rate also affects the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. While estimates of the expected term, volatility and forfeiture rate are derived primarily from the Company's historical data, the risk-free rate is based on the yield available on United States Treasury zero-coupon issues. The fair value of share-based awards was estimated based on the following weighted average assumptions for the three and nine months ended September 30, 2011 and 2010:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Dividend yield	0 %	0 %	0 %	0 %
Expected volatility	89 %	79 %	87 %	79 %
Risk-free interest rate	0.96 %	1.27 %	1.86 %	1.67 %
Expected term	5.6 years	5.6 years	5.3 years	5.3 years

Share option activity for the nine months ended September 30, 2011 was as follows:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2010	2,331,450	$ 25.36	7.71	$ 99
Granted	1,811,840	5.23		
Forfeited, expired or cancelled	(134,204)	37.35		
Options outstanding at September 30, 2011	4,009,086	$ 15.86	7.90	$ -
Options exercisable at September 30, 2011	2,500,259	$ 21.58	7.27	$ -

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9. Share Capital

Series B Preference Shares

In December of 2003, the Company issued 2,959 Series B preference shares to Genentech, Inc. in repayment of $29.6 million of the outstanding balance under a convertible subordinated debt agreement. Pursuant to the rights of the Series B preference shares, the holder of Series B preference shares was not entitled to receive any dividends on the Series B preference shares. The Series B preference shares ranked senior with respect to rights on liquidation, winding-up and dissolution of the Company to all classes of common shares. Upon any voluntary or involuntary liquidation, dissolution or winding-up of the Company, the holder of Series B preference shares would have been entitled to receive $10,000 per Series B preference share (or $29.6 million in the aggregate) before any distribution was made on the common shares. The holder of the Series B preference shares had no voting rights, except as required under Bermuda law.

The holder of Series B preference shares had the right to convert Series B preference shares into common shares at a conversion price equal to $116.25 per common share, subject to adjustment in certain circumstances.

In April of 2011, the 2,959 Series B convertible preference shares were converted by Genentech into 254,560 common shares. The $29.6 million liquidation preference associated with the Series B preference shares was eliminated as a result of this conversion.

10. Legal Proceedings, Commitments and Contingencies

On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned Hedrick et al. v. Genentech, Inc. et al, Case No. 09-446158. The complaint asserts claims against Genentech, the Company and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals' treatment with RAPTIVA®. The complaint seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to seventy six. The cases have been consolidated as a coordinated proceeding. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. On July 15, 2011, the Court dismissed with prejudice one of the cases in this coordinated proceeding, White v. Genentech, Inc., et al, Case No. RG-09-484026. On September 8, 2011, the Court granted defendants' Motions for Summary Judgment in two cases, Guerrero (Case No. RG-10-518396) and Harwell (Case No. RG-09-464039), and dismissed both cases. On September 19, 2011, the Court sustained defendants' Demurrer to another case (Young, Case No. RG-11-569879) and dismissed the complaint. On October 19, 2011, the Court granted defendants' Motion for Summary Judgment in Krawiec v. Genentech, Inc., et al., Case No. RG10-524963. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to these matters. The Company believes the claims against it to be without merit and intends to defend against them vigorously.

On August 4, 2010, a petition was filed in the District Court of Dallas County, Texas in a case captioned McCall v. Genentech, Inc., et al., No. 10-09544. The defendants filed a Notice of Removal to the United States District Court for the Northern District of Texas on September 3, 2010. The removed case is captioned McCall v. Genentech, Inc., et al., No. 3:10-cv-01747-B. The parties have fully briefed the plaintiff's Motion to Remand and are awaiting a final ruling from the Court. The petition asserts personal injury claims against Genentech, the Company, and others arising out of the plaintiff's treatment with RAPTIVA®. The petition alleges claims based on negligence, strict liability, misrepresentation and suppression, conspiracy, and actual and constructive fraud. The petition seeks compensatory damages and punitive damages in an unspecified amount. On June 6, 2011, the Court dismissed plaintiff's claims of

negligent misrepresentation, fraud, and conspiracy. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to this matter. The Company believes the claims against it to be without merit and intends to defend against them vigorously

On January 7, 2011, a complaint was filed in the United States District Court for the Northern District of Texas in a case captioned Massa v. Genentech, Inc., et al., No. 4:11CV70. On January 11, 2011, a complaint was filed in the United States District Court for the District of Massachusetts in a case captioned Sylvia, et al. v. Genentech, Inc., et al., No. 1:11-cv-10054-MLW. These two complaints allege the same claims against Genentech, the Company and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to these matters. The Company believes the claims against it to be without merit and intends to defend against them vigorously.

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On April 8, 2011, four complaints were filed in the United States District Court for the Eastern District of Michigan. The cases are captioned: Muniz v. Genentech, et al., 5:11-cv-11489-JCO-RSW; Tifenthal v. Genentech, et al., 2:11-cv-11488-DPH-LJM; Blair v. Genentech, et al., 2:11-cv-11463-SFC-MJH; and Marsh v. Genentech, et al., 2:11-cv-11462-RHC-MKM. The complaints allege the same claims against Genentech, the Company and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. All four cases have been transferred to the United States District Court for the Western District of Michigan. On October 26, 2011, the Court granted the Motions to Dismiss filed by Genentech and the Company in all four actions. Plaintiffs have filed a Notice of Appeal in each case. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to this matter. The Company believes the claims against it to be without merit and intends to defend against them vigorously.

11. Subsequent Events

Domestication of the Company

The Company announced its intention to change its jurisdiction of incorporation from Bermuda to Delaware (the "Domestication"). Upon completion of the Domestication, all of the outstanding common shares of the Bermuda company will automatically be converted by operation of law into common stock of a Delaware corporation on a one-for-one basis. A registration statement relating to the common stock of the Delaware corporation has been filed with the SEC but has not yet become effective. These securities may not be exchanged nor may offers to exchange be accepted prior to the time the registration statement becomes effective, and the announcement does not constitute an offer of any securities for exchange or sale. Although the Domestication will not require shareholder approval, it is subject to the final approval of XOMA's Board of Directors.

NIAID Contract

In October of 2011, the Company announced that NIAID had awarded the Company a new contract under Contract No. HHSN272201100031C for up to $28.0 million over 5 years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements and the related disclosures, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts in our condensed consolidated financial statements and accompanying notes. On an on-going basis, we evaluate our estimates including, but not limited to, those related to terms of revenue recognition, long-lived assets, derivative instruments, warrant liabilities and share-based compensation. We base our estimates on historical experience and on various other market-specific and other relevant assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates.

Overview

We are a leader in the discovery, development and manufacture of therapeutic antibodies designed to treat autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases. Our proprietary development pipeline includes gevokizumab (formerly referred to as XOMA 052), an antibody that inhibits interleukin-1 beta ("IL-1 beta"). Our collaboration partner on gevokizumab, Les Laboratoires Servier ("Servier"), and we are in the process of implementing an expanded gevokizumab clinical development plan. The plan includes a global Phase 3 trial in non-infectious uveitis involving the intermediate and/or posterior segments of the eye, including Behçet's uveitis ("NIU") and a Phase 3 trial outside the U.S. in Behçet's uveitis. Based on the timing of anticipated regulatory interactions to discuss the planned Phase 3 program, we anticipate initiating the NIU Phase 3 trial in the second quarter of 2012. We expect that these trials will be designed to meet the FDA ophthalmology requirement that at least 300 patients be treated for at least six months at the to-be-marketed dose. We also expect to have preliminary top-line results from the NIU Phase 3 trial approximately 18 to 24 months after initiation. In addition, we announced a proof-of-concept clinical program to identify additional conditions that may respond to treatment with gevokizumab. Also, Servier plans to advance gevokizumab into Phase 2 development for cardiovascular disease in 2012.

Our proprietary development pipeline also includes XOMA 3AB, a biodefense anti-botulism product candidate comprised of a combination, or cocktail, of antibodies; and preclinical antibody discovery programs in several indications, including autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases. We have a fully integrated product development platform, extending from preclinical science, clinical development to scale-up development, and manufacturing.

In December of 2010, we entered into a license and collaboration agreement with Servier to jointly develop and commercialize gevokizumab in multiple indications. Gevokizumab is designed to inhibit the pro-inflammatory cytokine IL-1 beta that is believed to be a primary trigger of pathologic inflammation in multiple diseases. In 2010, we announced positive results from a Phase 2 proof-of-concept clinical trial evaluating gevokizumab in Behçet's uveitis, demonstrating rapid improvement in vision-threatening disease exacerbations in all seven treated patients despite discontinuation of immunosuppressive drugs such as cyclosporine and/or azathioprine. Each of the five patients re-treated with gevokizumab after they experienced a new uveitis exacerbation responded again to gevokizumab treatment. Four of the seven patients have now received once-monthly treatment for approximately one year.

Our biodefense initiatives currently include a $65.0 million multiple-year contract funded by the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health ("NIH"), to support our ongoing development of anti-botulism antibody product candidates, of which the first, XOMA 3AB, is in a Phase 1 clinical trial. In October of 2011, we announced a new contract under Contract No. HHSN272201100031C ("NIAID 4") for up

to $28.0 million over five years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning, bringing the program's total potential awards to approximately $120 million. We also develop products with premier pharmaceutical companies including Novartis AG ("Novartis") and Takeda Pharmaceutical Company Limited ("Takeda").

We have a premier antibody discovery and development platform that incorporates a collection of antibody phage display libraries and proprietary Human Engineering™, affinity maturation, Bacterial Cell Expression ("BCE") and manufacturing technologies that enhance our ability and that of our collaboration and development partners to discover and develop new therapeutic antibodies. BCE is a key biotechnology for the discovery and manufacturing of antibodies and other proteins. To date, more than 50 pharmaceutical and biotechnology companies have signed BCE licenses, and a number of licensed product candidates are in clinical development. We continue to develop and commercialize additional antibody-related technologies including proprietary display technologies to enable antibody discovery and optimization. Our technologies have contributed to the success of marketed antibody products, including LUCENTIS® (ranibizumab injection) for wet age-related macular degeneration and CIMZIA® (certolizumab pegol) for rheumatoid arthritis and Crohn's disease.

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Significant Developments in 2011

Gevokizumab

- In December of 2010, we entered into an agreement with Servier to jointly develop and commercialize gevokizumab in multiple indications, which provided for a non-refundable upfront payment of $15.0 million that we received in January of 2011. In connection with this agreement, Servier will fully fund the first $50.0 million of future gevokizumab global clinical development and chemistry and manufacturing controls ("CMC") expenses, and 50% of further expenses for the Behcet's uveitis indication. Servier has agreed to include the NIU Phase 3 trial under the terms of the collaboration agreement for Behcet's uveitis discussed above so long as input from the European Medicines Agency enables the results to be useful for the European commercialization of gevokizumab. Based upon the timing of anticipated regulatory interactions, we anticipate initiating the NIU Phase 3 trial in the second quarter of 2012.

- In January of 2011, we received the full €15.0 million advance allowed under our loan agreement with Servier dated December 30, 2010, converting to U.S. dollar proceeds of approximately $19.5 million.

- In March of 2011, we announced that our Phase 2b trial of gevokizumab in Type 2 diabetes in 421 patients did not achieve the primary endpoint of reduction in hemoglobin A1c ("HbA1c") after six monthly treatments with gevokizumab compared to placebo. Significant decreases were observed in C-reactive protein ("CRP"), a biomarker for the risk of heart attack, stroke and other cardiovascular diseases, in all dose groups versus placebo. In addition, significant improvements in high-density lipoprotein ("HDL"), or "good" cholesterol, were observed in two of four gevokizumab dose groups versus placebo. Gevokizumab was well-tolerated in this trial, with no serious drug-related adverse events and a safety profile consistent with previous trials.

- In June of 2011, we announced top line trial results from our six-month Phase 2a trial in 74 patients where gevokizumab was shown to be well-tolerated with no significant differences in adverse events between gevokizumab and placebo. Evidence of biological activity was observed including a reduction in CRP. There were no differences in glycemic control between the drug and placebo groups as measured by HbA1c levels.

XOMA 3AB

- In May of 2011, the National Institute of Allergy and Infectious Diseases ("NIAID"), part of the National Institutes of Health ("NIH"), informed us that it is initiating a Phase 1 trial of XOMA 3AB, a novel formulation of three antibodies designed to prevent and treat botulism poisoning. This double-blind, dose-escalation study in approximately 24 healthy volunteers is designed to assess the safety and tolerability, and determine the pharmacokinetic profile, of XOMA 3AB.

- In October of 2011, we announced that NIAID had awarded us a new contract under Contract No. HHSN272201100031C for up to $28.0 million over 5 years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning.

Preclinical Pipeline

- In June of 2011, we announced our discovery of two new classes of fully-human monoclonal antibodies, XMetA and XMetS, which activate or sensitize the insulin receptor in vivo, each representing a distinct new therapeutic approach to the treatment of patients with diabetes. Studies of XMetA demonstrated that it reduced fasting blood glucose levels and improved glucose tolerance in a mouse model of diabetes. After six weeks of treatment, there was a statistically significant reduction in HbA1c levels, a standard measure of average blood glucose levels over

time, in mice treated with XMetA compared to a control group, and there was a statistically significant reduction in elevated non-HDL cholesterol levels. Studies of XMetS showed enhanced insulin sensitivity and statistically significant improvements in fasting blood glucose levels and glucose tolerance in mice treated with XMetS as compared to a control group, and there was a statistically significant reduction in elevated non-HDL cholesterol levels. These data were presented at the American Diabetes Association's 71st Scientific Sessions.

Management Change

- On August 31, 2011, we announced that Steven B. Engle resigned as Chief Executive Officer, President and Chairman of the Board of the Company. The Company's Board of Directors has appointed John Varian, a current Board member, as Interim Chief Executive Officer and W. Denman Van Ness, the Company's Lead Independent Director, as Chairman of the Board. The Board has initiated a search for a permanent Chief Executive Officer and has formed a committee to carry out the search.

Financing-Related

- In the first nine months of 2011, we sold 821,386 common shares through Wm Smith & Co. ("Wm Smith") and McNicoll, Lewis & Vlak LLC ("MLV") under our At Market Issuance Sales Agreement dated October 26, 2010 (the "2010 ATM Agreement"), for aggregate gross proceeds of $4.4 million, and 3,603,422 common shares through MLV under our At Market Issuance Sales Agreement dated February 4, 2011 (the "2011 ATM Agreement"), for aggregate gross proceeds of $8.5 million.

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- In April of 2011, the 2,959 Series B convertible preference shares previously issued to Genentech, Inc. were converted by Genentech into 254,560 common shares, and the associated liquidation preference of $29.6 million was eliminated.

- In May of 2011, we entered into two foreign exchange options contracts in order to manage our foreign currency exposure relating to principal and interest payments on our €15.0 million loan from Servier. Upfront premiums paid on these contracts totaled $1.5 million.

Results of Operations

Revenues

Total revenues for the three and nine months ended September 30, 2011 and 2010, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
License and collaborative fees	$4,859	$1,410	$16,725	$1,749
Contract and other revenue	11,349	5,733	31,477	18,025
Royalties	21	3,754	147	4,267
Total revenues	$16,229	$10,897	$48,349	$24,041

License and Collaborative Fees

License and collaborative fee revenue includes fees and milestone payments related to the out-licensing of our products and technologies. License and collaborative fee revenue increased by $3.5 million and $15.0 million for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. These increases were primarily due to $4.2 million and $15.9 million in revenue recognized in the three and nine months ended September 30, 2011, respectively, related to the collaboration and loan agreements with Servier to jointly develop and commercialize gevokizumab in multiple indications. The generation of future revenue related to license fees and other collaborative arrangements is dependent on our ability to attract new licensees to our antibody and bacterial cell expression technologies and new collaboration partners. Due to our collaboration agreement with Servier, we expect to experience an increase in these revenues in the fourth quarter of 2011 compared to the fourth quarter of 2010.

Contract and Other Revenue

Contract and other revenue includes agreements where we provide contracted research and development and manufacturing services to our contract and collaboration partners, including NIAID and Servier. The following table shows the activity in contract and other revenue for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Increase (Decrease)	2011	2010	Increase (Decrease)
NIAID	$5,069	$4,803	$266	$17,321	$13,097	$4,224
Servier	5,916	-	5,916	12,590	-	12,590
Takeda	317	263	54	901	3,289	(2,388)
Other	47	667	(620)	665	1,639	(974)

Total revenues	$11,349	$5,733	$5,616	$31,477	$18,025	$13,452

The increase in contract revenue was primarily due to gevokizumab clinical development and CMC activity under the collaboration with Servier. Also contributing to the increase in contract revenue was the increase in revenue from our NIAID Contract No. HHSN272200800028C ("NIAID 3") for the three and nine months ended September 30, 2011 as compared with the same periods of 2010 due to increased activity under the contract during the first nine months of 2011. Partially offsetting these increases was a decrease in revenue from our Takeda contracts in 2011 as a result of the cessation of certain Takeda programs in 2010.

Based on expected levels of revenue generating activity related to our Servier and NIAID 3 contracts, as well as our new NIAID 4 contract awarded in October of 2011, we expect contract and other revenue to increase in the fourth quarter of 2011 compared to the fourth quarter of 2010.

Royalties

Revenue from royalties decreased by $3.7 million and $4.1 million for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010, primarily due to the sale of our CIMZIA® royalty interest for $4.0 million in the third quarter of 2010, which included the receipt of $0.3 million in royalties in the second quarter of 2010. Royalties earned from sales of CIMZIA® for the first nine months of 2010 were $0.5 million. We will not receive any further royalties on sales of CIMZIA®.

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Research and Development Expenses

Biopharmaceutical development includes a series of steps, including in vitro and in vivo preclinical testing, and Phase 1, 2 and 3 clinical studies in humans. Each of these steps is typically more expensive than the previous step, but actual timing and the cost to us depends on the product being tested, the nature of the potential disease indication and the terms of any collaborative or development arrangements with other companies or entities. After successful conclusion of all of these steps, regulatory filings for approval to market the products must be completed, including approval of manufacturing processes and facilities for the product. Our research and development expenses currently include costs of personnel, supplies, facilities and equipment, consultants, third party costs and other expenses related to preclinical and clinical testing.

Research and development expenses were $15.9 million and $51.5 million for the three and nine months ended September 30, 2011, respectively, compared with $21.3 million and $58.3 million for the same periods of 2010. The decreases of $5.4 million and $6.8 million for the three and nine months ended September 30, 2011, respectively, as compared to the same periods in 2010, were primarily due to decreased spending on gevokizumab-related clinical trials. Partially offsetting these decreases were increases in spending on NIAID 3 in the first three quarters of 2011 due to increased activity under the contract.

Salaries and related personnel costs are a significant component of research and development expenses. We recorded $7.9 million and $25.5 million in research and development salaries and employee-related expenses for the three and nine months ended September 30, 2011, respectively, as compared with $7.5 million and $21.8 million for the same periods of 2010. The increases of $0.4 million and $3.7 million were primarily due to an increase in salaries and benefits of $0.8 million and $3.0 million for the three and nine months ended September 30, 2011, respectively, from a higher employee headcount related to manufacturing.

Our research and development activities can be divided into earlier stage programs and later stage programs. Earlier stage programs include molecular biology, process development, pilot-scale production and preclinical testing. Also included in earlier stage programs are costs related to excess manufacturing capacity, which we expect will decrease in 2011 due to the execution of the collaboration agreement with Servier, resulting in increased manufacturing capacity requirements. Later stage programs include clinical testing, regulatory affairs and manufacturing clinical supplies. The approximate costs associated with these programs for the three and nine months ended September 30, 2011 and 2010 were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Earlier stage programs	$ 10,103	$ 14,056	$ 36,408	$ 37,796
Later stage programs	5,748	7,289	15,071	20,482
Total	$ 15,851	$ 21,345	$ 51,479	$ 58,278

Our research and development activities can also be divided into those related to our internal projects and those projects related to collaborative and contract arrangements. The approximate costs related to internal projects and collaborative and contract arrangements for the three and nine months ended September 30, 2011 and 2010 were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010

Internal projects	$ 8,348	$ 17,332	$ 29,285	$ 45,856
Collaborative and contract arrangements	7,503	4,013	22,194	12,422
Total	$ 15,851	$ 21,345	$ 51,479	$ 58,278

For the three and nine months ended September 30, 2011, each of the two programs upon which we incurred the largest amount of expense (gevokizumab and NIAID) accounted for more than 20% but less than 30% of our total research and development expense. All remaining development programs accounted for less than 10% of our total research and development expense for the three and nine months ended September 30, 2011. For the three and nine months ended September 30, 2010, the program upon which we incurred the largest amount of expense (gevokizumab) accounted for more than 30% but less than 40%, and NIAID accounted for more than 10% but less than 20% of our total research and development expenses. All remaining development programs accounted for less than 10% of our total research and development expense for the three and nine months ended September 30, 2010.

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We expect our research and development spending in 2011 compared to 2010 will decrease primarily due to decreased spending on gevokizumab-related clinical trials.

Future research and development spending may be impacted by potential new licensing or collaboration or development arrangements, as well as the termination of existing agreements. Beyond this, the scope and magnitude of future research and development expenses are difficult to predict at this time.

Selling, General and Administrative Expenses

Selling, general and administrative expenses include salaries and related personnel costs, facilities costs and professional fees. Selling, general and administrative expenses were $7.3 million and $18.8 million for the three and nine months ended September 30, 2011, respectively, compared with $6.2 million and $16.8 million for the same periods of 2010. The increase of $1.1 million for the three months ended September 30, 2011, as compared to the same period of 2010, was primarily due to a one-time accrued $1.3 million severance expense and a $0.7 million share-based compensation charge incurred during the third quarter of 2011 in connection with the resignation of our Chairman, Chief Executive Officer and President. This increase was partially offset by a $0.5 million decrease in other share-based compensation, excluding the $0.7 million charge discussed above, and other decreases due to our continued focus on cost control. The increase of $2.0 million for the nine months ended September 30, 2011, as compared to the same period of 2010, was primarily due to the $1.3 million severance charge and $0.7 million share-based compensation charge as described above and an increase in other share-based compensation of $0.6 million, excluding the $0.7 million charge discussed above, partially offset by a decrease in financing fees and other costs due to our continued focus on cost control.

Other Income (Expense)

Interest expense was $0.7 million and $1.8 million for the three and nine months ended September 30, 2011, respectively, compared to $0.1 million and $0.3 million for the same periods of 2010. The increases in interest expense of $0.6 million and $1.5 million for the three and nine months ended September 30, 2011, respectively, as compared to the same periods of 2010, were primarily due to interest expense related to the loan with Servier, which was funded in January of 2011. Refer to Liquidity and Capital Resources: Servier Loan below for further discussion of the loan with Servier.

Other income primarily consisted of gains on revaluation of warrant liabilities and unrealized and realized gains (losses). The following table shows the activity in other income for the three and nine months ended September 30, 2011 and 2010 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Increase (Decrease)	2011	2010	Increase (Decrease)
Other income						
Gain on revaluation of warrant liabilities	$499	$3,120	$(2,621)	$3,349	$4,811	$(1,462)
Unrealized foreign exchange gain (loss) (1)	760	-	760	(1,114)	-	(1,114)
Realized foreign exchange gain (2)	(1)	(1)	-	555	(3)	558
Unrealized loss on foreign exchange options	(285)	-	(285)	(128)	-	(128)
Warrant modification expense	-	-	-	-	(4,500)	4,500

Other	45	(7)	52	35	(8)	43
Total other income	$1,018	$3,112	$(2,094)	$2,697	$300	$2,397

(1) Unrealized foreign exchange gain (loss) for the three and Nine Months ended September 30, 2011 primarily relates to gains (losses) on the re-measurement of the €15 million Servier loan.

(2) Realized foreign exchange gain for the Nine Months ended September 30, 2011 primarily relates to the conversion into U.S. dollars of the €15 million cash proceeds received from Servier in January of 2011.

Warrant Liabilities

In February of 2010, we issued warrants to purchase 1,260,000 of XOMA's common shares in connection with an underwritten offering. We have accounted for the warrants issued in February of 2010 as a liability at fair value. At December 31, 2010, the fair value of the warrant liabilities was $3.5 million, estimated using the Black-Scholes Option Pricing Model (the "Black-Scholes Model"). We revalued the warrant liability at September 30, 2011 using the Black-Scholes Model and recorded decreases in the fair value of $0.4 million and $2.7 million for the three and nine months ended September 30, 2011, respectively (primarily due to decreases in the market value of our common shares), as gains in the other income line of our condensed consolidated statement of operations. As of September 30, 2011, all of these warrants were outstanding and the fair value of the warrant liability was $0.8 million.

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In June of 2009, we issued warrants to certain institutional investors as part of a registered direct offering. The warrants represent the right to acquire an aggregate of up to 347,826 common shares over a five year period beginning December 11, 2009 at an exercise price of $19.50 per share (after giving effect to our reverse stock split). We have accounted for the warrants issued in June of 2009 as a liability at fair value. At December 31, 2010, the fair value of the warrant liabilities was $0.8 million, estimated using the Black-Scholes Model. We revalued the warrant liability at September 30, 2011 using the Black-Scholes Model and recorded decreases in the fair value of $0.1 million and $0.6 million for the three and nine months ended September 30, 2011, respectively (primarily due to decreases in the market value of our common shares), as gains in the other income line of our condensed consolidated statement of operations. As of September 30, 2011, all of these warrants were outstanding and the fair value of the warrant liability was $0.1 million.

Income Taxes

Income tax expense was not material for the three and nine months ended September 30, 2011 and 2010.

Accounting Standards Codification Topic 740, Income Taxes provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes our historical operating performance and carry-back potential, we have determined that total deferred tax assets should be fully offset by a valuation allowance.

We did not have unrecognized tax benefits as of September 30, 2011 and do not expect this to change significantly over the next twelve months. We will recognize future interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of September 30, 2011, we have not accrued interest or penalties related to uncertain tax positions.

Liquidity and Capital Resources

The following table summarizes our cash and cash equivalents, our working capital and our cash flow activities as of the end of, and for each of, the periods presented (in thousands):

	September 30, 2011	December 31, 2010	Change
Cash and cash equivalents	$45,707	$ 37,304	$8,403
Working Capital	$41,529	$ 23,352	$18,177

	Nine Months Ended September 30,		
	2011	2010	Change
Net cash used in operating activities	$(20,975)	$ (42,910)	$21,935
Net cash used in investing activities	$(2,586)	$ (277)	$(2,309)
Net cash provided by financing activities	$32,537	$ 36,138	$(3,601)
Effect of exchange rate changes on cash	$(573)	$ -	$(573)

Working Capital

The increase in working capital is primarily related to the $8.4 million increase in cash and cash equivalents and an $11.0 decrease in deferred revenue – current. The decrease in deferred revenue – current was primarily due to the recognition of $14.9 million during the nine months ended September 30, 2011, related to the $15.0 million license

fee received as consideration for the collaboration with Servier, partially offset by deferred revenue related to an adjustment to previously-reported revenue from NIAID resulting from an audit by NIAID's contracting office. This revenue will be recognized upon completion of the review of final audited rates by NIAID's contracting office.

Cash Used in Operating Activities

Net cash used in operating activities was $21.0 million for the nine months ended September 30, 2011, compared with $42.9 million for the same period in 2010. The decrease in net cash used in operating activities was primarily related to the receipt of the $15.0 million license fee received as consideration for the collaboration with Servier, cash receipts for contract services performed under the collaboration with Servier and a decrease in cash paid on gevokizumab-related clinical trials. Partially offsetting these decreases in cash used in operating activities was a decrease in accounts payable and an increase in salaries and benefits due to a higher employee headcount related to manufacturing.

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Cash Used in Investing Activities

Net cash used in investing activities was $2.6 million for the nine months ended September 30, 2011, compared with $0.3 million for the same period of 2010. Cash used in investing activities for the nine months ended September 30, 2011 and 2010 consisted of fixed asset purchases relating to CMC activity.

Cash Provided by Financing Activities

Net cash provided by financing activities was $32.5 million for the nine months ended September 30, 2011, compared with $36.1 million for the same period of 2010. Cash provided by financing activities in the first nine months of 2011 was primarily from proceeds received from Servier with respect to a loan of $20.1 million and the issuance of common shares for $12.4 million under the 2010 and 2011 ATM agreements. Cash provided by financing activities in the first nine months of 2010 related to proceeds received from the issuance of common shares of $40.6 million, including net proceeds of $19.2 million from an underwritten offering in February of 2010, $13.9 million from our common share purchase agreement with Azimuth in August of 2010, and $7.5 million under the 2009 and 2010 ATM agreements, partially offset by $4.5 million paid to the holders of warrants issued in June of 2009 upon modification of the terms.

Foreign Exchange Options

We hold debt and may incur expenses denominated in foreign currencies, which exposes us to market risk associated with foreign currency exchange rate fluctuations between the U.S. dollar and the Euro. We are required to make principal and accrued interest payments in Euros on our €15.0 million loan from Servier. In order to manage our foreign currency exposure related to these payments, in May of 2011, we entered into two foreign exchange option contracts to buy €15.0 million and €1.5 million on January 2016 and January 2014, respectively. By having these option contracts in place, our foreign exchange rate risk is reduced if the U.S. dollar weakens against the Euro. However, if the U.S. dollar strengthens against the Euro, we are not required to exercise these options, but will not receive any refund on premiums paid.

Upfront premiums paid on these foreign exchange option contracts totaled $1.5 million. The fair values of these option contracts are re-valued at each reporting period and are estimated based on pricing models using readily observable inputs from actively quoted markets. The fair values of these option contracts are included in other assets on the condensed consolidated balance sheet and changes in fair value on these contracts are included in other income (expense) on the condensed consolidated statements of operations. The foreign exchange options were revalued at September 30, 2011 and had an aggregate fair value of $1.4 million, and we recognized a loss of $0.1 million related to the revaluation for the three and nine months ended September 30, 2011.

Servier Loan

In December of 2010, in connection with the license and collaboration agreement entered into with Servier, we executed a loan agreement with Servier, which provided for an advance of up to €15.0 million. The loan was fully funded in January of 2011, with the proceeds converting to approximately $19.5 million. The loan is secured by an interest in XOMA’s intellectual property rights to all gevokizumab indications worldwide, excluding certain rights in the U.S. and Japan. Interest is calculated at a floating rate based on a Euro Inter-Bank Offered Rate (“EURIBOR”) and subject to a cap. The interest rate is reset semi-annually in January and July of each year. The interest rate for the initial interest period was 3.22%. The interest rate has been reset to 3.83% for the six-month period from July 2011 through January 2012. Interest is payable semi-annually; however, the loan agreement provides for a deferral of interest payments over a period specified in the agreement. During the deferral period, accrued interest will be added to the outstanding principal amount for the purpose of interest calculation for the next six-month interest period. On

the repayment commencement date, all unpaid and accrued interest shall be paid to Servier and thereafter, all accrued and unpaid interest shall be due and payable at the end of each six-month period. The loan matures in 2016; however, after a specified period prior to final maturity, the loan is to be repaid (i) at Servier's option, by applying up to a significant percentage of any milestone or royalty payments owed by Servier under our collaboration agreement and (ii) using a significant percentage of any upfront, milestone or royalty payments we receive from any third party collaboration or development partner for rights to gevokizumab in the U.S. and/or Japan. In addition, the loan becomes immediately due and payable upon certain customary events of default. At September 30, 2011, the outstanding principal balance under this loan was $20.4 million. For the three and nine months ended September 30, 2011, we recorded an unrealized foreign exchange gain of $1.2 million and an unrealized foreign exchange loss of $0.9 million, respectively, related to the re-measurement of the loan as of September 30, 2011.

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The loan has a stated interest rate lower than the market rate based on comparable loans held by similar companies, which represents additional value to us. We recorded this additional value as a discount to the face value of the loan amount, at its fair value of $8.9 million. The fair value of this discount, which was determined using a discounted cash flow model, represents the differential between the stated terms and rates of the loan and market rates. Based on the association of the loan with the collaboration arrangement, we recorded the offset to this discount as deferred revenue.

The loan discount is amortized under the effective interest method over the expected five-year life of the loan. We recorded non-cash interest expense of $0.3 million and $1.0 million during the three and nine months ended September 30, 2011, respectively, resulting from the amortization of the loan discount. At September 30, 2011, the net carrying value of the loan was $12.7 million.

We believe that realization of the benefit and the associated deferred revenue is contingent on the loan remaining outstanding over the five-year contractual term of the loan. If we were to stop providing service under the collaboration arrangement and the arrangement is terminated, the maturity date of the loan would be accelerated and a portion of measured benefit would not be realized. As the realization of the benefit is contingent, in part, on the provision of future services, we are recognizing the deferred revenue over the expected five-year life of the loan. The deferred revenue is amortized under the effective interest method, and we recorded $0.3 million and $1.0 million of related non-cash revenue during the three and nine months ended September 30, 2011.

ATM Agreements

In the third quarter of 2010, we entered into the 2010 ATM Agreement, with Wm Smith and MLV (the “Agents”), under which we could sell common shares from time to time through the Agents, as our agents for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-148342) filed with the U.S. Securities and Exchange Commission (the “SEC”) on December 26, 2007 and declared effective by the SEC on May 29, 2008. The Agents could sell the common shares by any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 of the Securities Act of 1933, as amended (the “Securities Act”), including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. The Agents could also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2010 ATM Agreement through May of 2011, we sold a total of 7,560,862 common shares under this agreement for aggregate gross proceeds of $34.0 million, including 821,386 common shares sold in 2011 for aggregate gross proceeds of $4.4 million. Total offering expenses incurred related to sales under the 2010 ATM Agreement from inception to May of 2011 were $1.0 million, including $0.1 million incurred in 2011. In May of 2011, 2010 ATM Agreement expired by its terms, and there will be no further issuances under this facility.

On February 4, 2011, we entered into an At Market Issuance Sales Agreement (the “2011 ATM Agreement”), with MLV, under which we may sell common shares from time to time through the MLV, as our agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through September 30, 2011, we sold a total of 3,603,422 common shares under this agreement for aggregate gross proceeds of $8.5 million. Total offering expenses incurred related to sales under the 2011 ATM Agreement from inception to September 30, 2011 were $0.3 million. From October 1, 2011 through November 7, 2011, 834,016 additional common shares were sold through MLV for aggregate gross proceeds of $1.4 million. Total offering expenses related

to these sales from October 1, 2011 to November 7, 2011 were approximately $42,000.

Net proceeds received during the first nine months of 2011 from the Servier loan, 2010 ATM Agreement and 2011 ATM Agreement were used to continue development of our gevokizumab product candidate and for other working capital and general corporate purposes. As of November 7, 2011, there were approximately $90.1 million of gross proceeds available for issuance pursuant to the above-mentioned registration statement.

* * *

We have incurred significant operating losses and negative cash flows from operations since our inception. At September 30, 2011, we had an accumulated deficit of $874.3 million, cash and cash equivalents of $45.7 million and working capital of $41.6 million. During the remainder of 2011, we expect to continue using our cash and cash equivalents to fund ongoing operations. Additional licensing, antibody discovery and development collaboration agreements, government funding and financing arrangements may positively impact our cash balances. Based on our cash reserves and anticipated spending levels, revenue from collaborations including the gevokizumab collaboration agreement with Servier, funding from the loan agreement with Servier, biodefense contracts and licensing transactions and other sources of funding that we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development programs and further reduce personnel-related costs. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms.

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Critical Accounting Estimates

Critical accounting estimates are those that require significant judgment and/or estimates by management at the time that the financial statements are prepared such that materially different results might have been reported if other assumptions had been made. We consider certain accounting policies including, but not limited to, revenue recognition, long-lived assets, derivative instruments, warrant liabilities and share-based compensation to be critical policies. There have been no significant changes in our critical accounting estimates during the nine months ended September 30, 2011, as compared with those previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the SEC on March 10, 2011.

Subsequent Events

Domestication of the Company

We have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware (the "Domestication"). Upon completion of the Domestication, all of the outstanding common shares of the Bermuda company will automatically be converted by operation of law into common stock of a Delaware corporation on a one-for-one basis. A registration statement relating to the common stock of the Delaware corporation has been filed with the SEC but has not yet become effective. These securities may not be exchanged nor may offers to exchange be accepted prior to the time the registration statement becomes effective, and the announcement does not constitute an offer of any securities for exchange or sale. Although the Domestication will not require shareholder approval, it is subject to the final approval of XOMA's Board of Directors.

New NIAID Contract

In October of 2011, we announced that NIAID had awarded us a new contract under Contract No. HHSN272201100031C for up to $28.0 million over 5 years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning.

Forward-Looking Information and Cautionary Factors That May Affect Future Results

Certain statements contained herein related to anticipated size of clinical trials, anticipated timing of initiation of clinical trials, expected availability of clinical trial results, the sufficiency of our cash resources and the amounts of certain revenues and certain costs in comparison to prior years, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things, clinical trials may not reach their anticipated size if trials are not initiated or due to enrollment issues such as unavailability of patients, competing product candidates or unanticipated safety issues; the timing of initiation of or availability of results of clinical trials may be delayed or may never occur as a result of actions or inaction by regulators or our present or future collaboration partners, complications in the design, implementation or third-party approval of clinical trials, complications in the collection or interpretation of statistical data or unanticipated safety issues; the period for which our cash resources are sufficient could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated, if anticipated revenue or cost sharing arrangements do not materialize, or if funds are not otherwise available on acceptable terms; and our revenues may be lower than anticipated, and our costs may be higher than expected, due to actions or inactions by our present or future collaboration partners, unanticipated safety issues or unavailability of additional licensing or collaboration opportunities. These and other risks, including those related the generally unstable nature of current economic and financial market conditions; the results of discovery

research and preclinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative or licensing relationships; the ability of collaborators, licensees and other third parties to meet their obligations and their discretion in decision-making; our ability to meet the demands of the United States government agency with which we have entered our government contracts; competition; market demand for products; scale-up, manufacturing and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in Part II — Item 1A: Risk Factors.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and our secured note and loan agreements. By policy, we make our investments in high quality debt securities, limit the amount of credit exposure to any one issuer and limit duration by restricting the term of the instrument. We generally hold investments to maturity, with a weighted average portfolio period of less than twelve months. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation.

We hold interest-bearing instruments that are classified as cash and cash equivalents. Fluctuations in interest rates can affect the principal values and yields of fixed income investments. If interest rates in the general economy were to rise rapidly in a short period of time, our fixed income investments could lose value.

The following table presents the amounts and related weighted average interest rates of our cash and cash equivalents at September 30, 2011 and December 31, 2010 (in thousands, except interest rates):

	Maturity	Carrying Amount (in thousands)	Fair Value (in thousands)	Average Interest Rate	
September 30, 2011					
Cash and cash equivalents	Daily to 90 days	$45,707	$45,707	0.07	%
December 31, 2010					
Cash and cash equivalents	Daily to 90 days	$37,304	$37,304	0.09	%

As of September 30, 2011, we have an outstanding principal balance on our note with Novartis of $13.9 million, which is due in 2015. The interest rate on this note is charged at a rate of USD six-month LIBOR plus 2%, which was 2.39% at September 30, 2011. No further borrowing is available under this note.

As of September 30, 2011, we have an outstanding principal balance on our loan with Servier of €15.0 million, which converts to approximately $20.4 million at September 30, 2011. The interest rate on this loan is charged at a floating rate based on a Euro Inter-Bank Offered Rate (“EURIBOR”) and subject to a cap. The interest rate for the initial interest period was 3.22%. The interest rate has been reset to 3.83% for six-month period from July 2011 through January 2012. No further borrowing is available under this loan.

The variable interest rates related to our long-term debt instruments are based on LIBOR and EURIBOR. We estimate that a hypothetical 100 basis point change in interest rates could increase or decrease our interest expense by approximately $0.4 million on an annualized basis.

Foreign Currency Risk

We hold debt and may incur expenses denominated in foreign currencies. The amount of debt owed or expenses incurred will be impacted by fluctuations in these foreign currencies. When the U.S. dollar weakens against foreign currencies, the U.S. dollar value of the foreign-currency denominated debt and expense increases, and when the U.S. dollar strengthens against these currencies, the U.S. dollar value of the foreign-currency denominated debt and expense decreases. Consequently, changes in exchange rates will affect the amount we are required to repay on our €15.0 million loan from Servier and may affect our results of operations. Our loan from Servier was fully funded in

January of 2011, with the proceeds converting to approximately $19.5 million using the January 13, 2011 Euro to USD exchange rate. At September 30, 2011, the €15.0 million outstanding principal balance under this loan agreement would have equaled approximately $20.4 million using the September 30, 2011 Euro to USD exchange rate. In May of 2011, in order to manage our foreign currency exposure relating to our principal and interest payments on our loan from Servier, we entered into two foreign exchange option contracts. Our use of derivative financial instruments represents risk management; we do not enter into derivative financial contracts for trading purposes. Refer to Item 1, Condensed Consolidated Financial Statements, Note 3 of Notes to Consolidated Financial Statements for additional information of the foreign exchange option contracts. Our derivative financial instruments are recorded in the consolidated balance sheets at fair value as of the balance sheet dates.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Controls and Procedures

Under the supervision and with the participation of our management, including our Interim Chief Executive Officer (our principal executive officer) and our Vice President, Finance and Chief Financial Officer (our principal financial officer), we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on this evaluation, our Interim Chief Executive Officer and our Vice President, Finance and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report in timely alerting them to material information relating to us and our consolidated subsidiaries required to be included in our periodic SEC filings.

Changes in Internal Control

There have been no changes in our internal controls over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned Hedrick et al. v. Genentech, Inc. et al, Case No. 09-446158. The complaint asserts claims against Genentech, us and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals' treatment with RAPTIVA®. The complaint seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to seventy six. The cases have been consolidated as a coordinated proceeding. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. On July 15, 2011, the Court dismissed with prejudice one of the cases in this coordinated proceeding, White v. Genentech, Inc., et al, Case No. RG-09-484026. On September 8, 2011, the Court granted defendants' Motions for Summary Judgment in two cases, Guerrero (Case No. RG-10-518396) and Harwell (Case No. RG-09-464039), and dismissed both cases. On September 19, 2011, the Court sustained defendants' Demurrer to another case (Young, Case No. RG-11-569879) and dismissed the complaint. On October 19, 2011, the Court granted defendants' Motion for Summary Judgment in Krawiec v. Genentech, Inc., et al., Case No. RG10-524963. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which we believe is applicable to these matters. We believe the claims against us to be without merit and intend to defend against them vigorously.

On August 4, 2010, a petition was filed in the District Court of Dallas County, Texas in a case captioned McCall v. Genentech, Inc., et al., No. 10-09544. The defendants filed a Notice of Removal to the United States District Court for the Northern District of Texas on September 3, 2010. The removed case is captioned McCall v. Genentech, Inc., et al., No. 3:10-cv-01747-B. The parties have fully briefed the plaintiff's Motion to Remand and are awaiting a final ruling from the Court. The petition asserts personal injury claims against Genentech, us and others arising out of the plaintiff's treatment with RAPTIVA®. The petition alleges claims based on negligence, strict liability, misrepresentation and suppression, conspiracy, and actual and constructive fraud. The petition seeks compensatory damages and punitive damages in an unspecified amount. On June 6, 2011, the Court dismissed plaintiff's claims of negligent misrepresentation, fraud, and conspiracy. Our agreement with Genentech provides for an indemnity of

XOMA and payment of legal fees by Genentech which we believe is applicable to this matter. We believe the claims against us to be without merit and intend to defend against them vigorously.

On January 7, 2011, a complaint was filed in the United States District Court for the Northern District of Texas in a case captioned Massa v. Genentech, Inc., et al., No. 4:11CV70. On January 11, 2011, a complaint was filed in the United States District Court for the District of Massachusetts in a case captioned Sylvia, et al. v. Genentech, Inc., et al., No. 1:11-cv-10054-MLW. These two complaints allege the same claims against Genentech, us and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which we believe is applicable to these matters. We believe the claims against us to be without merit and intend to defend against them vigorously.

On April 8, 2011, four complaints were filed in the United States District Court for the Eastern District of Michigan. The cases are captioned: Muniz v. Genentech, et al., 5:11-cv-11489-JCO-RSW; Tifenthal v. Genentech, et al., 2:11-cv-11488-DPH-LJM; Blair v. Genentech, et al., 2:11-cv-11463-SFC-MJH; and Marsh v. Genentech, et al., 2:11-cv-11462-RHC-MKM. The complaints allege the same claims against Genentech, us and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. All four cases have been transferred to the United States District Court for the Western District of Michigan. On October 26, 2011, the Court granted the Motions to Dismiss filed by Genentech and us in all four actions. Plaintiffs have filed a Notice of Appeal in each case. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which we believe is applicable to this matter. We believe the claims against us to be without merit and intend to defend against them vigorously.

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ITEM 1A. RISK FACTORS

The following risk factors and other information included in this quarterly report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

Because our product candidates are still being developed, we will require substantial funds to continue; we cannot be certain that funds will be available and, if they are not available, we may have to take actions that could adversely affect your investment and may not be able to continue operations.

We will need to commit substantial funds to continue development of our product candidates and we may not be able to obtain sufficient funds on acceptable terms, or at all. If adequate funds are not available, we may have to raise additional funds in a manner that may dilute or otherwise adversely affect the rights of existing shareholders, curtail or cease operations, or file for bankruptcy protection in extreme circumstances. We have spent, and we expect to continue to spend, substantial funds in connection with:

- research and development relating to our product candidates and production technologies,
- various human clinical trials, and
- protection of our intellectual property.

We finance our operations primarily through our multiple revenue streams resulting from discovery and development collaborations, sales of our common shares, biodefense contracts and the licensing of our antibody technologies. In September of 2009, we sold our royalty interest in LUCENTIS® to Genentech, Inc., a wholly-owned member of the Roche Group ("Genentech") for gross proceeds of $25.0 million, including royalty revenue from the second quarter of 2009. These proceeds, along with other funds, were used to fully repay our loan from Goldman Sachs Specialty Lending Holdings, Inc. ("Goldman Sachs"). As a result, we no longer have a royalty interest in LUCENTIS®. In August of 2010, we sold our royalty interest in CIMZIA® for gross proceeds of $4.0 million, including royalty revenue from the second quarter of 2010. As a result, we no longer have a royalty interest in CIMZIA®. We received revenue from this royalty interest of $0.5 million in 2010 and $0.5 million in 2009.

Based on our cash reserves and anticipated spending levels, revenue from collaborations including our gevokizumab (formerly referred to as XOMA 052) collaboration agreement with Les Laboratoires Servier ("Servier"), funding from our loan agreement with Servier, biodefense contracts and licensing transactions and other sources of funding that we believe to be available, we believe that we have sufficient cash resources to meet our anticipated net cash needs through the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development programs and further reduce personnel-related costs. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. As a result, we do not know when or whether:

- operations will generate meaningful funds,
- additional agreements for product development funding can be reached,
- strategic alliances can be negotiated, or

- adequate additional financing will be available for us to finance our own development on acceptable terms, or at all.

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Cash balances and operating cash flow are influenced primarily by the timing and level of payments by our licensees, collaborators and development partners, as well as by our operating costs.

Global credit and financial market conditions may reduce our ability to access capital and cash and could negatively impact the value of our current portfolio of cash equivalents and our ability to meet our financing objectives.

Traditionally, we have funded a large portion of our research and development expenditures through raising capital in the equity markets. Recent events, including failures and bankruptcies among large commercial and investment banks, have led to considerable declines and uncertainties in these and other capital markets and have led to new regulatory and other restrictions that may broadly affect the nature of these markets. These circumstances could severely restrict the raising of new capital by companies such as us in the future.

Volatility in the financial markets has also created liquidity problems in investments previously thought to bear a minimal risk. For example, money market fund investors, including us, have in the past been unable to retrieve the full amount of funds, even in highly-rated liquid money market accounts, upon maturity. Although as of September 30, 2011, we have received the full amount of proceeds from money market fund investments, an inability to retrieve funds from money market fund investments as they mature in the future could have a material and adverse impact on our business, results of operations and cash flows.

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. While as of the date of this filing, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents since September 30, 2011, no assurance can be given that further deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents or our ability to meet our financing objectives.

Because all of our product candidates are still being developed, we have sustained losses in the past and we expect to sustain losses in the future.

We have experienced significant losses and, as of September 30, 2011, we had an accumulated deficit of $873.6 million.

For the three and nine months ended September 30, 2011, we had net losses of approximately $5.9 million or $0.18 per common share (basic and diluted) and $20.3 million or $0.66 per common share (basic and diluted), respectively. For the three and nine months ended September 30, 2010, we had net losses of approximately $13.6 million or $0.69 per common share (basic and diluted) and $51.0 million or $2.87 per common share (basic and diluted), respectively.

Our ability to achieve profitability is dependent in large part on the success of our development programs, obtaining regulatory approval for our product candidates and entering into new agreements for product development, manufacturing and commercialization, all of which are uncertain. Our ability to fund our ongoing operations is dependent on the foregoing factors and on our ability to secure additional funds. Because our product candidates are still being developed, we do not know whether we will ever achieve sustained profitability or whether cash flow from future operations will be sufficient to meet our needs.

We may issue additional equity securities and thereby materially and adversely affect the price of our common shares.

We are authorized to issue, without shareholder approval, 1,000,000 preference shares, of which none were issued and outstanding as of November 7, 2011, which may give other shareholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common shares. In April of 2011, the

2,959 Series B convertible preference shares previously issued to Genentech were converted by Genentech into 254,560 common shares. In addition, we are authorized to issue, generally without shareholder approval, up to 92,666,666 common shares, of which 34,246,279 were issued and outstanding as of November 7, 2011. If we issue additional equity securities, the price of our common shares may be materially and adversely affected.

In the third quarter of 2009, we had entered into an At Market Issuance Sales Agreement (the "2009 ATM Agreement"), with Wm Smith & Co. ("Wm Smith"), under which we could sell up to 1.7 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith could sell these common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, as amended (the "Securities Act"), including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith could also sell the common shares in privately negotiated transactions, subject to our approval. From the inception of the 2009 ATM Agreement through October 27, 2010, we sold a total of 1,666,666 common shares through Wm Smith, constituting all of the shares available for sale under the agreement, for aggregate gross proceeds of $12.2 million.

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In February of 2010, we completed an underwritten offering of 2.8 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately $21.0 million, before deducting underwriting discounts and commissions and estimated offering expenses of $1.7 million. The investors purchased the units at a price of $7.50 per unit. The warrants, which represent the right to acquire an aggregate of up to 1.26 million common shares, are exercisable beginning six months and one day after issuance and have a five-year term and an exercise price of $10.50 per share.

In July of 2010, we entered into a common share purchase agreement with Azimuth Opportunity, Ltd. ("Azimuth"), pursuant to which we obtained a committed equity line of credit facility under which we could sell up to $30.0 million of our registered common shares to Azimuth over a 12-month period, subject to certain conditions and limitations. In August of 2010, we sold a total of 3,421,407 common shares under this facility for aggregate proceeds of $14.2 million, representing the maximum number of shares that could be sold under this facility.

In October of 2010, we entered into an At Market Issuance Sales Agreement (the "2010 ATM Agreement"), with Wm Smith and McNicoll, Lewis & Vlak LLC (the "Agents"), under which we could sell common shares from time to time through the Agents, as our agents for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-148342) filed with the U.S. Securities and Exchange Commission (the "SEC") on December 26, 2007 and declared effective by the SEC on May 29, 2008. The Agents could sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. The Agents could also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2010 ATM Agreement through May of 2011, we sold a total of 7.6 million common shares under this agreement for aggregate gross proceeds of $34.0 million, including 0.8 million common shares sold in 2011 for aggregate gross proceeds of $4.4 million. In May of 2011, the 2010 ATM Agreement expired by its terms, and there will be no further issuances under this facility.

On February 4, 2011, we entered into an At Market Issuance Sales Agreement with McNicoll, Lewis & Vlak LLC ("MLV"), under which we may sell common shares from time to time through the MLV, as our agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through November 7, 2011, we sold a total of 4,437,438 common shares under this agreement for aggregate gross proceeds of $9.9 million.

The financial terms of future collaborative or licensing arrangements could result in dilution of our share value.

Funding from collaboration partners and others has in the past and may in the future involve issuance by us of our shares. We cannot be certain how the purchase price of such shares, the relevant market price or premium, if any, will be determined or when such determinations will be made. Any such issuance could result in dilution in the value of our issued and outstanding shares.

Our share price may be volatile and there may not be an active trading market for our common shares.

There can be no assurance that the market price of our common shares will not decline below its present market price or that there will be an active trading market for our common shares. The market prices of biotechnology companies have been and are likely to continue to be highly volatile. Fluctuations in our operating results and general market conditions for biotechnology stocks could have a significant impact on the volatility of our common share price. We have experienced significant volatility in the price of our common shares. From January 1, 2011 through November 7, 2011, our share price has ranged from a high of $7.71 to a low of $1.38. Factors contributing to such volatility include, but are not limited to:

- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of products or product candidates,
- developments regarding regulatory filings,

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- announcements of new collaborations,
- failure to enter into collaborations,
- developments in existing collaborations,
- our funding requirements and the terms of our financing arrangements,
- technological innovations or new indications for our therapeutic products and product candidates,
- introduction of new products or technologies by us or our competitors,
- sales and estimated or forecasted sales of products for which we receive royalties, if any,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares issued and outstanding,
- the number of shares trading on an average trading day,
- announcements regarding other participants in the biotechnology and pharmaceutical industries, and
- market speculation regarding any of the foregoing.

If we are unable to continue to meet the requirements for continued listing on The NASDAQ Global Market, then we may be de-listed. In March of 2010, we received a Staff Determination letter from The NASDAQ Stock Market LLC ("NASDAQ") indicating that we had not regained compliance with the minimum $1.00 per share requirement for continued inclusion on The NASDAQ Global Market, pursuant to NASDAQ Listing Rule 5450(a)(1). On August 18, 2010, we effected a reverse split of our common shares in order to regain compliance.

We have received negative results from certain of our clinical trials, and we face uncertain results of other clinical trials of our potential products.

In March of 2011, we announced that our Phase 2b trial of gevokizumab in Type 2 diabetes in 421 patients did not achieve the primary endpoint of reduction in hemoglobin A1c ("HbA1c") after six monthly treatments with gevokizumab compared to placebo. In June of 2011, we announced top line trial results from our six-month Phase 2a trial of gevokizumab in Type 2 diabetes in 74 patients, and there were no differences in glycemic control between the drug and placebo groups as measured by HbA1c levels.

Our potential products, including gevokizumab and XOMA 3AB, will require significant additional research and development, extensive preclinical studies and clinical trials and regulatory approval prior to any commercial sales. This process is lengthy and expensive, often taking a number of years. As clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals, the length of time necessary to complete clinical trials and to submit an application for marketing approval for a final decision by a regulatory authority varies significantly. As a result, it is uncertain whether:

- our future filings will be delayed,

- our preclinical and clinical studies will be successful,
- we will be successful in generating viable product candidates to targets,
- we will be able to provide necessary additional data,
- results of future clinical trials will justify further development, or
- we will ultimately achieve regulatory approval for any of these product candidates.

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The timing of the commencement, continuation and completion of clinical trials may be subject to significant delays relating to various causes, including completion of preclinical testing and earlier-stage clinical trials in a timely manner, scheduling conflicts with participating clinicians and clinical institutions, difficulties in identifying and enrolling patients who meet trial eligibility criteria, and shortages of available drug supply. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites, the eligibility criteria for the trial, the existence of competing clinical trials and the availability of alternative or new treatments. In addition, we will conduct clinical trials in foreign countries in the future which may subject us to further delays and expenses as a result of increased drug shipment costs, additional regulatory requirements and the engagement of foreign clinical research organizations, as well as expose us to risks associated with foreign currency transactions insofar as we might desire to use U.S. dollars to make contract payments denominated in the foreign currency where the trial is being conducted.

All of our product candidates are prone to the risks of failure inherent in drug development. Preclinical studies may not yield results that would satisfactorily support the filing of an Investigational New Drug application ("IND") (or a foreign equivalent) with respect to our product candidates. Even if these applications would be or have been filed with respect to our product candidates, the results of preclinical studies do not necessarily predict the results of clinical trials. Similarly, early-stage clinical trials in healthy volunteers do not predict the results of later-stage clinical trials, including the safety and efficacy profiles of any particular product candidates. In addition, there can be no assurance that the design of our clinical trials is focused on appropriate indications, patient populations, dosing regimens or other variables which will result in obtaining the desired efficacy data to support regulatory approval to commercialize the drug. Preclinical and clinical data can be interpreted in different ways. Accordingly, Food and Drug Administration ("FDA") officials or officials from foreign regulatory authorities could interpret the data in different ways than we or our collaboration or development partners do which could delay, limit or prevent regulatory approval.

Administering any of our products or potential products may produce undesirable side effects, also known as adverse effects. Toxicities and adverse effects that we have observed in preclinical studies for some compounds in a particular research and development program may occur in preclinical studies or clinical trials of other compounds from the same program. Such toxicities or adverse effects could delay or prevent the filing of an IND (or a foreign equivalent) with respect to such products or potential products or cause us to cease clinical trials with respect to any drug candidate. In clinical trials, administering any of our products or product candidates to humans may produce adverse effects. These adverse effects could interrupt, delay or halt clinical trials of our products and product candidates and could result in the FDA or other regulatory authorities denying approval of our products or product candidates for any or all targeted indications. The FDA, other regulatory authorities, our collaboration or development partners or we may suspend or terminate clinical trials at any time. Even if one or more of our product candidates were approved for sale, the occurrence of even a limited number of toxicities or adverse effects when used in large populations may cause the FDA to impose restrictions on, or stop, the further marketing of such drugs. Indications of potential adverse effects or toxicities which may occur in clinical trials and which we believe are not significant during the course of such clinical trials may later turn out to actually constitute serious adverse effects or toxicities when a drug has been used in large populations or for extended periods of time. Any failure or significant delay in completing preclinical studies or clinical trials for our product candidates, or in receiving and maintaining regulatory approval for the sale of any drugs resulting from our product candidates, may severely harm our reputation and business.

In June of 2011, Novartis announced that an advisory committee of the FDA voted in favor of the overall efficacy but not the overall safety of Ilaris® (canakinumab), a fully-human monoclonal antibody that, like gevokizumab, targets IL-1 beta, to treat gouty arthritis attacks in patients who cannot obtain adequate relief with non-steroidal anti-inflammatory drugs or colchicine. Novartis also stated that in two pivotal Phase 3 studies of canakinumab in gouty arthritis patients, a higher percentage of patients had adverse events with canakinumab than with the standard treatment for gouty arthritis, and more serious adverse events were reported by patients treated with canakinumab compared to patients receiving the standard treatment. In August of 2011, Novartis announced that the FDA had

issued a Complete Response letter requesting additional information, including clinical data to evaluate the benefit risk profile of canakinumab in refractory gouty arthritis patients. We have not yet determined what impact, if any, these developments may have on the development of gevokizumab.

Given that regulatory review is an interactive and continuous process, we maintain a policy of limiting announcements and comments upon the specific details of regulatory review of our product candidates, subject to our obligations under the securities laws, until definitive action is taken.

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Our therapeutic product candidates have not received regulatory approval. If these product candidates do not receive regulatory approval, neither our third party collaborators nor we will be able to manufacture and market them.

Our product candidates, including gevokizumab and XOMA 3AB, cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. The United States government and governments of other countries extensively regulate many aspects of our product candidates, including:

- testing,
- manufacturing,
- promotion and marketing, and
- exporting.

In the United States, the FDA regulates pharmaceutical products under the Federal Food, Drug, and Cosmetic Act and other laws, including, in the case of biologics, the Public Health Service Act. At the present time, we believe that most of our product candidates will be regulated by the FDA as biologics. Initiation of clinical trials requires approval by health authorities. Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients under the supervision of a qualified principal investigator. Clinical trials must be conducted in accordance with FDA and International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use Good Clinical Practices and the European Clinical Trials Directive under protocols that detail the objectives of the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Other national, foreign and local regulations may also apply. The developer of the drug must provide information relating to the characterization and controls of the product before administration to the patients participating in the clinical trials. This requires developing approved assays of the product to test before administration to the patient and during the conduct of the trial. In addition, developers of pharmaceutical products must provide periodic data regarding clinical trials to the FDA and other health authorities, and these health authorities may issue a clinical hold upon a trial if they do not believe, or cannot confirm, that the trial can be conducted without unreasonable risk to the trial participants. We cannot assure you that U.S. and foreign health authorities will not issue a clinical hold with respect to any of our clinical trials in the future.

The results of the preclinical studies and clinical testing, together with chemistry, manufacturing and controls information, are submitted to the FDA and other health authorities in the form of a new drug application for a pharmaceutical product, and in the form of a Biologic License Application ("BLA") for a biological product, requesting approval to commence commercial sales. In responding to a new drug application or an antibody license application, the FDA or foreign health authorities may grant marketing approvals, request additional information or further research, or deny the application if it determines that the application does not satisfy its regulatory approval criteria. Regulatory approval of a new drug application, BLA, or supplement is never guaranteed, and the approval process can take several years and is extremely expensive. The FDA and foreign health authorities have substantial discretion in the drug and biologics approval processes. Despite the time and expense incurred, failure can occur at any stage, and we could encounter problems that cause us to abandon clinical trials or to repeat or perform additional preclinical, clinical or manufacturing-related studies.

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. State regulations may also affect our proposed products. The FDA has substantial discretion in both the product approval process and manufacturing facility approval process and, as a result of this discretion and uncertainties about outcomes of testing, we cannot predict at what point, or whether, the FDA

will be satisfied with our or our collaborators' submissions or whether the FDA will raise questions which may be material and delay or preclude product approval or manufacturing facility approval. As we accumulate additional clinical data, we will submit it to the FDA, and such data may have a material impact on the FDA product approval process.

Even once approved, a product may be subject to additional testing or significant marketing restrictions, its approval may be withdrawn or it may be voluntarily taken off the market.

Even if the FDA, the European Commission or another regulatory agency approves a product candidate for marketing, the approval may impose ongoing requirements for post-approval studies, including additional research and development and clinical trials, and the FDA, European Commission or other regulatory agency may subsequently withdraw approval based on these additional trials.

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Even for approved products, the FDA, European Commission or other regulatory agency may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, marketing and/or production of such product.

Furthermore, a marketing approval of a product may be withdrawn by the FDA, the European Commission or another regulatory agency or such a product may be voluntarily withdrawn by the company marketing it based, for example, on subsequently-arising safety concerns. In February of 2009, the European Medicines Agency ("EMA") announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and that its Committee for Medicinal Products for Human Use ("CHMP") had concluded that the benefits of RAPTIVA® no longer outweigh its risks because of safety concerns, including the occurrence of progressive multifocal leukoencephalopathy ("PML") in patients taking the medicine. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML.

The FDA, European Commission and other agencies also may impose various civil or criminal sanctions for failure to comply with regulatory requirements, including withdrawal of product approval.

Certain of our technologies are relatively new and are in-licensed from third parties, so our capabilities using them are unproven and subject to additional risks.

We license technologies from third parties. These technologies include but are not limited to phage display technologies licensed to us in connection with our bacterial cell expression technology licensing program. However, our experience with some of these technologies remains relatively limited and, to varying degrees, we are still dependent on the licensing parties for training and technical support for these technologies. In addition, our use of these technologies is limited by certain contractual provisions in the licenses relating to them and, although we have obtained numerous licenses, intellectual property rights in the area of phage display are particularly complex. If the owners of the patent rights underlying the technologies we license do not properly maintain or enforce those patents, our competitive position and business prospects could be harmed. Our success will depend in part on the ability of our licensors to obtain, maintain and enforce our licensed intellectual property. Our licensors may not successfully prosecute the patent applications to which we have licenses, or our licensors may fail to maintain existing patents. They may determine not to pursue litigation against other companies that are infringing these patents, or they may pursue such litigation less aggressively than we would. Our licensors may also seek to terminate our license, which could cause us to lose the right to use the licensed intellectual property and adversely affect our ability to commercialize our technologies, products or services.

We do not know whether there will be, or will continue to be, a viable market for the products in which we have an ownership or royalty interest.

Even if products in which we have an interest receive approval in the future, they may not be accepted in the marketplace. In addition, we or our collaborators or licensees may experience difficulties in launching new products, many of which are novel and based on technologies that are unfamiliar to the healthcare community. We have no assurance that healthcare providers and patients will accept such products, if developed. For example, physicians and/or patients may not accept a product for a particular indication because it has been biologically derived (and not discovered and developed by more traditional means) or if no biologically derived products are currently in widespread use in that indication. Similarly, physicians may not accept a product if they believe other products to be more effective or more cost-effective or are more comfortable prescribing other products.

Safety concerns may also arise in the course of on-going clinical trials or patient treatment as a result of adverse events or reactions. For example, in February of 2009, the EMA announced that it had recommended suspension of

the marketing authorization of RAPTIVA® in the European Union and EMD Serono Inc., the company that marketed RAPTIVA® in Canada ("EMD Serono") announced that, in consultation with Health Canada, the Canadian health authority ("Health Canada"), it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia Pty Ltd, the company that marketed RAPTIVA® in Australia ("Merck Serono Australia"), following a recommendation from the Therapeutic Goods Administration, the Australian health authority ("TGA"), announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.

Furthermore, government agencies, as well as private organizations involved in healthcare, from time to time publish guidelines or recommendations to healthcare providers and patients. Such guidelines or recommendations can be very influential and may adversely affect the usage of any products we may develop directly (for example, by recommending a decreased dosage of a product in conjunction with a concomitant therapy or a government entity withdrawing its recommendation to screen blood donations for certain viruses) or indirectly (for example, by recommending a competitive product over our product). Consequently, we do not know if physicians or patients will adopt or use our products for their approved indications.

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We or our third party collaborators or licensees may not have adequate manufacturing capacity sufficient to meet market demand.

If any of our product candidates are approved, because we have never commercially introduced any pharmaceutical products, we do not know whether the capacity of our existing manufacturing facilities can be increased to produce sufficient quantities of our products to meet market demand. Also, if we or our third party collaborators or licensees need additional manufacturing facilities to meet market demand, we cannot predict that we will successfully obtain those facilities because we do not know whether they will be available on acceptable terms. In addition, any manufacturing facilities acquired or used to meet market demand must meet the FDA's quality assurance guidelines.

Our agreements with third parties, many of which are significant to our business, expose us to numerous risks.

Our financial resources and our marketing experience and expertise are limited. Consequently, our ability to successfully develop products depends, to a large extent, upon securing the financial resources and/or marketing capabilities of third parties.

- In April of 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA®. In April of 1999, March of 2003, and January of 2005, the companies amended the agreement. In October of 2003, RAPTIVA® was approved by the FDA for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy and, in September of 2004, Merck Serono announced the product's approval in the European Union. In January of 2005, we entered into a restructuring of our collaboration agreement with Genentech which ended our existing cost and profit sharing arrangement related to RAPTIVA® in the United States and entitled us to a royalty interest on worldwide net sales. In February of 2009, the EMA announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and EMD Serono announced that, in consultation with Health Canada, it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia, following a recommendation from the TGA, announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.

- In March of 2004, we announced we had agreed to collaborate with Chiron Corporation (now Novartis) for the development and commercialization of antibody products for the treatment of cancer. In April of 2005, we announced the initiation of clinical testing of the first product candidate out of the collaboration, HCD122, an anti-CD40 antibody, in patients with advanced chronic lymphocytic leukemia. In October of 2005, we announced the initiation of the second clinical trial of HCD122 in patients with multiple myeloma. In November of 2008, we announced the restructuring of this product development collaboration, which involves six development programs including the ongoing HCD122 and LFA102 programs. In exchange for cash and debt reduction on our existing loan facility with Novartis, Novartis has control over the HCD122 and LFA102 programs and the additional ongoing program, as well as the right to expand the development of these programs into additional indications outside of oncology.

- In March of 2005, we entered into a contract with the National Institute of Allergy and Infectious Diseases ("NIAID") to produce three monoclonal antibodies designed to protect United States citizens against the harmful effects of botulinum neurotoxin used in bioterrorism. In July of 2006, we entered into an additional contract with NIAID for the development of an appropriate formulation for human administration of these three antibodies in a single injection. In September of 2008, we announced that we were awarded an additional contract with NIAID to support our on-going development of drug candidates toward clinical trials in the treatment of botulism poisoning. In October of 2011, we announced we had been awarded an additional contract with NIAID to develop

broad-spectrum antitoxins for the treatment of human botulism poisoning.

- In December of 2010, we entered into a license and collaboration agreement with Servier, to jointly develop and commercialize gevokizumab in multiple indications. Under the terms of the agreement, Servier has worldwide rights to diabetes and cardiovascular disease indications and rights outside the U.S. and Japan to Behcet's uveitis and other inflammatory and oncology indications. We retain development and commercialization rights for Behcet's uveitis and other inflammatory disease and oncology indications in the U.S. and Japan, and has an option to reacquire rights to diabetes and cardiovascular disease indications from Servier in these territories. Should we exercise this option, we will be required to pay Servier an option fee and partially reimburse their incurred development expenses. The agreement contains customary termination rights relating to matters such as material breach by either party, safety issues and patents. Servier also has a unilateral right to terminate the agreement on a country-by-country basis or in its entirety on six months' notice.

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- In December of 2010, we also entered into a loan agreement with Servier, which provides for an advance of up to €15.0 million and was fully funded in January of 2011 with the proceeds converting to approximately $19.5 million using the January 13, 2011 Euro to USD exchange rate. This loan is secured by an interest in our intellectual property rights to all gevokizumab indications worldwide, excluding the U.S. and Japan. The loan has a final maturity date in 2016; however, after a specified period prior to final maturity, the loan is required to be repaid (i) at Servier's option, by applying up to a significant percentage of any milestone or royalty payments owed by Servier under our collaboration agreement and (ii) using a significant percentage of any upfront, milestone or royalty payments we receive from any third party collaboration or development partner for rights to gevokizumab in the U.S. and/or Japan. In addition, the loan becomes immediately due and payable upon certain customary events of default. At September 30, 2011, the €15.0 million outstanding principal balance under this loan agreement would have equaled approximately $20.4 million using the September 30, 2011 Euro to USD exchange rate.

- We have licensed our bacterial cell expression technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to over 60 companies. As of September 30, 2011, we were aware of two antibody products manufactured using this technology that have received FDA approval, Genentech's LUCENTIS® (ranibizumab injection) for treatment of neovascular wet age-related macular degeneration and UCB's CIMZIA® (certolizumab pegol) for treatment of Crohn's disease and rheumatoid arthritis. In the third quarter of 2009, we sold our LUCENTIS® royalty interest to Genentech. In the third quarter of 2010, we sold our CIMZIA® royalty interest.

Because our collaborators and licensees are independent third parties, they may be subject to different risks than we are and have significant discretion in, and different criteria for, determining the efforts and resources they will apply related to their agreements with us. If these collaborators and licensees do not successfully develop and market these products, we may not have the capabilities, resources or rights to do so on our own. We do not know whether we, our collaborators or licensees will successfully develop and market any of the products that are or may become the subject of any of our collaboration or licensing arrangements. In some cases these arrangements provide for funding solely by our collaborators or licensees, and in other cases, such as our arrangement with Servier, all of the funding for certain projects and a significant portion of the funding for other projects is to be provided by our collaborator or licensee. In addition, third party arrangements such as ours also increase uncertainties in the related decision-making processes and resulting progress under the arrangements, as we and our collaborators or licensees may reach different conclusions, or support different paths forward, based on the same information, particularly when large amounts of technical data are involved. Furthermore, our contracts with NIAID contain numerous standard terms and conditions provided for in the applicable federal acquisition regulations and customary in many government contracts. Uncertainty exists as to whether we will be able to comply with these terms and conditions in a timely manner, if at all. In addition, we are uncertain as to the extent of NIAID's demands and the flexibility that will be granted to us in meeting those demands.

Even when we have a collaborative relationship, other circumstances may prevent it from resulting in successful development of marketable products.

- In September of 2006, we entered into an agreement with Taligen Therapeutics, Inc. ("Taligen") which formalized an earlier letter agreement, which was signed in May of 2006, for the development and cGMP manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement which provided that we would not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provided that we would conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate ("Avecia"). The letter agreement also provided that, subject to payment by Taligen of approximately $1.7 million, we would grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license

under our owned project innovations. We received $0.6 million as the first installment under the payment terms of the letter agreement but not the two additional payments totaling approximately $1.1 million to which we were entitled upon fulfillment of certain obligations. In May of 2009, the matter was resolved by agreement of the parties in a manner that had no further impact on our financial position.

Although we continue to evaluate additional strategic alliances and potential partnerships, we do not know whether or when any such alliances or partnerships will be entered into.

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Products and technologies of other companies may render some or all of our products and product candidates noncompetitive or obsolete.

Developments by others may render our products, product candidates, or technologies obsolete or uncompetitive. Technologies developed and utilized by the biotechnology and pharmaceutical industries are continuously and substantially changing. Competition in the areas of genetically engineered DNA-based and antibody-based technologies is intense and expected to increase in the future as a number of established biotechnology firms and large chemical and pharmaceutical companies advance in these fields. Many of these competitors may be able to develop products and processes competitive with or superior to our own for many reasons, including that they may have:

- significantly greater financial resources,
- larger research and development and marketing staffs,
- larger production facilities,
- entered into arrangements with, or acquired, biotechnology companies to enhance their capabilities, or
- extensive experience in preclinical testing and human clinical trials.

These factors may enable others to develop products and processes competitive with or superior to our own or those of our collaborators. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later; as a result, we may not be able to track development of competitive products, particularly at the early stages. Positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product's failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

The examples below pertain to competitive events in the market which we review quarterly and are not intended to be representative of all existing competitive events.

Gevokizumab

We, in collaboration with Servier, are developing gevokizumab, a potent anti-inflammatory monoclonal antibody targeting IL-1 beta. Other companies are developing other products based on the same or similar therapeutic targets as gevokizumab and these products may prove more effective than gevokizumab. We are aware that:

- In June of 2009, Novartis announced it had received U.S. marketing approval for Ilaris® (canakinumab), a fully-human monoclonal antibody targeting IL-1 beta, to treat children and adults with Cryopyrin-Associated Periodic Syndromes ("CAPS"). In October of 2009, Novartis announced that Ilaris® had been approved in the European Union for CAPS. In September of 2011, Novartis announced that Ilaris® had been approved in Japan for CAPS. Ilaris® is also being studied in other diseases such as systemic juvenile rheumatoid arthritis (known as SJIA), gouty arthritis and secondary prevention of cardiovascular events. In January of 2011, Novartis announced that it had filed for EMA approval of Ilaris® for the treatment and prevention of gout. In June of 2011, Novartis

announced that an advisory committee of the FDA voted in favor of the overall efficacy but not the overall safety of canakinumab to treat gouty arthritis attacks in patients who cannot obtain adequate relief with non-steroidal anti-inflammatory drugs or colchicine. In August of 2011, Novartis announced that the FDA had issued a Complete Response letter requesting additional information, including clinical data to evaluate the benefit risk profile of canakinumab in refractory gouty arthritis patients. In September of 2011, Novartis announced positive results of a pivotal Phase 3 trial of canakinumab in patients with SJIA and that it plans to seek regulatory approval for this indication in 2012.

- Eli Lilly and Company ("Lilly") is developing LY2189102, an investigational IL-1 beta antibody, for subcutaneous injection for the treatment of Type 2 diabetes. In June of 2011, Lily disclosed at a scientific conference that, in a double-blind, placebo controlled Phase 2 study of 106 patients with Type 2 diabetes, a significant ($p<0.05$), early reduction in C reactive protein occurred, HbA1c was moderately reduced and anti-inflammatory effects were shown.

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- In 2008, Biovitrum AB (now called Swedish Orphan Biovitrum, "Biovitrum") obtained a worldwide exclusive license to Amgen Inc.'s ("Amgen") Kineret® (anakinra) for its current approved indication. Kineret® is an IL-1 receptor antagonist (IL-1ra) currently marketed to treat rheumatoid arthritis and has been evaluated over the years in multiple IL-1 mediated diseases, including indications we are considering for gevokizumab. In addition to other on-going studies, a proof-of-concept clinical trial in the United Kingdom investigating Kineret® in patients with a certain type of myocardial infarction, or heart attack, has been completed. In August of 2010, Biovitrum announced that the FDA had granted orphan drug designation to Kineret® for the treatment of CAPS.

- In February of 2008, Regeneron Pharmaceuticals, Inc. ("Regeneron") announced it had received marketing approval from the FDA for ARCALYST® (rilonacept) Injection for Subcutaneous Use, an interleukin-1 blocker or IL-1 Trap, for the treatment of CAPS, including Familial Cold Auto-inflammatory Syndrome and Muckle-Wells Syndrome in adults and children 12 and older. In September of 2009, Regeneron announced that rilonacept was approved in the European Union for CAPS. In June of 2010 and February of 2011, Regeneron announced positive results of two Phase 3 clinical trials of rilonacept in gout. In March of 2011, Regeneron disclosed that it intends to file a supplemental BLA for ARCALYST® for the prevention and treatment of gout.

- Amgen has been developing AMG 108, a fully-human monoclonal antibody that targets inhibition of the action of IL-1. In April of 2008, Amgen discussed results from a Phase 2 study in rheumatoid arthritis. AMG 108 showed statistically significant improvement in the signs and symptoms of rheumatoid arthritis and was well tolerated. In January of 2011, MedImmune, the worldwide biologics unit for AstraZeneca PLC, announced that Amgen granted it rights to develop AMG 108 worldwide except in Japan.

- In June of 2009, Cytos Biotechnology AG announced the initiation of an ascending dose Phase 1/2a study of CYT013-IL1bQb, a therapeutic vaccine targeting IL-1 beta, in Type 2 diabetes. In 2010, this study was extended to include two additional groups of patients.

- We are aware that the following companies have completed or are conducting or planning Phase 3 clinical trials of the following products for the treatment of uveitis: Abbott - HUMIRA® (adalimumab); Lux Biosciences, Inc. - LUVENIQ (voclosporin); Novartis - Myfortic® (mycophenalate sodium) and Santen Pharmaceutical Co., Ltd. - Sirolimus (rapamycin).

XOMA 3AB

We are also developing XOMA 3AB, a combination, or cocktail, of antibodies designed to neutralize the most potent of botulinum toxins. Other companies are developing other products targeting botulism poisoning and these products may prove more effective than XOMA 3AB. We are aware that:

- In May of 2006, the U.S. Department of Health & Human Services ("DHHS") awarded Cangene Corporation ("Cangene") a five-year, $362.0 million contract under Project Bioshield. The contract requires Cangene to manufacture and supply 200,000 doses of an equine heptavalent botulism anti-toxin to treat individuals who have been exposed to the toxins that cause botulism. In May of 2008, Cangene announced significant product delivery under this contract. In March of 2010, this contract was extended for an additional two years, until May of 2013. In June of 2011, Cangene announced that DHHS will exercise options under the supply contract which are expected to increase the total contract to $423.0 million and to extend the delivery schedule to 2018.

- Emergent BioSolutions, Inc. ("Emergent") is currently in development of a botulism immunoglobulin candidate that may compete with our anti-botulinum neurotoxin monoclonal antibodies.

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We are aware of additional companies that are pursuing biodefense-related antibody products. PharmAthene, Inc. and Human Genome Sciences, Inc. are developing anti-anthrax antibodies. Cangene and Emergent are developing anti-anthrax immune globulin products. These products may compete with our efforts in the areas of other monoclonal antibody-based biodefense products and the manufacture of antibodies to supply strategic national stockpiles.

Manufacturing risks and inefficiencies may adversely affect our ability to manufacture products for ourselves or others.

To the extent we continue to provide manufacturing services for our own benefit or to third parties, we are subject to manufacturing risks. Additionally, unanticipated fluctuations in customer requirements have led and may continue to lead to manufacturing inefficiencies, which if significant could lead to an impairment on our long-lived assets or restructuring activities. We must utilize our manufacturing operations in compliance with regulatory requirements, in sufficient quantities and on a timely basis, while maintaining acceptable product quality and manufacturing costs. Additional resources and changes in our manufacturing processes may be required for each new product, product modification or customer or to meet changing regulatory or third party requirements, and this work may not be successfully or efficiently completed. In addition, to the extent we continue to provide manufacturing services, our fixed costs, such as facility costs, would be expected to increase, as would necessary capital investment in equipment and facilities.

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Manufacturing and quality problems may arise in the future to the extent we continue to perform these services for our own benefit or for third parties. Consequently, our development goals or milestones may not be achieved in a timely manner or at a commercially reasonable cost, or at all. In addition, to the extent we continue to make investments to improve our manufacturing operations, our efforts may not yield the improvements that we expect.

Because many of the companies we do business with are also in the biotechnology sector, the volatility of that sector can affect us indirectly as well as directly.

As a biotechnology company that collaborates with other biotechnology companies, the same factors that affect us directly can also adversely impact us indirectly by affecting the ability of our collaborators, partners and others we do business with to meet their obligations to us and reduce our ability to realize the value of the consideration provided to us by these other companies.

For example, in connection with our licensing transactions relating to our bacterial cell expression technology, we have in the past and may in the future agree to accept equity securities of the licensee in payment of license fees. The future value of these or any other shares we receive is subject both to market risks affecting our ability to realize the value of these shares and more generally to the business and other risks to which the issuer of these shares may be subject.

As we do more business internationally, we will be subject to additional political, economic and regulatory uncertainties.

We may not be able to successfully operate in any foreign market. We believe that, because the pharmaceutical industry is global in nature, international activities will be a significant part of our future business activities and that, when and if we are able to generate income, a substantial portion of that income will be derived from product sales and other activities outside the United States. Foreign regulatory agencies often establish standards different from those in the United States, and an inability to obtain foreign regulatory approvals on a timely basis could put us at a competitive disadvantage or make it uneconomical to proceed with a product or product candidate's development. International operations and sales may be limited or disrupted by:

- imposition of government controls,
- export license requirements,
- political or economic instability,
- trade restrictions,
- changes in tariffs,
- restrictions on repatriating profits,
- exchange rate fluctuations,
- withholding and other taxation, and
- difficulties in staffing and managing international operations.

We are subject to foreign currency exchange rate risks.

We are subject to foreign currency exchange rate risks because substantially all of our revenues and operating expenses are paid in U.S. dollars, but we pay interest and principal obligations with respect to our loan from Servier in Euros. To the extent that the U.S. dollar declines in value against the Euro, the effective cost of servicing our Euro-denominated debt will be higher. Changes in the exchange rate result in foreign currency gains or losses. Although we have managed some of our exposure to changes in foreign currency exchange rates by entering into foreign exchange option contracts, there can be no assurance that foreign currency fluctuations will not have a material adverse effect on our business, financial condition, liquidity or results of operations. In addition, our foreign exchange option contracts are re-valued at each financial reporting period, which may also result in gains or losses from time to time.

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If we and our partners are unable to protect our intellectual property, in particular our patent protection for our principal products, product candidates and processes, and prevent its use by third parties, our ability to compete in the market will be harmed, and we may not realize our profit potential.

We rely on patent protection, as well as a combination of copyright, trade secret, and trademark laws to protect our proprietary technology and prevent others from duplicating our products or product candidates. However, these means may afford only limited protection and may not:

- prevent our competitors from duplicating our products,
- prevent our competitors from gaining access to our proprietary information and technology, or
- permit us to gain or maintain a competitive advantage.

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our collaboration and development partners hold and are in the process of applying for a number of patents in the United States and abroad to protect our product candidates and important processes and also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the mere issuance of a patent is not conclusive as to its validity or its enforceability. The United States Federal Courts or equivalent national courts or patent offices elsewhere may invalidate our patents or find them unenforceable. In addition, the laws of foreign countries may not protect our intellectual property rights effectively or to the same extent as the laws of the United States. If our intellectual property rights are not adequately protected, we may not be able to commercialize our technologies, products, or services, and our competitors could commercialize our technologies, which could result in a decrease in our sales and market share that would harm our business and operating results. Specifically, the patent position of biotechnology companies generally is highly uncertain and involves complex legal and factual questions. The legal standards governing the validity of biotechnology patents are in transition, and current defenses as to issued biotechnology patents may not be adequate in the future. Accordingly, there is uncertainty as to:

- whether any pending or future patent applications held by us will result in an issued patent, or that if patents are issued to us, that such patents will provide meaningful protection against competitors or competitive technologies,
- whether competitors will be able to design around our patents or develop and obtain patent protection for technologies, designs or methods that are more effective than those covered by our patents and patent applications, or
- the extent to which our product candidates could infringe on the intellectual property rights of others, which may lead to costly litigation, result in the payment of substantial damages or royalties, and/or prevent us from using technology that is essential to our business.

We have established an extensive portfolio of patents and applications, both United States and foreign, related to our BPI-related product candidates, including novel compositions, their manufacture, formulation, assay and use. We have also established a portfolio of patents, both United States and foreign, related to our bacterial cell expression technology, including claims to novel promoter sequences, secretion signal sequences, compositions and methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products. Most of the more important European patents in our bacterial cell expression patent portfolio expired in July of 2008.

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require licenses from others in order to develop and commercialize certain potential products incorporating our technology or we may become involved in litigation to determine the proprietary rights of others. These licenses, if

required, may not be available on acceptable terms, and any such litigation may be costly and may have other adverse effects on our business, such as inhibiting our ability to compete in the marketplace and absorbing significant management time.

Due to the uncertainties regarding biotechnology patents, we also have relied and will continue to rely upon trade secrets, know-how and continuing technological advancement to develop and maintain our competitive position. All of our employees have signed confidentiality agreements under which they have agreed not to use or disclose any of our proprietary information. Research and development contracts and relationships between us and our scientific consultants and potential customers provide access to aspects of our know-how that are protected generally under confidentiality agreements. These confidentiality agreements may be breached or may not be enforced by a court. To the extent proprietary information is divulged to competitors or to the public generally, such disclosure may adversely affect our ability to develop or commercialize our products by giving others a competitive advantage or by undermining our patent position.

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Litigation regarding intellectual property can be costly and expose us to risks of counterclaims against us.

We may be required to engage in litigation or other proceedings to protect our intellectual property. The cost to us of this litigation, even if resolved in our favor, could be substantial. Such litigation could also divert management's attention and resources. In addition, if this litigation is resolved against us, our patents may be declared invalid, and we could be held liable for significant damages. In addition, we may be subject to a claim that we are infringing another party's patent. If such claim is resolved against us, we or our collaborators may be enjoined from developing, manufacturing, selling or importing products, processes or services unless we obtain a license from the other party. Such license may not be available on reasonable terms, thus preventing us from using these products, processes or services and adversely affecting our revenue.

Even if we or our third party collaborators or licensees bring products to market, we may be unable to effectively price our products or obtain adequate reimbursement for sales of our products, which would prevent our products from becoming profitable.

If we or our third party collaborators or licensees succeed in bringing our product candidates to the market, they may not be considered cost-effective, and reimbursement to the patient may not be available or may not be sufficient to allow us to sell our products on a competitive basis. In both the United States and elsewhere, sales of medical products and treatments are dependent, in part, on the availability of reimbursement to the patient from third-party payors, such as government and private insurance plans. Third-party payors are increasingly challenging the prices charged for pharmaceutical products and services. Our business is affected by the efforts of government and third-party payors to contain or reduce the cost of healthcare through various means. In the United States, there have been and will continue to be a number of federal and state proposals to implement government controls on pricing.

In addition, the emphasis on managed care in the United States has increased and will continue to increase the pressure on the pricing of pharmaceutical products. We cannot predict whether any legislative or regulatory proposals will be adopted or the effect these proposals or managed care efforts may have on our business.

Healthcare reform measures and other statutory or regulatory changes could adversely affect our business.

In both the United States and certain foreign jurisdictions, there have been a number of legislative and regulatory proposals to change the healthcare system in ways that could impact our business. In March of 2010, the U.S. Congress enacted and President Obama signed into law the Patient Protection and Affordable Care Act, which includes a number of healthcare reform provisions. Assuming the new law survives recent calls for its repeal, the reforms imposed by the new law would significantly impact the pharmaceutical industry, most likely in the area of pharmaceutical product pricing; however, the full effects of new law cannot be known until these provisions are implemented and the relevant federal and state agencies issue applicable regulations or guidance.

The pharmaceutical and biotechnology industries are subject to extensive regulation, and from time to time legislative bodies and governmental agencies consider changes to such regulations that could have significant impact on industry participants. For example, in light of certain highly-publicized safety issues regarding certain drugs that had received marketing approval, the U.S. Congress has considered various proposals regarding drug safety, including some which would require additional safety studies and monitoring and could make drug development more costly. We are unable to predict what additional legislation or regulation, if any, relating to safety or other aspects of drug development may be enacted in the future or what effect such legislation or regulation would have on our business.

The business and financial condition of pharmaceutical and biotechnology companies are also affected by the efforts of governments, third-party payors and others to contain or reduce the costs of healthcare to consumers. In the United States and various foreign jurisdictions there have been, and we expect that there will continue to be, a number of

legislative and regulatory proposals aimed at changing the healthcare system, such as proposals relating to the reimportation of drugs into the U.S. from other countries (where they are then sold at a lower price) and government control of prescription drug pricing. The pendency or approval of such proposals could result in a decrease in our share price or limit our ability to raise capital or to obtain strategic collaborations or licenses.

We are exposed to an increased risk of product liability claims, and a series of related cases is currently pending against us.

The testing, marketing and sales of medical products entails an inherent risk of allegations of product liability. In the event of one or more large, unforeseen awards of damages against us, our product liability insurance may not provide adequate coverage. A significant product liability claim for which we were not covered by insurance would have to be paid from cash or other assets. To the extent we have sufficient insurance coverage, such a claim would result in higher subsequent insurance rates. In addition, product liability claims can have various other ramifications including loss of future sales opportunities, increased costs associated with replacing products, and a negative impact on our goodwill and reputation, which could also adversely affect our business and operating results.

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On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned Hedrick et al. v. Genentech, Inc. et al, Case No. 09-446158. The complaint asserts claims against Genentech, us and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals' treatment with RAPTIVA®. The complaint seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to seventy six. The cases have been consolidated as a coordinated proceeding. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. On July 15, 2011, the Court dismissed with prejudice one of the cases in this coordinated proceeding, White v. Genentech, Inc., et al, Case No. RG-09-484026. On September 8, 2011, the Court granted defendants' Motions for Summary Judgment in two cases, Guerrero (Case No. RG-10-518396) and Harwell (Case No. RG-09-464039), and dismissed both cases. On September 19, 2011, the Court sustained defendants' Demurrer to another case (Young, Case No. RG-11-569879) and dismissed the complaint. On October 19, 2011, the Court granted defendants' Motion for Summary Judgment in Krawiec v. Genentech, Inc., et al., Case No. RG10-524963. Even though Genentech has agreed to indemnify us in connection with these matters, there can be no assurance that these or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such liabilities.

On August 4, 2010, a petition was filed in the District Court of Dallas County, Texas in a case captioned McCall v. Genentech, Inc., et al., No. 10-09544. The defendants filed a Notice of Removal to the United States District Court for the Northern District of Texas on September 3, 2010. The removed case is captioned McCall v. Genentech, Inc., et al., No. 3:10-cv-01747-B. The parties have fully briefed the plaintiff's Motion to Remand and are awaiting a final ruling from the Court. The petition asserts personal injury claims against Genentech, us and others arising out of the plaintiff's treatment with RAPTIVA®. The petition alleges claims based on negligence, strict liability, misrepresentation and suppression, conspiracy, and actual and constructive fraud. The petition seeks compensatory damages and punitive damages in an unspecified amount. On June 6, 2011, the Court dismissed plaintiff's claims of negligent misrepresentation, fraud, and conspiracy. Even though Genentech has agreed to indemnify us in connection with this matter, there can be no assurance that this or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such liabilities.

On January 7, 2011, a complaint was filed in the United States District Court for the Northern District of Texas in a case captioned Massa v. Genentech, Inc., et al., No. 4:11CV70. On January 11, 2011, a complaint was filed in the United States District Court for the District of Massachusetts in a case captioned Sylvia, et al. v. Genentech, Inc., et al., No. 1:11-cv-10054-MLW. These two complaints allege the same claims against Genentech, us and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. Even though Genentech has agreed to indemnify us in connection with these matters, there can be no assurance that these or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such liabilities.

On April 8, 2011, four complaints were filed in the United States District Court for the Eastern District of Michigan. The cases are captioned: Muniz v. Genentech, et al., 5:11-cv-11489-JCO-RSW; Tifenthal v. Genentech, et al., 2:11-cv-11488-DPH-LJM; Blair v. Genentech, et al., 2:11-cv-11463-SFC-MJH; and Marsh v. Genentech, et al., 2:11-cv-11462-RHC-MKM. The complaints allege the same claims against Genentech, us and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. All four cases have been transferred to the United States District Court for the Western District of Michigan. On October 26, 2011, the Court granted the Motions to Dismiss filed by Genentech and the Company in all four actions. Plaintiffs have filed a Notice of Appeal in each case. Even though Genentech has agreed to indemnify us in connection with these matters, there can be no assurance that these or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such

liabilities.

The loss of key personnel, including our Interim Chief Executive Officer, could delay or prevent achieving our objectives.

Our research, product development and business efforts could be adversely affected by the loss of one or more key members of our scientific or management staff, particularly our executive officers: John Varian, our Interim Chief Executive Officer; Patrick J. Scannon, M.D., Ph.D., our Executive Vice President and Chief Scientific Officer; Fred Kurland, our Vice President, Finance and Chief Financial Officer; Christopher J. Margolin, our Vice President, General Counsel and Secretary; and Paul Rubin, M.D., our Vice President, Clinical Development and Chief Medical Officer. We currently have no key person insurance on any of our employees.

Effective August 31, 2011, our previous Chairman of the Board, Chief Executive Officer and President, Steven B. Engle, resigned from those positions and John Varian, who is also a member of our Board, was appointed Interim Chief Executive Officer. Our Board has initiated a search for a permanent Chief Executive Officer, but there can be no assurance that a suitable candidate will be found or hired.

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A U.S. holder of our common shares or warrants could be subject to material adverse U.S. federal income tax consequences if we were considered to be a PFIC at any time during the U.S. holder's holding period.

Although we have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware, we have not yet done so and we currently remain a Bermuda company.

A non-U.S. corporation generally will be a "passive foreign investment company," or PFIC, for U.S. federal income tax purposes in any taxable year in which, after applying the relevant look-through rules with respect to the income and assets of its subsidiaries, either 75% or more of its gross income is "passive income" (generally including (without limitation) dividends, interest, annuities and certain royalties and rents not derived in the active conduct of a business) or the average value of its assets that produce passive income or are held for the production of passive income is at least 50% of the total value of its assets. In determining whether we meet the 50% test, cash is considered a passive asset and the total value of our assets generally will be treated as equal to the sum of the aggregate fair market value of our outstanding common shares plus our liabilities. If we own at least 25% (by value) of the stock of another corporation, we will be treated, for purposes of the PFIC tests, as owning our proportionate share of the other corporation's assets and receiving our proportionate share of the other corporation's income.

We believe that we were not a PFIC for the 2010 taxable year. However, because PFIC status is determined annually and depends on the composition of a company's income and assets and the fair market value of its assets (including goodwill), which may be volatile in our industry, there can be no assurance that we will not be considered a PFIC for 2011 or any subsequent year. For example, taking into account our existing cash balances, if the value of our common shares were to decline materially, it is possible that we could become a PFIC in 2011 or a subsequent year. Additionally, due to the complexity of the PFIC provisions and the limited authority available to interpret such provisions, there can be no assurance that our determination regarding our PFIC status could not be successfully challenged by the Internal Revenue Service ("IRS").

If we were found to be a PFIC for any taxable year in which a U.S. holder (as defined below) held common shares or warrants, certain adverse U.S. federal income tax consequences could apply to such U.S. holder, including a recharacterization of any capital gain recognized on a sale or other disposition of common shares or warrants (which may include an exchange of common shares or warrants in the Domestication) as ordinary income, ineligibility for any preferential tax rate otherwise applicable to any "qualified dividend income," a material increase in the amount of tax that such U.S. holder would owe and the possible imposition of interest charges, an imposition of tax earlier than would otherwise be imposed and additional tax form filing requirements.

For purposes of this discussion, the term "U.S. holder" means a beneficial owner of common shares or warrants that is, for U.S. federal income tax purposes, (i) an individual who is a U.S. citizen or resident, (ii) a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia, (iii) an estate the income of which is includable in gross income for U.S. income tax purposes regardless of its source, or (iv) a trust, if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust, or if the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person. Special rules apply to a U.S. investor who owns our common shares or warrants through an entity treated as a partnership for U.S. federal income tax purposes.

A U.S. holder owning shares in a PFIC (or a corporation that might become a PFIC) might be able to mitigate the adverse tax consequences of PFIC status by making certain elections, including "qualified electing fund" (a "QEF") or "mark-to-market" elections, if deemed appropriate based on guidance provided by the U.S. holder's tax advisor. However, it should be noted that (1) the beneficial effect of a QEF election or a mark-to-market election may be substantially diminished if such election is not made from the inception of a U.S. holder's holding period (a "Year One

Election"), (2) neither a QEF election nor a mark-to-market election can be made with respect to warrants, (3) a Year One Election generally cannot be made for any common shares received upon exercise of warrants ("Warrant Shares") because the holding period of Warrant Shares is deemed, for QEF election and mark-to-market election purposes, to include the holding period of the underlying warrants but the QEF election or mark-to-market election will not be effective until the underlying warrants are exercised, and (4) a QEF election or a mark-to-market election is made on a shareholder-by-shareholder basis and, once made, can only be revoked with the consent of the IRS.

The PFIC rules are very complex, as are the requirements and effects of the various elections designed to mitigate the adverse consequences of the PFIC rules. A U.S. holder should consult its own tax advisor regarding the PFIC rules, including the foregoing limitations on the ability to make a QEF election or a mark-to-market election (or to qualify either such election as a Year One Election), the timing requirements with respect to the various elections and the irrevocability of certain elections (absent the consent of the IRS).

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As a result of a recent legislative change, a U.S. holder generally will be required to file IRS Form 8621 if the U.S. holder holds our common shares or warrants in any taxable year in which we are classified as a PFIC (whether or not a QEF or mark-to-market election is made).

Our ability to use our net operating loss carry-forwards and other tax attributes will be substantially limited by Section 382 of the Internal Revenue Code.

Section 382 of the Internal Revenue Code of 1986, as amended, generally limits the ability of a corporation that undergoes an "ownership change" to utilize its net operating loss carry-forwards ("NOLs") and certain other tax attributes against any taxable income in taxable periods after the ownership change. The amount of taxable income in each taxable year after the ownership change that may be offset by pre-change NOLs and certain other pre-change tax attributes is generally equal to the product of (a) the fair market value of the corporation's outstanding shares (or, in the case of a foreign corporation, the fair market value of items treated as connected with the conduct of a trade or business in the United States) immediately prior to the ownership change and (b) the long-term tax exempt rate (i.e., a rate of interest established by the IRS that fluctuates from month to month). In general, an "ownership change" occurs whenever the percentage of the shares of a corporation owned, directly or indirectly, by "5-percent shareholders" (within the meaning of Section 382 of the Internal Revenue Code) increases by more than 50 percentage points over the lowest percentage of the shares of such corporation owned, directly or indirectly, by such "5-percent shareholders" at any time over the preceding three years.

Based on our initial analysis under Section 382 (which subjects the amount of pre-change NOLs and certain other pre-change tax attributes that can be utilized to an annual limitation), we experienced an ownership change in 2009, which would substantially limit the future use of our pre-change NOLs and certain other pre-change tax attributes per year. We have and will continue to evaluate alternative analyses permitted under Section 382 and IRS notices in order to determine whether or not any ownership changes have occurred and may occur (and if so, when they occurred) that would result in limitations on our NOLs or certain other tax attributes.

Recently proposed legislation, if enacted, could subject us to U.S. federal income taxation as if we were a U.S. corporation.

Although we have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware, we have not yet done so and we currently remain a Bermuda company.

A bill recently introduced in the House of Representatives provides in certain instances that a foreign corporation would, for any taxable year beginning on or after the second anniversary of the bill's enactment, be treated as a U.S. corporation for U.S. federal income taxes purposes if such corporation were managed and controlled primarily in the United States. If this bill were enacted in 2011 in its present form and we were to make no changes to our current management structure, we would likely be treated, beginning in 2014, as a U.S. corporation subject to U.S. federal income taxation on our worldwide income. A similar bill has also been recently introduced in the Senate. There can be no assurance that the foregoing bills or another similar legislative proposal will not become law.

Because we are a relatively small biopharmaceutical company with limited resources, we may not be able to attract and retain qualified personnel.

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. We had approximately 240 employees as of November 7, 2011. We may require additional experienced executive, accounting, research and development, legal, administrative and other personnel from time to time in the future. There is intense competition for the services of these personnel, especially

in California. Moreover, we expect that the high cost of living in the San Francisco Bay Area, where our headquarters and manufacturing facilities are located, may impair our ability to attract and retain employees in the future. If we do not succeed in attracting new personnel and retaining and motivating existing personnel, our operations may suffer and we may be unable to implement our current initiatives or grow effectively.

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Calamities, power shortages or power interruptions at our Berkeley headquarters and manufacturing facility could disrupt our business and adversely affect our operations, and could disrupt the businesses of our customers.

Our principal operations are located in Northern California, including our corporate headquarters and manufacturing facility in Berkeley, California. In addition, many of our collaborators and licensees are located in California. All of these locations are in areas of seismic activity near active earthquake faults. Any earthquake, terrorist attack, fire, power shortage or other calamity affecting our facilities or our customers' facilities may disrupt our business and could have material adverse effect on our business and results of operations.

We may be subject to increased risks because we are a Bermuda company.

Although we have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware, we have not yet done so and we currently remain a Bermuda company.

Alleged abuses by certain companies that have changed their legal domicile from jurisdictions within the United States to Bermuda have created an environment where, notwithstanding that we changed our legal domicile in a transaction that was approved by our shareholders and fully taxable to our company under United States law, we may be exposed to various prejudicial actions, including:

- "blacklisting" of our common shares by certain pension funds,
- legislation restricting certain types of transactions, and
- punitive tax legislation.

We do not know whether any of these things will happen, but if implemented one or more of them may have an adverse impact on our future operations or our share price.

It may be difficult to enforce a judgment obtained against us because we are a foreign entity.

Although we have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware, we have not yet done so and we currently remain a Bermuda company.

All or a substantial portion of our assets, including substantially all of our intellectual property, may be located outside the United States. As a result, it may be difficult for shareholders and others to enforce in United States courts judgments obtained against us. We have irrevocably agreed that we may be served with process with respect to actions based on offers and sales of securities made hereby in the United States by serving Christopher J. Margolin, c/o XOMA Ltd., 2910 Seventh Street, Berkeley, California 94710, our United States agent appointed for that purpose. Uncertainty exists as to whether Bermuda courts would enforce judgments of United States courts obtained in actions against us or our directors and officers that are predicated upon the civil liability provisions of the United States securities laws or entertain original actions brought in Bermuda against us or such persons predicated upon the United States securities laws. There is no treaty in effect between the United States and Bermuda providing for such enforcement, and there are grounds upon which Bermuda courts may not enforce judgments of United States courts. Certain remedies available under the United States federal securities laws may not be allowed in Bermuda courts as contrary to that nation's policy.

Our shareholder rights agreement, Bermuda bye-laws and proposed Delaware organizational documents contain provisions that may prevent transactions that could be beneficial to our shareholders and may insulate our management from removal.

In February of 2003, we adopted a new shareholder rights agreement (to replace the shareholder rights agreement that had expired), which could make it considerably more difficult or costly for a person or group to acquire control of us in a transaction that our Board of Directors opposes. We have announced our intention to change our jurisdiction of incorporation from Bermuda to Delaware, and if we do so we intend to keep our rights agreement in place following the Domestication.

Our Bermuda bye-laws currently, and our proposed Delaware organizational documents will:

- require certain procedures to be followed and time periods to be met for any shareholder to propose matters to be considered at annual meetings of shareholders, including nominating directors for election at those meetings; and

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- authorize our Board of Directors to issue up to 1,000,000 preference shares without shareholder approval and to set the rights, preferences and other designations, including voting rights, of those shares as the Board of Directors may determine.

In addition, our Bermuda bye-laws currently contain provisions, similar to those contained in the Delaware General Corporation Law (the "DGCL"), that may make business combinations with interested shareholders more difficult, and upon effectiveness of the Domestication these provisions of the DGCL will apply to us.

These provisions of our shareholders rights agreement, our Bermuda bye-laws, our proposed Delaware organizational documents and, once applicable, the DGCL, alone or in combination with each other, may discourage transactions involving actual or potential changes of control, including transactions that otherwise could involve payment of a premium over prevailing market prices to holders of common shares or common stock, could limit the ability of shareholders to approve transactions that they may deem to be in their best interests, and could make it considerably more difficult for a potential acquirer to replace management.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

On November 9, 2011, the Company issued the press release attached hereto as Exhibit 99.2 furnished herewith relating to the expansion of its gevokizumab development program.

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ITEM 6. EXHIBITS

Exhibit Number	
10.1	Form of Restricted Share Unit Agreement for 2010 Long Term Incentive and Share Award Plan
31.1	Certification of John Varian, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Fred Kurland, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of John Varian, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Fred Kurland, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.1	Earnings Press Release dated November 9, 2011, furnished herewith
99.2	Gevokizumab Press Release dated November 9, 2011, furnished herewith
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

XOMA Ltd.

Date: November 9, 2011	By:	/s/ JOHN VARIAN John Varian Interim Chief Executive Officer (principal executive officer)
Date: November 9, 2011	By:	/s/ FRED KURLAND Fred Kurland Vice President, Finance and Chief Financial Officer (principal financial officer and chief accounting officer)