XOMA Corp
Form 10-Q
May 08, 2012

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

FORM 10-Q

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

For the quarterly period ended March 31, 2012

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 Corporation
(Exact name of registrant as specified in its charter)

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

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

Indicate by 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 ¨ 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 May 4, 2012
Common Stock, $0.0075 par value	68,083,980

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PART I - FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

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

	March 31, 2012 (unaudited)	December 31, 2011 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$74,887	$ 48,344
Trade and other receivables, net	10,164	12,332
Prepaid expenses and other current assets	3,674	2,019
Total current assets	88,725	62,695
Property and equipment, net	10,329	12,709
Other assets	2,268	2,632
Total assets	$101,322	$ 78,036
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,852	$ 2,128
Accrued and other liabilities	6,297	10,012
Deferred revenue	6,912	5,695
Interest bearing obligation – current	2,796	2,796
Total current liabilities	18,857	20,631
Deferred revenue – long-term	7,207	7,539
Interest bearing obligations – long-term	33,569	33,524
Contingent warrant liabilities	21,122	379
Other liabilities - long term	1,079	952
Total liabilities	81,834	63,025
Stockholders' equity:		
Preferred stock, $0.05 par value, 1,000,000 shares authorized	-	-
Common stock, $0.0075 par value, 92,666,666 shares authorized, 68,076,152 and 35,107,007 shares outstanding at March 31, 2012 and December 31, 2011, respectively	511	263
Additional paid-in capital	935,455	900,801
Accumulated deficit	(916,478)	(886,053)
Total stockholders' equity	19,488	15,011
Total liabilities and stockholders' equity	$101,322	$ 78,036

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

(Note 1) The condensed consolidated balance sheet as of December 31, 2011 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, 2011.

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

	Three months ended March 31, 2012	2011
Revenues:		
License and collaborative fees	$ 1,014	$ 5,827
Contract and other	8,851	9,768
Total revenues	9,865	15,595
Operating expenses:		
Research and development	15,771	17,347
Selling, general and administrative	4,679	5,369
Restructuring	3,777	-
Total operating expenses	24,227	22,716
Loss from operations	(14,362)	(7,121)
Other income (expense):		
Interest expense	(1,042)	(532)
Other expense	(664)	(1,057)
Revaluation of contingent warrant liabilities	(14,357)	2,390
Net loss before taxes	(30,425)	(6,320)
Provision for income tax expense	-	(15)
Net loss	$ (30,425)	$ (6,335)
Basic and diluted net loss per share of common stock	$ (0.69)	$ (0.22)
Shares used in computing basic and diluted net loss per share of common stock	44,353	29,180

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

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

	Three Months Ended March 31, 2012	2011
Cash flows from operating activities:		
Net loss	$ (30,425)	$ (6,335)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	1,265	1,346
Common stock contribution to 401(k)	1,134	1,046
Stock-based compensation expense	674	1,772
Accrued interest on interest bearing obligations	394	231
Revaluation of contingent warrant liabilities	14,357	(2,390)
Restructuring charge related to long-lived assets	1,707	-
Amortization of discount and final payment fee on debt and debt issuance costs	467	298
Unrealized loss on foreign currency exchange	376	1,619
Unrealized loss on foreign exchange options	276	-
Other non-cash adjustments	(43)	10
Changes in assets and liabilities:		
Trade and other receivables, net	2,168	10,631
Prepaid expenses and other assets	(1,651)	247
Accounts payable and accrued liabilities	(3,221)	(5,429)
Deferred revenue	884	(6,156)
Other liabilities	(37)	(90)
Net cash used in operating activities	(11,675)	(3,200)
Cash flows from investing activities:		
Purchase of property and equipment	(548)	(888)
Net cash used in investing activities	(548)	(888)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	39,480	4,129
Proceeds from issuance of long-term debt	-	20,102
Principal payments of debt	(714)	-
Net cash provided by financing activities	38,766	24,231
Effect of exchange rate changes on cash	-	(573)
Net increase in cash and cash equivalents	26,543	20,143
Cash and cash equivalents at the beginning of the period	48,344	37,304
Cash and cash equivalents at the end of the period	$ 74,887	$ 56,874
Supplemental Cash Flow Information:		
Cash paid during the quarter for:		
Income taxes	$ -	$ 15
Non-cash investing and financing activities:		
Discount on long-term debt		$ (8,899)
Issuance of contingent warrant liabilities	$ 6,386	$ -

Interest added to principal balances on long-term debt	$ 398	$ -

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

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XOMA Corporation
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of Business

XOMA Corporation ("XOMA" or the "Company"), a Delaware corporation, combines a portfolio of late-stage clinical programs and research activities to develop innovative therapeutic antibodies with its recently launched commercial operations. XOMA focuses its scientific research on allosteric modulation, which offers opportunities for new classes of therapeutic antibodies to treat a wide range of human diseases. XOMA is developing its lead product gevokizumab (IL-1 beta modulating antibody) with Les Laboratoires Servier ("Servier") through a global Phase 3 program and ongoing proof-of-concept studies in other IL-1-mediated diseases. XOMA's scientific research also has produced the XMet platform, which consists of three classes of preclinical antibodies, including Selective Insulin Receptor Modulators that could offer new approaches in the treatment of diabetes. In order to retain significant value from its scientific discoveries, XOMA initiated commercial operations in January 2012 through the licensing of U.S. commercial rights to Servier's ACEON® (perindopril erbumine) and certain U.S. rights to a patent-protected portfolio of fixed dose combination product candidates where perindopril is combined with other active ingredients to treat cardiovascular disease. XOMA has the right to develop and commercialize one of these product candidates and options to develop and commercialize two more product candidates, all for the U.S. market.

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, 2011, filed with the U.S. Securities and Exchange Commission ("SEC") on March 14, 2012.

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 March 31, 2012, the consolidated results of the Company's operations and the Company's cash flows for the three months ended March 31, 2012 and 2011. 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 contingent warrant liabilities, revenue recognition, research and development expense, long-lived assets, restructuring liabilities, derivative instruments and stock-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.

At March 31, 2012, the Company changed its expected volatility assumption in the Black-Scholes Option Pricing Model ("Black-Scholes Model") used to calculate the fair value of its contingent warrant liabilities. The Company changed its assumption from an estimate of volatility based on historical stock price volatility observed on XOMA's underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions, which was determined to be a more precise indicator for the fair value calculation of the Company's warrants.

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Reclassifications

Certain reclassifications of prior period amounts have been made to the financial statements and accompanying notes to conform to the current period presentation. Prior period presentation of contingent warrant liabilities has been reclassified from current liabilities to long-term liabilities based on the contingent nature of these obligations. These contingent warrant liabilities represent a conditional obligation of the Company to repurchase certain warrants for cash in the event of a change in control. In addition, gain or loss on revaluation of the contingent warrant liabilities included in the other income (expense) line of the condensed consolidated statement of operations in the prior period has been reclassified to the revaluation of contingent warrant liabilities line of the condensed consolidated statement of operations. These reclassifications had no impact on the Company's previously reported net loss or cash flows.

Long-lived Assets

The Company reviews the carrying values and depreciation estimates of its long-lived assets whenever events or changes in circumstances indicate that the asset may not be recoverable. An impairment loss is recognized when the estimated future net cash flows expected to result from the use of an asset is less than its carrying amount. Long-lived assets include property and equipment and building and leasehold improvements. During the three months ended March 31, 2012, the Company recorded an impairment loss of $0.8 million and accelerated depreciaton of $0.9 million on long-lived assets in connection with the Company's 2012 streamlining plan. See Note 6: Streamlining and Restructuring Charges for additional disclosure on the 2012 streamlining plan.

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 2012.

The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the three months ended March 31, 2012, two customers represented 49% and 40% of total revenue and 63% and 37% of the accounts receivable balance.

For the three months ended March 31, 2011, these two customers represented 51% and 44% of total revenues. As of December 31, 2011, there were receivables outstanding from these two customers representing 57% and 43% of the accounts receivable balance.

Newly Adopted Accounting Pronouncements

In May 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 adopted this guidance as of January 1, 2012 on a retrospective basis and this adoption did not have a material effect on the Company's consolidated financial statements.

In June 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 adopted this guidance as of January 1, 2012 on a retrospective basis and this adoption 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 both the three months ended March 31, 2012 and 2011.

Net Loss Per Share of Common Stock

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

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

	Three Months Ended March 31,	
	2012	2011
Common stock options and restricted stock units	5,722	2,638
Convertible preferred stock	-	254
Warrants for common stock	5,457	1,607
Total	11,179	4,499

For the three months ended March 31, 2012 and 2011, all outstanding securities were considered anti-dilutive, and therefore the calculation of basic and diluted net loss per share was the same.

Cash and Cash Equivalents

At March 31, 2012 cash equivalents consisted of demand deposits of $14.4 million, money market funds of $50.5 million, and U.S. government securities of $10.0 million with maturities of less than 90 days at the date of purchase. At December 31, 2011, cash equivalents consisted of demand deposits of $21.1 million and money market funds of $27.2 million with maturities of less than 90 days at the date of purchase.

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 Servier (See Note 7: Long-Term Debt and Other Financings). In order to manage its foreign currency exposure related to these payments, in May 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 March 31, 2012 and had an aggregate fair value of $0.9 million resulting in a related loss of $0.3 million for the three months ended March 31, 2012.

Accrued Liabilities

Accrued liabilities consisted of the following at March 31, 2012 and December 31, 2011 (in thousands):

	March 31, 2012	December 31, 2011
Accrued payroll and other benefits	$ 2,155	$ 3,007

Accrued management incentive compensation		996		4,096
Accrued restructuring costs		891		70
Accrued professional fees		760		917
Accrued severance payments		551		1,207
Other		944		715
Total	$	6,297	$	10,012

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Contingent Warrant Liabilities

In March 2012, in connection with an underwritten offering, the Company issued five-year warrants to purchase 14,834,577 shares of XOMA's common stock at an exercise price of $1.76 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate the Company to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Model on the date of such change in control. Due to these provisions, the Company is required to account for the warrants issued in March 2012 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At issuance, the fair value of the warrant liability was estimated to be $6.4 million using the Black-Scholes Model. The Company revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded an increase in the fair value of $14.7 million as a loss in the revaluation of contingent warrant liabilities line of the condensed consolidated statement of operations. As of March 31, 2012, 14,832,827 of these warrants were outstanding and had a fair value of $21.1 million. This increase in liability is primarily due to the excess of the market value of the Company's common stock at March 31, 2012 compared to the warrant exercise price. See Note 4: Fair Value Measurements for further disclosure regarding the fair value of this warrant liability.

In February 2010, in connection with an underwritten offering, the Company issued five-year warrants to purchase 1,260,000 shares of XOMA's common stock at an exercise price of $10.50 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate the Company to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Model on the date of such change in control. Due to these provisions, the Company is required to account for the warrants issued in February 2010 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At December 31, 2011, the fair value of the warrant liability was estimated to be $0.3 million using the Black-Scholes Model. At March 31, 2012, the Company changed its expected volatility assumption in the Black-Scholes Model from an estimate of volatility based on historical stock price volatility observed on XOMA's underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions. The Company revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded a decrease in the fair value of $0.3 million as a gain in the revaluation of contingent warrant liabilities line of the condensed consolidated statement of operations. As of March 31, 2012, all of these warrants were outstanding. See Note 4: Fair Value Measurements for further disclosure regarding the fair value of this warrant liability.

In June 2009, the Company 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 shares of XOMA's common stock over a five year period beginning December 11, 2009 at an exercise price of $19.50 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate the Company to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Model on the date of such change in control. Due to these provisions, the Company is required to account for the warrants issued in June 2009 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At December 31, 2011, the fair value of the warrant liability was estimated to be $0.1 million using the Black-Scholes Model. At March 31, 2012, the Company changed its expected volatility assumption in the Black-Scholes Model from an estimate of volatility based on historical stock price volatility observed on XOMA's underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions. The Company revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded a decrease in the fair value of $0.1 million as a gain in the revaluation of contingent warrant liabilities line of the condensed consolidated statement of operations. As of March 31, 2012, all of these warrants were outstanding. See Note 4: Fair Value Measurements for further disclosure regarding the fair value of this warrant liability.

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. The Company applies ASC 820, which establishes a framework for measuring fair value and a fair value hierarchy that prioritizes the inputs used in valuation techniques. ASC 820 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

Level 1 – Quoted prices in active markets for identical assets or liabilities.

Level 2 – Observable inputs other than quoted prices in active markets for similar assets or liabilities.

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Level 3 – Unobservable inputs.

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 March 31, 2012 and December 31, 2011.

Financial assets and liabilities carried at fair value as of March 31, 2012 and December 31, 2011 were classified as follows (in thousands):

	Fair Value Measurements at March 31, 2012 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)	$ 50,523	$ -	$ -	$ 50,523
U.S. government securities (1)	9,999	-	-	9,999
Foreign exchange options		926	-	926
Total	$ 60,522	$ 926	$ -	$ 61,448
Liabilities:				
Contingent warrant liabilities	$ -	$ -	$ 21,122	$ 21,122

	Fair Value Measurements at December 31, 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)	$ 27,222	$ -	$ -	$ 27,222
Foreign exchange options	-	1,202	-	1,202
Total	$ 27,222	$ 1,202	$ -	$ 28,424
Liabilities:				
Contingent warrant liabilities	$ -	$ -	$ 379	$ 379

(1) Included in cash and cash equivalents

The fair value of the foreign exchange options at March 31, 2012 and December 31, 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 contingent warrant liabilities was determined at March 31, 2012 and December 31, 2011 using the Black-Scholes Model, which requires inputs such as the expected term of the warrants, volatility and risk-free interest rate. These inputs are subjective and generally require significant analysis and judgment to develop. At March 31, 2012, the Company changed its expected volatility assumption in the Black-Scholes Model from an estimate of volatility based on historical stock price volatility observed on XOMA’s underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions. A market-based volatility rate was determined to be a more precise indicator for the fair value calculation of the Company’s warrants.

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The fair value of the contingent warrant liabilities was estimated using the following range of assumptions at March 31, 2012 and December 31, 2011:

	March 31, 2012	December 31, 2011
Expected volatility	40 %	102.1% - 103.2 %
Risk-free interest rate	0.5% - 1.05 %	0.4 %
Expected term	2.7 - 4.9 years	2.9 - 3.1 years

The following table provides a summary of changes in the fair value of the Company's Level 3 financial liabilities for the three months ended March 31, 2012 (in thousands):

Contingent warrant liabilities	March 31, 2012
Balance at December 31, 2011	$ 379
Initial fair value of warrants issued in March 2012	6,390
Reclassification of contingent warrant liability to equity upon exercise of warrants	(4)
Net increase in fair value of contingent warrant liabilities upon revaluation	14,357
Balance at March 31, 2012	$ 21,122

The net increase of $14.4 million in the estimated fair value of the contingent warrant liabilities was recognized as a loss in the revaluation of contingent warrant liabilities line of the condensed consolidated statements of operations for the three months ended March 31, 2012.

For the three months ended March 31, 2011, the Company recognized a net decrease of $2.4 million in the estimated fair value of the contingent warrant liabilities as a gain in the revaluation of contingent warrant liabilities line of the condensed consolidated statements of operations.

5. Licensing, Collaborative and Other Arrangements

Servier – U.S. Perindopril Franchise

On January 17, 2012, the Company announced that it had acquired certain U.S. rights to a portfolio of antihypertensive products from Servier. The portfolio includes ACEON® (perindopril erbumine), a currently marketed ACE inhibitor, and three fixed-dose combination ("FDC") product candidates where a form of proprietary perindopril (perindopril arginine) is combined with another active ingredient(s), such as a calcium channel blocker. The Company assumed commercialization activities for ACEON® in January 2012 following the transfer from Servier's previous licensee. In late February 2012, the Company initiated enrollment in a Phase 3 trial for perindopril arginine and amlodipine besylate, the first FDC product candidate. The trial, named PATH (Perindopril Amlodipine for the Treatment of Hypertension), is expected to enroll approximately 816 patients with hypertension to determine the safety and efficacy of the FDC versus either perindopril or amlodipine alone. Based on regulatory interaction to date, if the trial generates positive results, it is expected to be the only efficacy trial needed to complement existing clinical data and will support the submission of an application to the FDA seeking approval for this product candidate. Partial funding for the PATH trial was provided by Servier; the balance of study expenses, consisting primarily of costs generated by the Company's contract research organization, are expected to be paid over time from the profits generated by the Company's ACEON® sales.

In connection with the original agreement, the Company paid a $1.5 million license fee to Servier in the third quarter of 2010. The Company also is required to pay a royalty on ACEON® sales at a rate that is tiered based on sales levels and ranges from a mid-single digit to a mid-teen percentage rate. If approved, the Company also will pay a royalty on sales of the FDC product candidates in the mid-teen percentage rate. The FDC royalty rate is subject to reduction in the event of generic competition or if other intellectual property rights are required. The Company may be required to pay the following milestones: development milestones aggregating $8.5 million (assuming the Company exercises its options on the additional FDCs) and sales milestones of up to an aggregate $15.1 million, in each case for all of the FDC product candidates. The Company also may be required to make certain additional payments if the FDC product candidates receive FDA approval but certain minimum sales levels are not reached. The Company generally will be responsible for its development and commercialization expenses, but Servier has agreed to partially fund development of the first FDC product candidate.

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6. Streamlining and Restructuring Charges

In January 2012, the Company implemented a streamlining of operations, which resulted in a restructuring plan designed to sharpen its focus on value-creating opportunities led by gevokizumab and its unique antibody discovery and development capabilities. The restructuring plan included a reduction of XOMA's personnel by 84 positions, or 34%, of which 52 were eliminated immediately and the remainder eliminated as of April 6, 2012. These staff reductions resulted primarily from the Company's decisions to utilize a contract manufacturing organization for Phase 3 and commercial antibody production and to eliminate internal research functions that are non-differentiating or that can be obtained cost-effectively by contract service providers.

During the three months ended March 31, 2012, in connection with this streamlining of operations, the Company recorded charges of $2.1 million related to severance, other termination benefits and outplacement services. The Company expects to incur an additional $0.1 million restructuring charge in the second quarter of 2012 related to severance, other termination benefits and outplacement services.

The Company plans to vacate two of its leased buildings in 2012 related to manufacturing operations and internal research functions. The Company did not incur any restructuring charges during the first quarter of 2012 in connection with the exit of these leased buildings as they are still in use; however, it expects to incur restructuring charges of approximately $1.2 million in the remainder of 2012, primarily related to the net present value of future minimum lease payments at the cease-use date, less potential estimated future sublease income.

As of March 31, 2012, the Company performed an impairment analysis of property and equipment and leasehold improvements related to its manufacturing operations. Since the estimated undiscounted future cash inflows from a certain group of these assets were less than the carrying value, the Company determined that these assets were impaired and recorded a restructuring charge of $0.8 million. Further, the Company changed the useful life of certain property and equipment and leasehold improvements impacted by XOMA's plans to vacate two leased buildings. As a result, the Company recorded accelerated depreciation of $0.9 million as a restructuring charge. The Company expects to incur additional restructuring charges of approximately $0.7 million in the remainder of 2012 related to the accelerated depreciation of leasehold improvements.

The current and long-term portions of the outstanding restructuring liabilities are included in accrued and other liabilities and other liabilities – long-term on the condensed consolidated balance sheets and are based upon restructuring charges recognized as of March 31, 2012 and December 31, 2011 in connection with the 2009 and 2012 restructuring plans. As of March 31, 2012, the components of these liabilities are shown below (in thousands):

	Employee Severance and Other Benefits	Facility Charges	Asset Impairment (1)	Total
Balance at December 31, 2011	$ -	$ 162	$ -	$162
Restructuring charges	2,070	-	1,707	3,777
Cash payments	(1,258)	(23)	-	(1,281)
Adjustments	-	8	(1,707)	(1,699)
Balance at March 31, 2012	$ 812	$ 147	$ -	$959

(1) Restructuring charges include non-cash impairments of property and equipment and leasehold improvements. However, these amounts are not included in the restructuring accrual.

The restructuring charges the Company expects to incur in connection with the 2012 streamlining of operations are subject to various assumptions, and actual results may differ.

7. Long-Term Debt and Other Financings

Long-Term Debt

Novartis Note

In May 2005, the Company executed a secured note agreement with Novartis (then Chiron Corporation), which is due and payable in full in June 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 million in aggregate principal amount. Interest on the principal amount of the loan accrues at six-month LIBOR plus 2%, which was equal to 2.80% at March 31, 2012, 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 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.

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At March 31, 2012 and December 31, 2011, the outstanding principal balance under this note agreement was $14.0 million. Pursuant to the terms of the arrangement as restructured in November 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 2010, in connection with the license and collaboration agreement entered into with Servier, the Company executed a loan agreement with Servier, which provided for an advance of up to €15 million. The loan was fully funded in January 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 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 and 3.54% for the six-month period from January 2012 through July 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 March 31, 2012 and December 31, 2011, the outstanding principal balance under this loan was $20.0 million and $19.4 million, respectively, using the Euro to US Dollar ("USD") exchange rate at each such date. For the three months ended March 31, 2012 and 2011, the Company recorded unrealized foreign exchange losses of $0.6 million and $1.6 million, respectively, related to the re-measurement of the loan.

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 in the three months ended March 31, 2012 and 2011, resulting from the amortization of the loan discount. At March 31, 2012 and December 31, 2011, the net carrying value of the loan was $13.2 million and $12.5 million, respectively. For the three months ended March 31, 2012, the Company recorded an unrealized foreign exchange loss of $0.2 million related to the re-measurement of the loan discount as of March 31, 2012.

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 of related non-cash revenue during both the three months ended March 31, 2012 and 2011.

General Electric Capital Corporation Term Loan

In December 2011, the Company entered into a loan agreement (the “Loan Agreement”) with General Electric Capital Corporation (“GECC”), under which GECC agreed to make a term loan in an aggregate principal amount of $10 million (the “Term Loan”) to XOMA (US) LLC, a wholly owned subsidiary of the Company, and upon execution of the Loan Agreement, GECC funded the Term Loan. The Term Loan is guaranteed by the Company and its two other principal subsidiaries, XOMA Ireland Limited and XOMA Technology Ltd. As security for their obligations under the Loan Agreement, the Company, XOMA (US) LLC, XOMA Ireland Limited and XOMA Technology Ltd. each granted a security interest pursuant to a guaranty, pledge and security agreement in substantially all of their existing and after-acquired assets, excluding their intellectual property assets (such as those relating to the Company’s gevokizumab and anti-botulism products). The Company incurred debt issuance costs of approximately $1.3 million in connection with the Term Loan and will make an additional payment equal to 5% of the Term Loan (the “Final Payment Fee”) on the maturity date, or such earlier date as the Term Loan is paid in full. The debt issuance costs and Final Payment Fee are being amortized and accreted, respectively, to interest expense over the term of the Term Loan using the effective interest method.

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The Term Loan accrues interest at a fixed rate of 11.71% per annum. We are required to repay the principal amount of the Term Loan over a period of 42 consecutive equal monthly installments of principal and accrued interest, commencing on January 4, 2012, and thereafter on the first calendar day of each succeeding month. The Term Loan matures and is due and payable in full on June 30, 2015.

The Loan Agreement contains customary representations and warranties and customary affirmative and negative covenants, including restrictions on the ability to incur indebtedness, grant liens, make investments, dispose of assets, enter into transactions with affiliates and amend existing material agreements, in each case subject to various exceptions. In addition, the Loan Agreement contains customary events of default that entitle GECC to cause any or all of the indebtedness under the Loan Agreement to become immediately due and payable. The events of default include any event of default under a material agreement or certain other indebtedness. Upon an event of default, the Term Loan and other obligations under the Loan Agreement will, at the election of GECC, bear interest from and after the occurrence and during the continuation of an event of default at a rate equal to the lesser of 5.0% above the stated rate of interest or the maximum rate allowed by law.

The Company may voluntarily prepay the Term Loan in full, but not in part, and any voluntary and certain mandatory prepayments are subject to a prepayment premium of 3% in the first year of the loan, 2% in the second year and 1% thereafter, although mandatory prepayments in connection with entering into certain exclusive licenses, granting certain negative pledges or incurring certain collaboration-related indebtedness will not be subject to such prepayment premium. The Company will also be required to pay the Final Payment Fee in connection with any voluntary or mandatory prepayment. At March 31, 2012 and December 31, 2011, the outstanding principal balance under the Loan Agreement was $9.3 million and $10.0 million respectively.

In December 2011, pursuant to the loan agreement, the Company issued to GECC unregistered stock purchase warrants, which entitle GECC to purchase up to an aggregate of 263,158 unregistered shares of XOMA common stock at an exercise price equal to $1.14 per share. These warrants are immediately exercisable and will expire on December 30, 2016. The Company allocated the aggregate proceeds of the GECC Term Loan between the warrants and the debt obligation based on their relative fair values. The fair value of the warrants issued to GECC was determined using the Black-Scholes Model. The warrants fair value of $0.2 million is recorded as a discount to the debt obligation and is being amortized over the term of the loan using the effective interest method. If the maturity of the debt is accelerated in connection with any voluntary or mandatory prepayment, then the remaining discount amortization would be recognized immediately.

Interest Expense

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

	Three Months Ended March 31, 2012	2011
Interest expense		
Servier loan	$ 516	$ 442
GECC term loan	417	-
Novartis note	99	84
Other	10	6
Total interest expense	$ 1,042	$ 532

Other Financings

ATM Agreement

On February 4, 2011, the Company entered into an At Market Issuance Sales Agreement (the “2011 ATM Agreement”), with McNicoll, Lewis & Vlak LLC (now known as MLV & Co. LLC, “MLV”), under which it may sell shares of its common stock from time to time through the MLV, as the agent for the offer and sale of the 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, June 3, 2011 and January 3, 2012, which was most recently declared effective by the SEC on January 17, 2012. MLV may sell the 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 Company’s common stock or to or through a market maker. MLV may also sell the shares in privately negotiated transactions, subject to the Company’s prior approval. From the inception of the 2011 ATM Agreement through March 31, 2012, the Company sold a total of 7,572,327 shares of common stock under this agreement for aggregate gross proceeds of $14.6 million, including 2,285,375 shares of common stock sold in the first quarter of 2012 for aggregate gross proceeds of $3.3 million. Total offering expenses incurred related to sales under the 2011 ATM Agreement from inception to March 31, 2012, were $0.4 million, including $0.1 million incurred in the first quarter of 2012.

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Underwritten Offering and Amendment to Shareholder Rights Plan

On March 9, 2012, the Company completed an underwritten public offering of 29,669,154 shares of its common stock, and accompanying warrants to purchase one half of a share of common stock for each share purchased, at a public offering price of $1.32 per share. Total gross proceeds from the offering were approximately $39.2 million, before deducting underwriting discounts and commissions and estimated offering expenses totaling approximately $2.9 million. The warrants, which represent the right to acquire an aggregate of up to 14,834,577 shares of common stock, are immediately exercisable and have a five-year term and an exercise price of $1.76 per share.

The Company has amended its shareholder rights agreement to provide that it will not apply to any person or entity who becomes the beneficial owner of 20% or more but less than 40% of its outstanding common stock with the prior approval of its board of directors, and its board has approved purchasers in the March 2012 public offering becoming beneficial owners of 20% or more but less than 40% of its outstanding common stock as a result of their participation in the offering. As a result, such ownership by any such purchaser will not trigger the provisions of the rights agreement that would give each holder of the rights the right to receive upon exercise that number of common stock equivalents having a market value of two times the exercise price. The board's approval in this regard only applies to purchasers in such offering.

8. Income Taxes

The Company did not recognize any income tax expense for the three months ended March 31, 2012 and income tax expense was not material for the three months ended March 31, 2011. 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.

9. Stock-based Compensation

In the first quarter of 2012, the Board of Directors of the Company approved grants under the Long Term Incentive Plan for an aggregate of 940,900 stock options and an aggregate of 343,115 restricted stock units (“RSUs”) to certain employees of the Company. The options vest monthly over four years and the RSUs vest annually over three years in equal increments.

The Company recognizes compensation expense for all stock-based payment awards made to the Company’s employees, consultants and directors based on estimated fair values. The valuation of stock option 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. To establish an estimate of expected term, the Company considers the vesting period and contractual period of the award and its historical experience of stock option exercises, post-vesting cancellations and volatility. The estimate of expected volatility is based on the Company’s historical volatility. The risk-free rate is based on the yield available on United States Treasury zero-coupon issues. The forfeiture rate impacts the amount of aggregate compensation for both stock options and RSUs. To establish an estimate of forfeiture rate, the Company considers its historical experience of option forfeitures and terminations.

The fair value of stock-based awards was estimated based on the following weighted average assumptions for the three months ended March 31, 2011 and 2010:

	Three Months Ended March 31,	
	2012	2011
Dividend yield	0 %	0 %

Expected volatility	92 %	86 %
Risk-free interest rate	1.05 %	2.20 %
Expected term	5.6 years	5.6 years

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Stock option activity for the three months ended March 31, 2012 was as follows:

	Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2011	5,053,435	$ 12.55	6.89	$ -
Granted	940,900	1.45		
Exercised	(24,730)	1.69		
Forfeited, expired or cancelled	(167,484)	21.65		
Options outstanding at March 31, 2012	5,802,121	$ 10.53	7.28	$ 2,375
Options exercisable at March 31, 2012	3,567,292	$ 14.96	6.45	$ 867

The valuation of RSUs is determined at the date of grant using the closing stock price. To establish an estimate of forfeiture rate, the Company considers its historical experience of forfeitures and terminations.

Unvested RSU activity for the three months ended March 31, 2012 is summarized below:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested balance at December 31, 2011	903,874	$ 1.69
Granted	343,115	1.29
Vested	-	-
Forfeited	(132,575)	1.69
Unvested balance at March 31, 2012	1,114,414	$ 1.57

The following table shows total stock-based compensation expense included in the condensed consolidated statements of operations for the three months ended March 31, 2012 and 2011 (in thousands):

	Three Months Ended March 31,	
	2012	2011
Research and development	$ 385	$ 1,061
Selling, general and administrative	289	711
Total stock-based compensation expense	$ 674	$ 1,772

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 filed cases to seventy seven. 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®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of all but one of the cases pending in Alameda County Superior Court. The one Alameda County case not included in this settlement agreement is Kilzer v. Genentech, Inc., et al, Case No. RG-10-502461. The Company's agreement with Genentech provides for an indemnity of XOMA, and payment of legal fees and funding of this settlement agreement 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 petition asserts personal injury claims against Genentech, the Company and others arising out of plaintiff's treatment with RAPTIVA®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this case. The Company's agreement with Genentech provides for an indemnity of XOMA, and payment of legal fees and funding of this settlement agreement by Genentech, which the Company believes is applicable to these matters.

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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. This complaint alleges the same claims against Genentech, the Company and others and seeks the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this case. The Company's agreement with Genentech provides for an indemnity of XOMA, and payment of legal fees and funding of this settlement agreement by Genentech, which the Company believes is applicable to these matters.

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. On June 13, 2011, a complaint was filed in the Supreme Court for the State of New York, Onondaga County. Defendants removed the case to the United States District Court for the Northern District of New York on November 3, 2011. 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. No trial date has been set in either 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 these matters. The Company believes the claims against it to be without merit and intends 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, 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 were 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. On October 31, 2011, Plaintiffs filed a Notice of Appeal in each case in the United States Court of Appeal for the Sixth Circuit. 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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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, contingent warrant liabilities and stock-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 and development of innovative antibody-based therapeutics. Our lead drug candidate is gevokizumab (formerly XOMA 052), a humanized antibody that binds to the inflammatory cytokine interleukin-1 beta ("IL-1 beta"). In collaboration with our partner, Les Laboratoires Servier ("Servier"), gevokizumab is expected to enter global Phase 3 clinical development in 2012 for non-infectious uveitis ("NIU") and Behçet's uveitis. We anticipate Servier will enter gevokizumab into a Phase 2 study in a cardiovascular disease indication during 2012. Separately we have launched a Phase 2 proof-of-concept program for gevokizumab to evaluate additional indications for further development, including a clinical trial in moderate-to-severe inflammatory acne, which began enrolling patients in December 2011, and a clinical trial in erosive osteoarthritis of the hand, for which we plan to initiate enrollment in the second quarter of 2012.

We have 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, which is believed to be a primary trigger of pathologic inflammation in multiple diseases.

Our proprietary preclinical pipeline includes classes of antibodies that activate or sensitize the insulin receptor in vivo and represent potential new therapeutic approaches to the treatment of diabetes. We have developed these and other antibodies using some or all of our ADAPT™ antibody discovery and development platform, our ModulX™ technologies for generating allosterically modulating antibodies, and our OptimX™ technologies for optimizing biophysical properties of antibodies, including affinity, immunogenicity, stability and manufacturability.

In January 2012, we announced that we had acquired certain U.S. rights to a portfolio of antihypertensive products from Servier. The portfolio includes ACEON® (perindopril erbumine), a currently marketed angiotensin converting enzyme ("ACE") inhibitor, and three fixed-dose combination ("FDC") product candidates where perindopril is combined with another active ingredient(s), such as a calcium channel blocker. The proprietary form of perindopril in each of the combination product candidates provides patent protection until December 2023. We assumed commercialization activities for ACEON® in January 2012 following the transfer from Servier's previous licensee. In late February 2012, we initiated enrollment in a Phase 3 trial for perindopril arginine and amlodipine besylate, the first FDC product candidate. Partial funding for the Phase 3 trial will be provided by Servier; the balance of study expenses, consisting primarily of costs generated by our contract research organization, are expected to be paid by us over time from any profits generated by our ACEON® sales.

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. This contract is the third that NIAID has awarded us for the development of botulinum antitoxins. In October 2011, we announced that we had been awarded a fourth contract 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. In January 2012, we announced that we will complete NIAID biodefense contracts currently in place but will not actively pursue future contracts. Should the government choose to acquire XOMA 3AB or other biodefense products in the future, we expect to be able to provide these antibodies through an outside manufacturer.

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We also have developed antibody product candidates with premier pharmaceutical companies including Novartis AG ("Novartis") and Takeda Pharmaceutical Company Limited ("Takeda"). Two antibodies developed with Novartis, LFA102 and HCD122 (lucatumumab), are in Phase 1 and/or 2 clinical development by Novartis for the potential treatment of breast or prostate cancer and hematological malignancies, respectively.

Significant Developments in the First Quarter of 2012

Perindopril Franchise

On January 17, 2012, we announced that we had acquired certain U.S. rights to a portfolio of antihypertensive products from Servier. The portfolio includes ACEON®, a currently marketed ACE inhibitor, and three FDC product candidates where a proprietary form of perindopril (perindopril arginine) is combined with another active ingredient(s), such as a calcium channel blocker. We assumed commercialization activities for ACEON® in January 2012 following the transfer from Servier's previous licensee.

In February 2012, we initiated enrollment in a Phase 3 trial for perindopril arginine and amlodipine besylate, the first FDC product candidate. The trial is expected to enroll approximately 816 patients with hypertension to determine the safety and efficacy of the FDC versus either perindopril or amlodipine alone. Based on regulatory interaction to date, if the trial generates positive results, it is expected to be the only efficacy trial needed to complement existing clinical data and will support the submission of an application to the FDA seeking approval for this product candidate. Partial funding for the PATH trial was provided by Servier; the balance of study expenses, consisting primarily of costs generated by our contract research organization, are expected to be paid over time from the profits generated by our ACEON® sales.

Streamlining and Restructuring Charges

On January 5, 2012, we implemented a streamlining of operations, which resulted in a restructuring designed to sharpen our focus on value-creating opportunities led by gevokizumab and our unique antibody discovery and development capabilities. The restructuring plan included a reduction of our personnel by 84 positions, or 34%, of which 52 were eliminated immediately and the remainder eliminated as of April 6, 2012. These staff reductions resulted primarily from our decisions to utilize a contract manufacturing organization for Phase 3 and commercial antibody production and to eliminate internal research functions that are non-differentiating or that can be obtained cost-effectively by contract service providers. As a result, we expect to reduce ongoing internal spending by approximately $14 million in 2012 compared to the 2011 level. In connection with the streamlining of operations, we incurred restructuring charges of $2.1 million related to severance, other termination benefits and outplacement services and $1.7 million related to the impairment and accelerated depreciation of various assets and leasehold improvements in the first quarter of 2012. In the remainder of 2012, we anticipate incurring an additional $0.1 million in severance charges and approximately $1.2 million in facility charges related to this streamlining of operations.

Management Change

On January 4, 2012, the Company's Board of Directors appointed John Varian, a current Board member and the interim Chief Executive Officer, as Chief Executive Officer. W. Denman Van Ness continues to serve as Chairman of the Board.

Financings

In the first quarter of 2012, we sold 2,285,375 shares of common stock through McNicoll, Lewis & Vlak LLC (now known as MLV & Co. LLC, "MLV"), under our At Market Issuance Sales Agreement dated February 4, 2011 (the "2011 ATM Agreement"), for aggregate gross proceeds of $3.3 million.

In March 2012, we completed an underwritten public offering of 29,669,154 shares of our common stock, and accompanying warrants to purchase one half of a share of common stock for each share purchased, for gross proceeds of $39.2 million.

Results of Operations

Revenues

Total revenues for the three months ended March 31, 2012 and 2011, were as follows (in thousands):

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	Three Months Ended March 31,		
	2012	2011	Increase (Decrease)
License and collaborative fees	$ 1,014	$ 5,827	$ (4,813)
Contract and other	8,851	9,768	(917)
Total revenues	$ 9,865	$ 15,595	$ (5,730)

License and Collaborative Fees

License and collaborative fee revenue includes fees and milestone payments related to the out-licensing of our products and technologies. The decrease in license and collaborative fee revenue for the three months ended March 31, 2012, as compared to the same period of 2011, was primarily due to $5.5 million in revenue recognized in the first quarter of 2011 related to the collaboration and license agreement with Servier to jointly develop and commercialize gevokizumab in multiple indications. This decrease was partially offset by an increase in other licensing fees of $0.6 million. 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 technologies and new collaboration partners. We expect our revenues from license and collaborative fees in 2012 to remain comparable to 2011 levels.

Contract and Other Revenue

Contract and other revenues include agreements where we provide contracted research and development 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 months ended March 31, 2012 and 2011 (in thousands):

	Three Months Ended March 31,		
	2012	2011	Increase (Decrease)
NIAID	$ 4,837	$ 6,884	$ (2,047)
Servier	3,649	2,082	1,567
Other	365	802	(437)
Total contract and other	$ 8,851	$ 9,768	$ (917)

The decrease in NIAID revenue is primarily due to decreased activity under NIAID Contract No. HHSN272200800028C (“NIAID 3”). This decrease in NIAID 3 contract revenue is partially offset by the recognition of $2.0 million in revenue related to an adjustment to previously-reported revenue from NIAID resulting from an audit by NIAID’s contracting office. This revenue, which was previously deferred, was recognized upon the completion of negotiations with and approval by the NIH in March 2012. Also partially offsetting the decrease in contract and other revenue was an increase in gevokizumab clinical development and CMC activity under the collaboration with Servier and $0.5 million in activity under Contract No. HHSN272201100031C (“NIAID 4”), which was executed in October 2011.

Based on expected levels of revenue generating activities related to contract and other revenue, we expect a slight decrease in contract and other revenue in 2012 compared to 2011.

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 $15.7 million for the three months ended March 31, 2012, compared with $17.3 million for the same period of 2011. The decrease of $1.6 million for the three months ended March 31, 2012, as compared to the same period in 2011, was primarily due to a decrease in salaries and related personnel costs.

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Salaries and related personnel costs are a significant component of research and development expenses. We recorded $7.0 million in research and development salaries and employee-related expenses for the three months ended March 31, 2012, as compared with $8.8 million for the same period of 2011. The decrease of $1.8 million was primarily due to a decrease of $1.0 million in salaries and benefits due to decreased headcount in manufacturing as result of the 2012 streamlining of operations, and a $0.7 million decrease in stock-based compensation.

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 2012 due to our streamlining objectives to utilize a contract manufacturing organization. Later stage programs include clinical testing, regulatory affairs and manufacturing clinical supplies. Certain research and development segment reclassifications have been made to previously reported amounts to conform to the current year's presentation. The costs associated with these programs approximate the following (in thousands):

	Three Months Ended March 31,	
	2012	2011
Earlier stage programs	$ 8,333	$ 11,383
Later stage programs	7,438	5,964
Total	$ 15,771	$ 17,347

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. Certain research and development segment reclassifications have been made to previously reported amounts to conform to the current year's presentation. The costs related to internal projects versus collaborative and contract arrangements approximate the following (in thousands):

	Three Months Ended March 31,	
	2012	2011
Internal projects	$ 6,682	$ 7,408
Collaborative and contract arrangements	9,089	9,939
Total	$ 15,771	$ 17,347

For the three months ended March 31, 2012, the program upon which we incurred the largest amount of expense (gevokizumab) accounted for more than 40% but less than 50% of our total research and development expense, one development program (NIAID) accounted for more than 20% but less than 30%, and one development program (XMet) accounted for more than 10% but less than 20% 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 months ended March 31, 2012. For the three months ended March 31, 2011, the program upon which we incurred the largest amount of expense (NIAID) accounted for more than 40% but less than 50%, and one development program (NIAID) accounted for more than 30% but less than 40% 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 months ended March 31, 2011.

We expect our research and development spending in 2012 will increase primarily due to the expected initiation of our Phase 3 clinical program for gevokizumab for the NIU indication, the initiation of our Phase 2 proof-of-concept program for gevokizumab to evaluate moderate-to-severe inflammatory acne and the expected initiation of our Phase 2 proof-of-concept program for erosive osteoarthritis of the hand, all under our license and collaboration agreement with Servier. In addition, we plan to announce the final proof-of-concept indication later in 2012. Also contributing to the expected increase is the initiation of a Phase 3 trial for perindopril arginine in combination with amlodipine besylate.

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 $4.7 million for the three months ended March 31, 2012, compared with $5.4 million for the same period of 2011. The $0.7 million decrease for the first quarter of 2012, as compared to the same period of 2011, was primarily due to a decrease of $0.6 million in salary and related personnel costs, including a $0.4 million decrease in stock-based compensation.

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Streamlining and Restructuring Charges

In January 2012, we implemented a streamlining of operations, which resulted in a restructuring designed to sharpen our focus on value-creating opportunities led by gevokizumab and its unique antibody discovery and development capabilities. The restructuring plan included a reduction of XOMA's personnel by 84 positions, or 34%, of which 52 were eliminated immediately and the remainder eliminated as of April 6, 2012. These staff reductions result primarily from our decision to utilize a contract manufacturing organization for Phase 3 and commercial antibody production and to eliminate internal research functions that are non-differentiating or that can be obtained cost-effectively by contract service providers.

During the three months ended March 31, 2012, in connection with this streamlining of operations, we recorded charges of $2.1 million related to severance, other termination benefits and outplacement services. We expect to incur an additional $0.1 million restructuring charge in the second quarter of 2012 related to severance, other termination benefits and outplacement services.

We plan to vacate two of our leased buildings in 2012 related to manufacturing operations and internal research functions. We did not incur any restructuring charges during the first quarter of 2012 in connection with the exit of these leased buildings as they were still in use; however, we expect to incur restructuring charges of approximately $1.2 million in the remainder of 2012, primarily related to the net present value of future minimum lease payments at the cease-use date, less potential estimated future sublease income.

As of March 31, 2012, we performed an impairment analysis of property and equipment and leasehold improvements related to our manufacturing operations. Since the estimated undiscounted future cash inflows from a certain group of these assets were less than the carrying value, we determined that these assets were impaired and recorded a related restructuring charge of approximately $0.8 million. Further, we changed the useful life of certain property and equipment and leasehold improvements impacted by our plans to vacate two leased buildings. As a result, we recorded accelerated depreciation of $0.9 million as a restructuring charge. We expect to incur additional restructuring charges of approximately $0.7 million in the remainder of 2012 related to the accelerated depreciation of leasehold improvements.

Other Income (Expense)

Interest Expense

Interest expense and amortization of debt issuance costs are shown below for the three months ended March 31, 2012 and 2011 (in thousands):

	Three Months Ended March 31,		
	2012	2011	Increase (Decrease)
Interest expense			
Servier loan	$ 516	$ 442	$ 74
GECC term loan	417	-	417
Novartis note	99	84	15
Other	10	6	4
Total interest expense	$ 1,042	$ 532	$ 510

The increase of $0.5 million in interest expense in 2012 as compared to 2011 was primarily due to interest expense related to the loan with GECC, which was funded in December 2011.

Other Expense

Other expense primarily consisted of unrealized and realized (losses) gains. The following table shows the activity in other expense for the three months ended March 31, 2012 and 2011 (in thousands):

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	Three Months Ended March 31,		
	2012	2011	Increase (Decrease)
Other expense			
Unrealized foreign exchange loss (1)	$ (402)	$ (1,617)	$ 1,215
Realized foreign exchange gain (2)	10	560	(550)
Unrealized loss on foreign exchange options	(276)	-	(276)
Other	4	-	4
Total other expense	$ (664)	$ (1,057)	$ 393

(1) Unrealized foreign exchange gain (loss) for the three months ended March 31, 2012 and 2011 primarily relates to gains (losses) on the re-measurement of the €15 million Servier loan.

(2) Realized foreign exchange gain for the three months ended March 31, 2011 primarily relates to the conversion into U.S. dollars of the €15 million cash proceeds received from Servier in January of 2011.

Revaluation of Contingent Warrant Liabilities

In March 2012, in connection with an underwritten offering, we issued five-year warrants to purchase 14,834,577 shares of XOMA's common stock at an exercise price of $1.76 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate us to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Option Pricing Model (the "Black-Scholes Model") on the date of such change in control. We believe the likelihood of a change in control prior to the expiration of the warrants is remote; however, due to these provisions, we are required to account for the warrants issued in March 2012 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At issuance, the fair value of the warrant liability was estimated to be $6.4 million using the Black-Scholes Model. We revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded an increase in the fair value of $14.7 million as a loss in the revaluation of contingent warrant liabilities line of our condensed consolidated statement of operations. As of March 31, 2012, 14,832,827 of these warrants were outstanding and had a fair value of $21.1 million. This increase in liability is primarily due to the excess of the market value of the Company's common stock at March 31, 2012 compared to the warrant exercise price.

In February 2010, in connection with an underwritten offering, we issued five-year warrants to purchase 1,260,000 shares of XOMA's common stock at an exercise price of $10.50 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate us to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Model the date of such change in control. We believe the likelihood of a change in control prior to the expiration of the warrants is remote; however, due to these provisions, we are required to account for the warrants issued in February 2010 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At December 31, 2011, the fair value of the warrant liability was estimated to be $0.3 million using the Black-Scholes Model. At March 31, 2012, we changed our expected volatility assumption in the Black-Scholes Model from an estimate of volatility based on historical stock price volatility observed on XOMA's underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions. We revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded a decrease in the fair value of $0.3 million as a gain in the revaluation of contingent warrant liabilities line of our condensed consolidated statement of operations. As of March 31, 2012, all of these warrants were outstanding.

In June 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 shares of XOMA's common stock over a five year period beginning December 11, 2009 at an exercise price of $19.50 per share. These warrants contain provisions that are contingent on the remote occurrence of a change in control, which would conditionally obligate us to repurchase the warrants for cash in an amount equal to their fair value using the Black-Scholes Model on the date of such change in control. We believe the likelihood of a change in control prior to the expiration of the warrants is remote; however, due to these provisions, we are required to account for the warrants issued in June 2009 as a liability at fair value. In addition, the estimated liability related to the warrants is required to be revalued at each reporting period until the earlier of the exercise of the warrants, at which time the liability will be reclassified to stockholders' equity, or expiration of the warrants. At December 31, 2011, the fair value of the warrant liability was estimated to be $0.1 million using the Black-Scholes Model. At March 31, 2012, we changed our expected volatility assumption in the Black-Scholes Model from an estimate of volatility based on historical stock price volatility observed on XOMA's underlying stock to a volatility estimate based on the volatility implied from warrants issued by XOMA in recent private placement transactions. We revalued the warrant liability at March 31, 2012 using the Black-Scholes Model and recorded a decrease in the fair value of $0.1 million as a gain in the revaluation of contingent warrant liabilities line of our condensed consolidated statement of operations. As of March 31, 2012, all of these warrants were outstanding.

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The following table provides a summary of the changes in fair value of contingent warrant liabilities for the three months ended March 31, 2012 (in thousands):

Contingent warrant liabilities	March 31, 2012	
Balance at December 31, 2011	$	379
Initial fair value of warrants issued in March 2012		6,390
Reclassification of contingent warrant liability to equity upon exercise of warrants		(4)
Net increase in fair value of contingent warrant liabilities upon revaluation		14,357
Balance at March 31, 2012	$	21,122

Income Taxes

We did not recognize any income tax expense for the three month ended March 31, 2012 and income tax expense was not material for the three months ended March 31, 2011.

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 March 31, 2012 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 March 31, 2012, 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):

	March 31, 2012		December 31, 2011		Change	
Cash and cash equivalents	$	74,887	$	48,344	$	26,543
Working Capital	$	69,868	$	42,064	$	27,804

	Three Months Ended March 31, 2012		2011		Change	
Net cash used in operating activities	$	(11,675)	$	(3,200)	$	(8,475)
Net cash used in investing activities		(548)		(888)		340
Net cash provided by financing activities		38,766		24,231		14,535
Effect of exchange rate changes on cash		-		(573)		573
Net increase in cash and cash equivalents	$	26,543	$	19,570	$	6,973

Working Capital

The increase in working capital was primarily due to an increase of $26.5 million in cash and cash equivalents, primarily due to the March 2012 underwritten public offering of 29,669,154 shares of our common stock and accompanying warrants for gross proceeds of $39.2 million.

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Cash Used in Operating Activities

Net cash used in operating activities was $11.7 million for the three months ended March 31, 2012, compared with $3.2 million for the same period in 2011. Net cash used in operating activities was $8.5 million higher in the first quarter of 2012 because a $15.0 million license fee was received in the first quarter of 2011 as consideration for the collaboration with Servier. In addition, accounts payable decreased and prepaid expenses increased.

Cash Used in Investing Activities

Net cash used in investing activities was $0.5 million for the three months ended March 31, 2012, compared with $0.9 million for the same period of 2011. Cash used in investing activities for the three months ended March 31, 2012 and 2011 primarily consisted of fixed asset purchases.

Cash Provided by Financing Activities

Net cash provided by financing activities was $38.8 million for the three months ended March 31, 2012, compared with $24.2 million for the same period of 2011. Cash provided by financing activities in the first quarter of 2012 related to net proceeds received from the issuance of common stock and warrants of $36.2 million in the March 2012 underwritten public offering and net proceeds of $3.2 million received from the issuance of common stock under the 2011 ATM Agreement, offset by $0.7 million principal payments on our loan with GECC. Cash provided by financing activities in the first quarter of 2011 related to proceeds received from the Servier loan for $20.1 million and the net proceeds of $4.1 million received from the issuance of common stock under the our previous at market issuance sales agreement.

Underwritten Offering and Amendment to Shareholder Rights Plan

On March 9, 2012, we completed an underwritten public offering of 29,669,154 shares of our common stock, and accompanying warrants to purchase one half of a share of common stock for each share purchased, at a public offering price of $1.32 per share. Total gross proceeds from the offering were approximately $39.2 million, before deducting underwriting discounts and commissions and estimated offering expenses totaling approximately $2.9 million. The warrants, which represent the right to acquire an aggregate of up to 14,834,577 shares of common stock, are immediately exercisable and have a five-year term and an exercise price of $1.76 per share.

We have amended our shareholder rights agreement to provide that it will not apply to any person or entity who becomes the beneficial owner of 20% or more but less than 40% of our outstanding common stock with the prior approval of our board of directors, and our board has approved purchasers in the March 2012 public offering becoming beneficial owners of 20% or more but less than 40% of our outstanding common stock as a result of their participation in the offering. As a result, such ownership by any such purchaser will not trigger the provisions of the rights agreement that would give each holder of the rights the right to receive upon exercise that number of common stock equivalents having a market value of two times the exercise price. The board's approval in this regard only applies to purchasers in such offering.

ATM Agreement

On February 4, 2011, we entered into the 2011 ATM Agreement with MLV, under which we may sell shares of our common stock from time to time through the MLV, as our agent for the offer and sale of the 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, June 3, 2011 and January 3, 2012, which was most recently declared effective by the SEC on January 17, 2012. MLV may sell the 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 our common stock or to or through a market maker. MLV may also sell the shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through May 4, 2012, we sold a total of 7,572,327 shares of common stock under this agreement for aggregate gross proceeds of $14.6 million.

Net proceeds received during the first quarter of 2012 from the March 2012 public offering and 2011 ATM Agreement were used to continue development of our gevokizumab product candidate and for other working capital and general corporate purposes.

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We have incurred significant operating losses and negative cash flows from operations since our inception. At March 31, 2012, we had cash and cash equivalents of $74.9 million. During 2012, 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 license and collaboration agreement with Servier, funding from the loan agreement with GECC, our March 2012 public offering, 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 into 2014. 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.

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, research and development expense, long-lived assets, contingent warrant liabilities, derivative instruments and stock-based compensation to be critical policies. There have been no significant changes in our critical accounting estimates during the three months ended March 31, 2012, as compared with those previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, filed with the SEC on March 14, 2012.

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

Certain statements contained herein related to the anticipated size of clinical trials, the anticipated timing of initiation of clinical trials, continued sales of approved products, regulatory approval of unapproved product candidates, anticipated restructuring charges, 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 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; continued sales of approved products may be impacted by XOMA's ability to implement its marketing efforts, competition or unanticipated safety issues; regulatory approval of unapproved product candidates may be affected by the results of future clinical trials, actions or inaction by the FDA or unanticipated safety issues; restructuring charges may be other than as anticipated if we have not estimated them properly or if we implement additional or different streamlining activities; 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 regulatory authorities or our present or future collaboration partners, unanticipated safety issues or unavailability of additional financing, 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 Food and Drug Administration, 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; and uncertainties as to the costs of protecting intellectual property 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 loan facilities. 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, cash equivalents and short-term investments. 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 March 31, 2012 and December 31, 2011 (in thousands, except interest rates):

	Maturity	Carrying Amount (in thousands)	Fair Value (in thousands)	Average Interest Rate
March 31, 2012				
Cash and cash equivalents	Daily to 90 days	$ 74,887	$ 74,887	0.07 %
December 31, 2011				
Cash and cash equivalents	Daily to 90 days	$ 48,344	$ 48,344	0.25 %

As of March 31, 2012, we have an outstanding principal balance on our note with Novartis of $14.0 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 2.80% at March 31, 2012. No further borrowing is available under this note.

As of March 31, 2012, we have an outstanding principal balance on our loan with Servier of €15.0 million, which converts to approximately $20.0 million at March 31, 2012. 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 and 3.54% for the six-month period from January 2012 through July 2012. No further borrowing is available under this loan.

As of March 31, 2012, we have an outstanding principal balance on our loan with GECC of $9.3 million, which is to be repaid over a period of 39 consecutive equal monthly installments. The loan accrues interest at a fixed rate of 11.71% per annum. No further borrowing is available under this note.

The variable interest rate related to our long-term debt instruments is based on LIBOR for our Novartis note and EURIBOR for our Servier loan. We estimate that a hypothetical 100 basis point change in interest rates could increase or decrease our interest expense by approximately $0.3 million on an annualized basis. Our loan with GECC is not subject to interest rate risk as it accrues interest at a fixed rate.

Foreign Currency Risk

We hold debt, may incur expenses, and may be owed milestones denominated in foreign currencies. The amount of debt owed, expenses incurred, or milestones owed to us 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, expense, and milestones increases, and when the U.S. dollar strengthens against these currencies, the U.S. dollar value of the foreign-currency denominated debt, expense, and milestones 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 2011, with the proceeds converting to approximately $19.5 million using the January 13, 2011 Euro to USD exchange rate. At March 31, 2012, the €15.0 million outstanding principal balance under this loan agreement would have equaled approximately $20.0 million using the March 31, 2012 Euro to USD exchange rate. In May 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 to buy €15.0 million and €1.5 million on January 2016 and January 2014, respectively. Upfront premiums paid on these foreign exchange option contracts totaled $1.5 million and they had an aggregate fair value of $0.9 million at March 31, 2012. Our use of derivative financial instruments represents risk management; we do not enter into derivative financial contracts for trading purposes.

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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 Chief Executive Officer (our principal executive officer) and our Vice President, Finance and Chief Financial Officer (our principal financial and principal accounting 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 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 filed cases to seventy seven. 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®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of all but one of the cases pending in Alameda County Superior Court. The one Alameda County case not included in this settlement agreement is Kilzer v. Genentech, Inc., et al, Case No. RG-10-502461. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees and funding of this settlement agreement 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 petition asserts personal injury claims against Genentech, us and others arising out of plaintiff's treatment with RAPTIVA®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this case. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees and funding of this settlement agreement by Genentech, which we believe is applicable to these matters.

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. This complaint alleges the same claims against Genentech, us and others and seeks the same types of damages as the complaints filed in the Superior Court of

Alameda County, California referenced above. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this case. Our agreement with Genentech provides for an indemnity of XOMA and payment of legal fees and funding of this settlement agreement by Genentech, which we believe is applicable to these matters.

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. On June 13, 2011, a complaint was filed in the Supreme Court for the State of New York, Onondaga County. Defendants removed the case to the United States District Court for the Northern District of New York on November 3, 2011. 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. No trial date has been set in either case. 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.

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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, 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 were 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. On October 31, 2011, Plaintiffs filed a Notice of Appeal in each case in the United States Court of Appeal for the Sixth Circuit. 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.

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 we raise additional funds by issuing equity securities, our stockholders will experience dilution. Any debt financing or additional equity that we raise may contain terms that are not favorable to our stockholders or us. If we raise additional funds through collaboration and licensing arrangements with third parties, we may be required to relinquish some rights to our technologies or our product candidates, grant licenses on terms that are not favorable to us or enter into a collaboration arrangement for a product candidate at an earlier stage of development or for a lesser amount than we might otherwise choose.

Additional funds may not be available when we need them on terms that are acceptable to us, or at all. If adequate funds are not available on a timely basis, we may:

- terminate or delay clinical trials for one or more of our product candidates;
- further reduce our headcount and capital or operating expenditures; or
- curtail our spending on protecting our intellectual property.

We finance our operations primarily through our multiple revenue streams resulting from discovery and development collaborations, biodefense contracts, the licensing of our antibody technologies, and sales of our common stock. In September 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 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 agreements with Servier and General Electric Capital Corporation ("GECC"), our March 2012 public offering, 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 into 2014. 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 or otherwise have a material adverse impact on our ability to finance our continued operations. 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.

Cash balances and operating cash flow are influenced primarily by the timing and level of payments by our licensees, collaboration 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 March 31, 2012, 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 March 31, 2012, 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 March 31, 2012, we had an accumulated deficit of $916.5 million.

For the three months ended March 31, 2012, we had a net loss of approximately $30.4 million or $0.69 per share of common stock (basic and diluted). For the three months ended March 31, 2011, we had a net loss of approximately $6.3 million or $0.22 per share of common stock (basic and diluted).

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 have received negative results from certain of our clinical trials, and we face uncertain results of other clinical trials of our product candidates.

In March 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 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.

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Many of our product candidates, 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.

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. Regardless of the initial size or relative complexity of a clinical trial, the costs of such trial may be higher than expected due to increases in duration or size of the trial, changes in the protocol pursuant to which the trial is being conducted, additional or special requirements of one or more of the healthcare centers where the trial is being conducted, changes in the regulatory requirements applicable to the trial or in the standards or guidelines for approval of the product candidate being tested or for other unforeseen reasons. 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.

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In June 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 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.

If our therapeutic 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, perindopril arginine in combination with amlodipine besylate (“FDC1”) 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 many of our product candidates (including gevokizumab and XOMA 3AB) will be regulated by the FDA as biologics and that some of our product candidates (including FDC1) will be regulated by the FDA as drugs. 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 (“NDA”) for a drug, and in the form of a Biologic License Application (“BLA”) for a biological product, requesting approval to commence commercial sales. In responding to an NDA or BLA, 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 an NDA, 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.

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The FDA and other regulatory agencies have 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 or other regulatory agencies will be satisfied with our or our collaborators' submissions or whether the FDA or other regulatory agencies will raise questions which may be material and delay or preclude product approval or manufacturing facility approval. In light of this discretion and the complexities of the scientific, medical and regulatory environment, our interpretation or understanding of the FDA's or other regulatory agencies' requirements, guidelines or expectations may prove incorrect, which could also further delay or increase the cost of the approval process. As we accumulate additional clinical data, we will submit it to the FDA and other regulatory agencies, as appropriate and such data may have a material impact on the approval process.

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.

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. As the current holder of the ACEON® NDA, we are required to submit annual reports to the FDA and are responsible for pharmacovigilance activities related to the product.

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 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.

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

We are authorized to issue, without stockholder approval, 1,000,000 shares of preferred stock, of which none were issued and outstanding as of May 4, 2012, which may give other stockholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common stock. In April 2011, the 2,959 Series B convertible preference shares previously issued to Genentech were converted by Genentech into 254,560 shares of common stock. In addition, we are authorized to issue, generally without stockholder approval, up to 92,666,666 shares of common stock, of which 68,083,980 were issued and outstanding as of May 4, 2012. If we issue additional equity securities, the price of our common stock 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 shares of our common stock from time to time through Wm Smith, as the agent for the offer and sale of the shares. Wm Smith could sell these 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 our common stock or to or through a market maker. Wm Smith could also sell the 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 shares of common stock through Wm Smith, constituting all of the shares available for sale under the agreement, for aggregate gross proceeds of $12.2 million.

In February 2010, we completed an underwritten offering of 2.8 million units, with each unit consisting of one share of our common stock and a warrant to purchase 0.45 of a share of common stock, 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 shares of common stock, 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 2010, we entered into a common stock 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 shares of common stock to Azimuth over a 12-month period, subject to certain conditions and limitations. In August 2010, we sold a total of 3,421,407 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 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 shares of our common stock from time to time through the Agents, as our agents for the offer and sale of the 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 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 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 our common stock or to or through a market maker. The Agents could also sell the shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2010 ATM Agreement through May 2011, we sold a total of 7.6 million shares of common stock under this agreement for aggregate gross proceeds of $34.0 million, including 0.8 million shares sold in 2011 for aggregate gross proceeds of $4.4 million. In May 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 (the “2011 ATM Agreement”) with McNicoll, Lewis & Vlak LLC (now known as MLV & Co. LLC, “MLV”), under which we may sell shares of our common stock from time to time through the MLV, as our agent for the offer and sale of the 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, June 3, 2011 and January 3, 2012, which was most recently declared effective by the SEC on January 17, 2012. MLV may sell the 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 our common stock or to or through a market maker. MLV may also sell the shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through May 4, 2012, we sold a total of 7,572,327 shares of common stock under this agreement for aggregate gross proceeds of $14.6 million.

On March 9, 2012, we completed an underwritten public offering of 29,669,154 shares of our common stock, and accompanying warrants to purchase one half of a share of common stock for each share purchased, at a public offering price of $1.32 per share. Total gross proceeds from the offering were approximately $39.2 million, before deducting underwriting discounts and commissions and estimated offering expenses totaling approximately $2.9 million. The warrants, which represent the right to acquire an aggregate of up to 14,834,577 shares of common stock, are immediately exercisable and have a five-year term and an exercise price of $1.76 per share.

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 stock.

There can be no assurance that the market price of our common stock will not decline below its present market price or that there will be an active trading market for our common stock. 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 stock price. We have experienced significant volatility in the price of our common stock. From January 1, 2011 through May 4, 2012, the share price of our common stock has ranged from a high of $7.71 to a low of $1.12. Factors contributing to such volatility include, but are not limited to:

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results of preclinical studies and clinical trials,

information relating to the safety or efficacy of products or product candidates,

developments regarding regulatory filings,

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 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 stock in order to regain compliance.

We may not be successful in commercializing our products, which could also affect our development efforts.

We began commercializing our first product, ACEON®, in January 2012, and we have limited experience in the sales, marketing and distribution of pharmaceutical products. There can be no assurance that we will be able to maintain the arrangements we have with third-party suppliers, distributors and other service providers that are necessary for us to perform these activities or that our efforts will be successful. Maintaining or expanding these arrangements, or developing our own capabilities, may divert attention and resources from or otherwise negatively affect our development programs.

Our rights to commercialize ACEON® are licensed from Servier, and we are obligated to develop and commercialize the products covered by our agreement in accordance with the terms and conditions of that agreement. Our ability to satisfy some of these obligations is dependent on factors that are outside of our control, and our agreement may be terminated if we materially breach our obligations and fail to cure such breach or for other reasons. If our agreement is terminated, we would have no further rights to develop and commercialize these products.

Furthermore, because we intend to use revenues generated by sales of ACEON® in part to fund development of FDC1, lower than expected revenues from such sales could adversely affect our ability to fund the costs of such development.

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We are subject to various state and federal healthcare related laws and regulations that may impact the commercialization of ACEON® or our product candidates and could subject us to significant fines and penalties.

Our operations may be directly or indirectly subject to various state and federal healthcare laws, including, without limitation, the federal Anti-Kickback Statute, the federal False Claims Act and HIPAA/HITECH. These laws may impact, among other things, the commercial operations for ACEON or any of our product candidates that may be approved for commercial sale.

The federal Anti-Kickback Statute prohibits persons from knowingly and willingly soliciting, offering, receiving or providing remuneration, directly or indirectly, in exchange for or to induce either the referral of an individual, or the furnishing or arranging for a good or service, for which payment may be made under a federal healthcare program such as the Medicare and Medicaid programs. Several courts have interpreted the statute's intent requirement to mean that if any one purpose of an arrangement involving remuneration is to induce referrals of federal healthcare covered business, the statute has been violated. The Anti-Kickback Statute is broad and prohibits many arrangements and practices that are lawful in businesses outside of the healthcare industry. Penalties for violations of the federal Anti-Kickback Statute include criminal penalties and civil sanctions such as fines, imprisonment and possible exclusion from Medicare, Medicaid and other federal healthcare programs. Many states have also adopted laws similar to the federal Anti-Kickback Statute, some of which apply to the referral of patients for healthcare items or services reimbursed by any source, not only the Medicare and Medicaid programs. The Physician Payments Sunshine Act also has several state equivalents, which require, and under which the federal government will require in 2013, disclosure of payments we make to physicians for consulting and other services.

The federal False Claims Act prohibits persons from knowingly filing, or causing to be filed, a false claim to, or the knowing use of false statements to obtain payment from the federal government. Suits filed under the False Claims Act, known as "qui tam" actions, can be brought by any individual on behalf of the government and such individuals, commonly known as "whistleblowers," may share in any amounts paid by the entity to the government in fines or settlement. The filing of qui tam actions has caused a number of pharmaceutical, medical device and other healthcare companies to have to defend a False Claims Act action. When an entity is determined to have violated the False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties for each separate false claim. Various states have also enacted laws modeled after the federal False Claims Act.

The federal Health Insurance Portability and Accountability Act of 1996, or HIPAA, created new federal criminal statutes that prohibit executing a scheme to defraud any healthcare benefit program and making false statements relating to healthcare matters and was amended by the Health Information Technology and Clinical Health Act, or HITECH, and its implementing regulations, which imposes certain requirements relating to the privacy, security and transmission of individually identifiable health information. In order to comply with these laws, we have implemented a compliance program to actively identify, prevent and mitigate risk through the implementation of compliance policies and systems and by promoting a culture of compliance. Although we take our obligation to maintain our compliance with these various laws and regulations seriously and our compliance program is designed to prevent the violation of these laws and regulations, if we are found to be in violation of any of the laws and regulations described above or other applicable state and federal healthcare fraud and abuse laws, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion from government healthcare reimbursement programs and the curtailment or restructuring of our operations, all of which could have a material adverse effect on our business and results of operations.

Certain of our technologies are in-licensed from third parties, so our capabilities using them are restricted 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 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 in-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.

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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 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 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.

Even approved and marketed products are subject to risks relating to changes in the market for such products. Introduction or increased availability of generic versions of products can alter the market acceptance of branded products, such as ACEON®. In addition, unforeseen safety issues may arise at any time, regardless of the length of time a product has been on the market.

Our third party collaborators, licensees, suppliers or contractors may not have adequate manufacturing capacity sufficient to meet market demand.

Upon approval of any of our product candidates or in the event of increased demand for marketed products, we do not know whether the capacity of the manufacturing facilities of our existing or future third-party collaborators, licensees, suppliers or contractors will be available or can be increased to produce sufficient quantities of our products to meet market demand. Also, if we or our third party collaborators, licensees, suppliers or contractors 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 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA®. In April 1999, March 2003, and January 2005, the companies amended the agreement. In October 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 2004, Merck Serono announced the product's approval in the European Union. In January 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 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 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 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 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 2005, we announced the initiation of the second clinical trial of HCD122 in patients with multiple myeloma. In November 2008, we announced the restructuring of this product development collaboration, which involved 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 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 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 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 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 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 Behçet’s uveitis and other inflammatory and oncology indications. We retain development and commercialization rights for Behçet’s uveitis and other inflammatory disease and oncology indications in the U.S. and Japan, and have 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.

In December 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 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 March 31, 2012, the €15.0 million outstanding principal balance under this loan agreement would have equaled approximately $20.0 million using the March 31, 2012 Euro to USD exchange rate.

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In December 2011, we entered into a loan agreement with GECC, under which GECC agreed to make a term loan in an aggregate principal amount of $10 million to XOMA (US) LLC, our wholly owned subsidiary, and upon execution of the loan agreement, GECC funded the term loan. The term loan is guaranteed by us and our two other principal subsidiaries, XOMA Ireland Limited and XOMA Technology Ltd. As security for our obligations under the loan agreement, we, XOMA (US) LLC, XOMA Ireland Limited and XOMA Technology Ltd. each granted a security interest pursuant to a guaranty, pledge and security agreement in substantially all of our existing and after-acquired assets, excluding our intellectual property assets (such as those relating to our gevokizumab and anti-botulism products). We are required to repay the principal amount of the Term Loan over a period of 42 consecutive equal monthly installments of principal and accrued interest. The term loan matures on June 30, 2015, and at maturity, we will make an additional payment equal to 5% of the term loan ("Final Payment Fee"). The loan agreement contains customary representations and warranties and customary affirmative and negative covenants, including restrictions on the ability to incur indebtedness, grant liens, make investments, dispose of assets, enter into transactions with affiliates and amend existing material agreements, in each case subject to various exceptions. In addition, the loan agreement contains customary events of default that entitle GECC to cause any or all of the indebtedness under the loan agreement to become immediately due and payable. The events of default include any event of default under a material agreement or certain other indebtedness. We may voluntarily prepay the term loan in full, but not in part, and any voluntary and certain mandatory prepayments are subject to a prepayment premium of 3% in the first year of the loan, 2% in the second year and 1% thereafter, with certain exceptions. We will also be required to pay the Final Payment Fee in connection with any voluntary or mandatory prepayment. Pursuant to the loan agreement, we issued to GECC unregistered stock purchase warrants, which entitle GECC to purchase up to an aggregate of 263,158 unregistered shares of XOMA common stock at an exercise price equal to $1.14 per share, are immediately exercisable and expire on December 30, 2016.

Effective in January 2012, we entered into an amended and restated agreement with Servier for the U.S. commercialization rights to ACEON® and the development and commercialization in the U.S. of up to three products combining perindopril with other cardiovascular drugs in fixed-dose combinations, or FDCs. This agreement, together with a related trademark license agreement, provides us with exclusive U.S. rights to ACEON® and the first FDC product, and options on two additional FDCs. The arrangement also provides that Servier will supply to us, and we will purchase exclusively from Servier, the active ingredients in ACEON® and the FDCs, in some cases for a limited period. The agreement contains customary termination rights relating to matters such as material breach by either party, insolvency of either party or safety issues. Each party also has the right to terminate the arrangement if the first FDC product does not receive FDA approval by December 31, 2014. Servier also has the right to terminate the arrangement if certain aspects of our commercialization strategy are not successful and Servier does not consent to an alternative strategy or, as to the FDCs, if we breach our obligations to certain of our service providers.

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 May 4, 2012, 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, licensees, suppliers and contractors 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, licensees, suppliers and contractors do not successfully perform the functions for which they are responsible, 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 for gevokizumab, 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. Even when we have a collaborative relationship, other circumstances may prevent it from resulting in successful development of marketable products. 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.

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.

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 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:

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- 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:

Novartis markets and is developing Ilaris® (canakinumab, ACZ885), a fully human monoclonal antibody that selectively binds to and neutralizes IL-1 beta. Since 2009, canakinumab has been approved in over 50 countries for the treatment of children and adults suffering from Cryopyrin-Associated Periodic Syndrome ("CAPS"). Novartis has filed for regulatory approval of canakinumab in the U.S. and Europe for the treatment acute attacks in gouty arthritis. In August 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 2011, Novartis announced positive results of a pivotal Phase 3 trial of canakinumab in patients with systemic juvenile idiopathic arthritis and that it plans to seek regulatory approval for this indication in 2012. Novartis is also pursuing other diseases in which IL-1 beta may play a prominent role, such as systemic secondary prevention of cardiovascular events.

Eli Lilly and Company ("Lilly") is developing a monoclonal antibody to IL-1 beta in Phase 1 development for the treatment of cardiovascular disease. In June 2011, Lilly reported results from a Phase 2 study of LY2189102 in 106 patients with Type 2 diabetes, showing a significant ($p<0.05$), early reduction in C reactive protein, moderate reduction in HbA1c and anti-inflammatory effects. We do not know whether LY2189102 remains in development.

In 2008, Swedish Orphan Biovitrum obtained from Amgen the global exclusive rights to Kineret® (anakinra) for rheumatoid arthritis as currently indicated in its label. In November 2009, the agreement regarding Swedish Orphan

Biovitrum's Kineret® license was expanded to include certain orphan indications. Kineret® is an IL-1 receptor antagonist (IL-1ra) which has been evaluated 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 2010, Biovitrum announced that the FDA had granted orphan drug designation to Kineret® for the treatment of CAPS.

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In February 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 2009, Regeneron announced that rilonacept was approved in the European Union for CAPS. In June 2010 and February 2011, Regeneron announced positive results of two Phase 3 clinical trials of rilonacept in gout. In November 2011, Regeneron announced that the FDA had accepted for review Regeneron’s supplemental BLA for ARCALYST® for the prevention and treatment of gout. A meeting of an FDA advisory panel to review this supplemental BLA is scheduled for May 2012.

Amgen has been developing AMG 108, a fully-human monoclonal antibody that targets inhibition of the action of IL-1. In April 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 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 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).

Perindopril

We are currently selling ACEON, an angiotensin converting enzyme (“ACE”) inhibitor, and developing FDC1, a fixed-dose combination product candidate comprised of perindopril arginine and amlodipine besylate, a calcium channel blocker.

The ACE inhibitor market is highly genericized with all options being available generically. We are aware that:

The number one product (based on annual sales) within the ACE inhibitor category is lisinopril, formerly marketed by Astra-Zeneca Pharmaceuticals LP under the brand ZESTRIL® and by Merck & Co. under the brand Prinivil®.

There are multiple options in the fixed-dose combination market combining ACE inhibitors with diuretics, and two options combining an ACE inhibitor with a calcium channel blocker. Current options with a calcium channel blocker are benazepril/amlodipine, formerly marketed by Novartis Pharmaceuticals as Lotrel®, and trandolapril/verapamil, formerly marketed by Abbot Laboratories as Tarka®.

ACE inhibitors are a segment of the larger Renin Angiotensin Aldosterone System, or RAAS, market. This market is comprised of ACE inhibitors and angiotensin receptor blockers (ARB). Both classes act on the RAAS in different ways to control blood pressure. We are aware that:

The most successful of the ARBs (in terms of annual sales) is valsartan, trade name Diovan®, which is marketed by Novartis. This compound, along with other ARBs, has been developed in multiple fixed-dose combination products: with a diuretic, a calcium channel blocker (amlodipine) and as a triple combining all three.

Our perindopril franchise will compete directly with fixed-dose combinations containing an ACE inhibitor and secondarily with fixed-dose combinations containing an ARB.

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:

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Cangene Corporation has a contract with the U.S. Department of Health & Human Services, expected to be for $423.0 million, to manufacture and supply an equine heptavalent botulism anti-toxin.

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

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.

Manufacturing and quality problems may arise in the future to the extent we continue to perform these manufacturing activities 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.

Failure of our products to meet current Good Manufacturing Practices standards may subject us to delays in regulatory approval and penalties for noncompliance.

Our contract manufacturers are required to produce ACEON® and our clinical product candidates under current Good Manufacturing Practices, or cGMP, in order to meet acceptable standards for use in our clinical trials and for commercial sale, as applicable. If such standards change, the ability of contract manufacturers to produce ACEON® and our product candidates on the schedule we require for our clinical trials or to meet commercial requirements may be affected. In addition, contract manufacturers may not perform their obligations under their agreements with us or may discontinue their business before the time required by us to successfully produce clinical and commercial supplies of ACEON® and our product candidates. We and our contract manufacturers are subject to pre-approval inspections and periodic unannounced inspections by the FDA and corresponding state and foreign authorities to ensure strict compliance with cGMP and other applicable government regulations and corresponding foreign standards. We do not have control over a third-party manufacturer’s compliance with these regulations and standards. Any difficulties or delays in our contractors’ manufacturing and supply of ACEON® and our product candidates or any failure of our contractors to maintain compliance with the applicable regulations and standards could increase our costs, cause us to lose revenue, make us postpone or cancel clinical trials, prevent or delay regulatory approval by the FDA and corresponding state and foreign authorities, prevent the import and/or export of ACEON® and our product candidates, or cause ACEON® and any of our product candidates that may be approved for commercial sale to be recalled or withdrawn.

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.

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:

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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 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 2008 or earlier.

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.

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.

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.

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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 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 this law survives on-going calls for its repeal, the reforms imposed by the law would significantly impact the pharmaceutical industry, most likely in the area of pharmaceutical product pricing. While the law may increase the number of patients who have insurance coverage for our products or product candidates, its cost containment measures could also adversely affect reimbursement for our existing or potential products; however, the full effects of this 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 the share price of our common stock 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 or indemnified by a third party would have to be paid from cash or other assets, which could have an adverse affect on our business and the value of our common stock. 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. As examples, following are summaries of certain product liability related complaints to which we are a party.

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 filed cases to seventy seven. 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®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of all but one of the cases pending in Alameda County Superior Court. The one Alameda County case not included in this settlement agreement is Kilzer v. Genentech, Inc., et al, Case No. RG-10-502461. 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.

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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 petition asserts personal injury claims against Genentech, us and others arising out of plaintiff's treatment with RAPTIVA®. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this 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.

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. This complaint alleges the same claims against Genentech, us and others and seeks the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced above. Effective April 18, 2012, the parties entered into a Confidential Settlement Agreement that will result in the dismissal, with prejudice, of this 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.

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. On June 13, 2011, a complaint was filed in the Supreme Court for the State of New York, Onondaga County. Defendants removed the case to the United States District Court for the Northern District of New York on November 3, 2011. 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. No trial date has been set in either 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.

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 were 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. On October 31, 2011, Plaintiffs filed a Notice of Appeal in each case in the United States Court of Appeal for the Sixth Circuit. 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 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 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 D. Rubin, M.D., our Senior Vice President, Research and Development and Chief Medical Officer. We currently have no key person insurance on any of our employees.

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.

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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.

We may not realize the expected benefits of our initiatives to reduce costs across our operations, and we may incur significant charges or write-downs as part of these efforts.

We have pursued and may continue to pursue a number of initiatives to reduce costs of our operations. In January 2012, we implemented a workforce reduction of approximately 34% in order to improve our cost structure. This workforce reduction resulted primarily from our decisions to utilize a contract manufacturing organization for Phase 3 and commercial antibody production and to eliminate internal research functions that are non-differentiating or that can be obtained cost-effectively by contract service providers. As a result, we expect to reduce ongoing internal spending by approximately $14 million in 2012 compared to the 2011 level. In the first quarter of 2012, as a result of our streamlining of operations, we incurred restructuring and related severance costs totaling approximately $3.8 million, of which $2.1 million were cash charges. For the remainder of 2012, we expect to incur an additional $2.1 million in restructuring and severance costs, of which $1.4 million are expected to result in cash charges.

We may not realize some or all of the expected benefits of our current and future initiatives to reduce costs. In addition to restructuring or other charges, we may experience disruptions in our operations as a result of these initiatives.

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 157 employees as of May 4, 2012. 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.

Our business and operations would suffer in the event of system failures.

Despite the implementation of security measures, our internal computer systems and those of our current and any future collaborators, licensees, suppliers, contractors and consultants are vulnerable to damage from cyber–attacks, computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failures. We could experience failures in our information systems and computer servers, which could be the result of a cyber–attack and could result in an interruption of our normal business operations and require substantial expenditure of financial and administrative resources to remedy. System failures, accidents or security breaches can cause interruptions in our operations and can result in a material disruption of our development programs, commercialization activities and other business operations. The loss of clinical trial data from completed or future clinical trials could result in delays in our regulatory approval efforts and significantly increase our costs to recover or reproduce the data. Similarly, we rely on third parties to supply components for and manufacture our product and product candidates, conduct clinical trials of our product candidates and warehouse and distribute ACEON®, and similar events relating to their computer systems could also have a material adverse effect on our business. To the extent that any disruption or security breach were to result in a loss of, or damage to, our data or applications, or inappropriate disclosure of confidential or proprietary information, we could incur liability and the development of gevokizumab, FDC1 or any of our other product candidates and the commercialization of ACEON® could be delayed or otherwise adversely affected.

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

Our principal operations are located in Northern California, including our corporate headquarters and manufacturing facility in Berkeley, California. This location is in an area of seismic activity near active earthquake faults. Any earthquake, terrorist attack, fire, power shortage or other calamity affecting our facilities may disrupt our business and could have material adverse effect on our business and results of operations.

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We have a significant stockholder, which may limit other stockholders' ability to influence corporate matters and may give rise to conflicts of interest.

Entities controlled by Felix J. Baker and Julian C. Baker beneficially own approximately 30.6% of our outstanding common stock as of May 4, 2012. Accordingly, these entities may exert significant influence over us and any action requiring the approval of the holders of our stock, including the election of directors and approval of significant corporate transactions. We have agreed to allow a representative of these investors to receive information and attend meetings of our board of directors as an observer. These entities have indicated that they may be interested in nominating a member of our board of directors at some future date, but that no decision has been made on whether or not to make such a request. Furthermore, conflicts of interest could arise in the future between us, on the one hand, and these entities, on the other hand, concerning potential competitive business activities, business opportunities, the issuance of additional securities and other matters.

Our shareholder rights agreement and organizational documents contain provisions that may prevent transactions that could be beneficial to our stockholders and may insulate our management from removal.

In February 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.

Our charter and by-laws:

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

- authorize our Board of Directors to issue up to 1,000,000 shares of preferred stock without stockholder 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, we are subject to the provisions of Section 203 of the Delaware General Corporation Law (the "DGCL"), that may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from merging or combining with us.

These provisions of our shareholder rights agreement, our organizational documents and 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 stock, could limit the ability of stockholders 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. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

Exhibit Number	
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	Press Release dated May 8, 2012, 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 Corporation	
Date: May 8, 2012	By:	/s/ JOHN VARIAN John Varian Chief Executive Officer (principal executive officer) and Director
Date: May 8, 2012	By:	/s/ FRED KURLAND Fred Kurland Vice President, Finance and Chief Financial Officer (principal financial and principal accounting officer)