XOMA Corp
Form 10-Q
November 07, 2013

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2013

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 o

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

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

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

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 November 5, 2013
Common Stock, $0.0075 par value	93,077,887

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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)

	September 30, 2013 (unaudited)	December 31, 2012 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$73,988	$45,345
Short-term investments	-	39,987
Trade and other receivables, net	5,630	8,249
Prepaid expenses and other current assets	3,150	2,256
Total current assets	82,768	95,837
Property and equipment, net	6,917	8,143
Other assets	1,321	1,696
Total assets	$91,006	$105,676
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY		
Current liabilities:		
Accounts payable	$6,505	$3,867
Accrued and other liabilities	8,016	13,045
Deferred revenue	3,414	3,409
Interest bearing obligation – current	4,085	3,391
Accrued Interest on interest bearing obligations – current	1,969	121
Total current liabilities	23,989	23,833
Deferred revenue – long-term	4,457	6,315
Interest bearing obligations – long-term	36,941	37,653
Contingent warrant liabilities	39,162	15,001
Other liabilities - long term	-	1,407
Total liabilities	104,549	84,209
Stockholders' (deficit) equity:		
Common stock, $0.0075 par value, 138,666,666 shares authorized, 92,701,155 and 82,447,274 shares outstanding at September 30, 2013 and December 31, 2012, respectively	692	615
Additional paid-in capital	1,014,642	977,962
Accumulated other comprehensive income	-	8
Accumulated deficit	(1,028,877)	(957,118)
Total stockholders' (deficit) equity	(13,543)	21,467
Total liabilities and stockholders' (deficit) equity	$91,006	$105,676

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

(Note 1) The condensed consolidated balance sheet as of December 31, 2012 has been derived from the audited consolidated financial statements as of that date included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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XOMA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited)
(in thousands, except per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Revenues:				
License and collaborative fees	$1,574	$1,127	$2,578	$4,665
Contract and other	4,738	6,124	20,339	21,725
Total revenues	6,312	7,251	22,917	26,390
Operating expenses:				
Research and development	18,198	18,409	51,905	52,702
Selling, general and administrative	5,225	4,672	13,429	12,918
Restructuring	112	323	209	4,776
Total operating expenses	23,535	23,404	65,543	70,396
Loss from operations	(17,223)	(16,153)	(42,626)	(44,006)
Other expense:				
Interest expense	(1,159)	(1,144)	(3,495)	(3,211)
Other expense	(132)	(420)	92	(542)
Revaluation of contingent warrant liabilities	(11,125)	(9,208)	(25,745)	(25,746)
Net loss before taxes	(29,639)	(26,925)	(71,774)	(73,505)
Provision for income tax benefit	15	74	15	74
Net loss	$(29,624)	$(26,851)	$(71,759)	$(73,431)
Basic and diluted net loss per share of common stock	$(0.34)	$(0.39)	$(0.85)	$(1.22)
Shares used in computing basic and diluted net loss per share of common stock	87,033	68,189	84,205	60,239
Other comprehensive loss:				
Net loss	$(29,624)	$(26,851)	$(71,759)	$(73,431)
Net unrealized loss on available-for-sale securities	-	7	-	12
Comprehensive loss	$(29,624)	$(26,844)	$(71,759)	$(73,419)

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)

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	$(71,759)	$(73,431)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	2,014	3,308
Common stock contribution to 401(k)	828	1,134
Stock-based compensation expense	3,946	3,368
Accrued interest on interest bearing obligations	2,031	878
Revaluation of contingent warrant liabilities	25,745	25,746
Restructuring charge related to long-lived assets	-	2,241
Amortization of debt discount, final payment fee on debt, and debt issuance costs	1,841	1,388
Loss on sale and retirement of property & equipment	281	-
Unrealized gain on foreign currency exchange	(55)	(88)
Unrealized loss on foreign exchange options	184	721
Other non-cash adjustments	(21)	17
Changes in assets and liabilities:		
Trade and other receivables, net	2,637	5,251
Prepaid expenses and other assets	(1,042)	(421)
Accounts payable and accrued liabilities	(2,130)	3,451
Deferred revenue	(1,436)	(2,948)
Other liabilities	(1,666)	(47)
Net cash used in operating activities	(38,602)	(29,432)
Cash flows from investing activities:		
Purchase of investments	-	(16,988)
Proceeds from maturities of investments	40,000	-
Net purchase of property and equipment	(1,069)	(2,097)
Proceeds from sale of property and equipment	-	452
Net cash provided by (used in) investing activities	38,931	(18,633)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of issuance costs	29,959	39,624
Proceeds from exercise of warrants	438	-
Proceeds from issuance of long-term debt, net of issuance costs	-	4,439
Principal payments of debt	(2,083)	(2,143)
Net cash provided by financing activities	28,314	41,920
Net increase in cash and cash equivalents	28,643	(6,145)
Cash and cash equivalents at the beginning of the period	45,345	48,344
Cash and cash equivalents at the end of the period	$73,988	$42,199
Supplemental Cash Flow Information:		
Cash paid for:		

Interest	$988	$723
Non-cash investing and financing activities:		
Issuance of warrants	$-	$6,390
Reclassification of contingent warrant liability to equity upon exercise of warrants	$(1,585)	$(337)
Interest added to principal balances on long-term debt	$745	$941
Investment in noncontrolling interest	$171	$-
Discount on long-term debt	$-	$(55)

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 for which it intends to commercialize. 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 candidate gevokizumab (IL-1 beta modulating antibody) with Les Laboratoires Servier ("Servier") through a global Phase 3 clinical development 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. 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 ("FDC") product candidates where perindopril is combined with other active ingredients to treat cardiovascular disease. In July 2013, the Company transferred these rights to Symplmed Pharmaceuticals, LLC ("Symplmed") in exchange for a minority equity position in Symplmed and up to double-digit royalties on sales of the first FDC product, if it is approved by the U.S. Food and Drug Administration (the "FDA").

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 were 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, 2012, filed with the U.S. Securities and Exchange Commission ("SEC") on March 12, 2013.

In management's opinion, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which are necessary to present fairly the Company's consolidated financial position as of September 30, 2013, the consolidated results of the Company's operations for the three and nine months ended September 30, 2013 and 2012 and the Company's cash flows for the nine months ended September 30, 2013 and 2012. 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, derivative instruments, stock-based compensation, and restructuring liabilities. 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 adjustments to revenues previously reported.

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 net product sales has been reclassified into contract and other revenue because the net product sales were not material for all periods presented. These reclassifications had no impact on the Company's previously reported net loss or cash flows.

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Long-lived Assets

The Company reviews the carrying values and depreciation lives 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. In connection with the Company's 2012 streamlining plan, the Company recorded an impairment loss of $0.8 million during the nine months ended September 30, 2012. During the three and nine months ended September 30, 2012, the Company recorded accelerated depreciation of $0.1 million and $1.4 million, respectively, on long-lived assets. 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 2013.

The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the nine months ended September 30, 2013, two customers represented 57% and 30% of total revenue and 27% and 50% of the accounts receivable balance.

For the nine months ended September 30, 2012, these two customers represented 45% and 35% of total revenues. As of December 31, 2012, there were receivables outstanding from these two customers representing 58% and 35% of the accounts receivable balance.

Newly Adopted Accounting Pronouncements

In February 2013, Accounting Standards Codification Topic 220, Comprehensive Income was amended to require companies to report, in one place, information about reclassifications out of accumulated other comprehensive income. Accordingly, a company can present this information on the face of the financial statements, if certain requirements are met, or the information must be presented in the notes to the financial statements. The Company adopted this guidance as of January 1, 2013, on a retrospective basis and the items reclassified out of accumulated other comprehensive income are not material for all periods presented.

3. Condensed Consolidated Financial Statement Detail

Net Loss Per Share of Common Stock

Basic net loss per share of common stock is based on the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share of common stock is based on the weighted average number of shares outstanding during the period, adjusted to include the assumed conversion of certain stock options, restricted stock units ("RSUs"), and warrants for common stock.

Potentially dilutive securities are excluded from the calculation of loss 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 September 30,	Nine Months Ended September 30,

	2013	2012	2013	2012
Common stock options and restricted stock units	6,825	5,730	6,017	5,788
Warrants for common stock	15,970	16,626	16,106	12,942
Total	22,795	22,356	22,123	18,730

For the three and nine months ended September 30, 2013 and 2012, all outstanding securities were considered anti-dilutive, and therefore the calculation of basic and diluted net loss per share was the same.

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Cash and Cash Equivalents

At September 30, 2013, cash and cash equivalents consisted of demand deposits of $16.2 million and money market funds of $57.8 million with maturities of less than 90 days at the date of purchase. At December 31, 2012, cash and cash equivalents consisted of demand deposits of $7.8 million and money market funds of $37.5 million with maturities of less than 90 days at the date of purchase.

Short-term Investments

At September 30, 2013, the Company did not have short-term investments. At December 31, 2012, short-term investments consisted of U.S. treasury securities of $40.0 million with maturities of greater than 90 days and less than one year from the date of purchase.

Foreign Exchange Options

The Company holds debt and may incur revenue and 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 in the future 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 €1.5 million and €15.0 million in January 2014 and January 2016, 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 revalued 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 consolidated balance sheet and changes in fair value on these contracts are included in other income (expense) on the condensed consolidated statements of comprehensive loss.

The foreign exchange options were revalued at September 30, 2013 and had an aggregate fair value of $0.3 million. The Company recognized a $0.2 million loss on revaluation for the nine months ended September 30, 2013. The Company recognized losses for the three and nine months ended September 30, 2012 of $0.1 million and $0.7 million, respectively, as a result of the revaluation.

Accrued Liabilities

Accrued liabilities consisted of the following at September 30, 2013 and December 31, 2012 (in thousands):

	September 30, 2013	December 31, 2012
Accrued management incentive compensation	$ 3,112	$ 3,978
Accrued payroll and other benefits	2,708	2,461
Accrued clinical trial costs	500	4,702
Other	1,696	1,904
Total	$ 8,016	$ 13,045

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 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 Option Pricing Model (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 December 31, 2012, the fair value of the warrant liability was estimated to be $15.0 million using the Black-Scholes Model. The Company revalued the warrant liability at September 30, 2013 using the Black-Scholes Model and recorded the $25.7 million increase in the fair value as a loss in the revaluation of contingent warrant liabilities line of its condensed consolidated statements of comprehensive loss. The Company also reclassified $1.6 million from contingent warrant liabilities to equity on its condensed consolidated balance sheets due to the exercise of warrants. As of September 30, 2013, 13,673,183 of these warrants were outstanding and had a fair value of $39.1 million. This increase in liability is due primarily to the increase in the market price of the Company's common stock at September 30, 2013 compared to December 31, 2012.

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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. In June 2009, the Company issued warrants to certain institutional investors as part of a registered direct offering. These 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 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 and June 2009 as liabilities at fair value. As of September 30, 2013, all of these warrants were outstanding and had an aggregate fair value of approximately $0.1 million.

4. Fair Value Measurements

Fair value is defined as the price that would be received from selling an asset or the amount that would be 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.

Level 3 – Unobservable inputs.

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The following tables set forth the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012.

Financial assets and liabilities carried at fair value as of September 30, 2013 and December 31, 2012 were classified as follows (in thousands):

	Fair Value Measurements at September 30, 2013 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]	$57,756	$ -	$ -	$57,756
Foreign exchange options [3]	-	304	-	304
Total	$57,756	$ 304	$ -	$58,060
Liabilities:				
Contingent warrant liabilities	$-	$ -	$ 39,162	$39,162

	Fair Value Measurements at December 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]	$37,461	$ -	$ -	$37,461
U.S. treasury securities [2]	39,987	-	-	39,987
Foreign exchange options [3]	-	488	-	488
Total	$77,448	$ 488	$ -	$77,936
Liabilities:				
Contingent warrant liabilities	$-	$ -	$ 15,001	$15,001

(1) Included in cash and cash equivalents
(2) Included in short-term investments
(3) Included in other assets

The fair value of the foreign exchange options at September 30, 2013 and December 31, 2012 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 September 30, 2013 and December 31, 2012 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.

The fair value of the contingent warrant liabilities was estimated using the following range of assumptions at September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
Expected volatility	40 %	40 %
Risk-free interest rate	0.1% - 0.7 %	0.3% - 0.7 %
Expected term	1.2 - 3.4 years	1.9 - 4.2 years

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The following table provides a summary of changes in the fair value of the Company's Level 3 financial liabilities for the nine months ended September 30, 2013 (in thousands):

Contingent warrant liabilities	September 30, 2013
Balance at December 31, 2012	15,001
Reclassification of contingent warrant liability to equity upon exercise of warrants	(1,585)
Net increase in fair value of contingent warrant liabilities upon revaluation	25,746
Balance at September 30, 2013	39,162

For the three and nine months ended September 30, 2013, the Company recognized net increases of $11.1 million and $25.7 million, respectively, in the estimated fair value of the contingent warrant liabilities resulting in recognized losses in the revaluation of contingent warrant liabilities line of the condensed consolidated statements of comprehensive loss.

For the three and nine months ended September 30, 2012, the Company recognized net increases of $9.2 million and $25.7 million, respectively, in the estimated fair value of the contingent warrant liabilities resulting in recognized losses in the revaluation of contingent warrant liabilities line of the condensed consolidated statements of comprehensive loss.

5. Licensing, Collaborative and Other Arrangements

In July 2013, the Company transferred U.S. development and commercialization rights to the perindopril franchise to Symplmed. Under the terms of the arrangement, XOMA received a minority equity position in Symplmed and up to double-digit royalties on sales of the first fixed-dose combination containing perindopril arginine and amlodipine besylate, if it is approved by the FDA. The Company recorded the minority equity position in the other assets line of its condensed consolidated balance sheets. Symplmed, under a sublicense agreement, assumes U.S. marketing responsibilities for ACEON (perindopril erbumine), and XOMA continues to manage and be reimbursed for sales and distribution within its established commercial infrastructure until the ACEON New Drug Application ("NDA") is transferred to Symplmed. XOMA also continues to record gross ACEON sales in the contracts and other revenue line of its condensed consolidated statements of comprehensive loss until the ACEON NDA is transferred. Following the ACEON NDA transfer, Symplmed will pay XOMA single-digit royalties on sales of ACEON.

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.

In connection with the streamlining of operations, the Company incurred restructuring charges in the first nine months of 2012 of $2.0 million related to severance, other termination benefits and outplacement services, $2.2 million related to the impairment and accelerated depreciation of various assets and leasehold improvements, and $0.7 million related to moving and other facility costs. In the first nine months of 2013, the Company has incurred $0.2 million in restructuring charges related to facility costs and does not expect to incur additional significant restructuring charges during the remainder of 2013 related to these streamlining activities.

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 the 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 2.41% at September 30, 2013, and is payable semi-annually in June and December of each year. Additionally, the interest rate resets 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 its collaboration with Novartis, including any payments owed to it thereunder.

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At September 30, 2013 and December 31, 2012, the outstanding principal balance under this note agreement was $14.6 million and $14.4 million, respectively. 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 (the "Servier Loan Agreement"), which provided for an advance of up to €15.0 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 is reset semi-annually in January and July of each year. The interest rate for the initial interest period was 3.22%. The interest rate has been reset to 3.83% for the six-month period from July 2011 through January 2012, 3.54% for the six-month period from January 2012 through July 2012, 2.80% for the six-month period from July 2012 through January 2013, 2.33% for the six-month period from January 2013 through July 2013, and 2.33% for the six-month period from July 2013 through January 2014. Interest is payable semi-annually; however, the Servier Loan Agreement provides for a deferral of interest payments over a period specified in the agreement. During the deferral period, accrued interest will be added to the outstanding principal amount for the purpose of interest calculation for the next six-month interest period. On the repayment commencement date, all unpaid and accrued interest shall be paid to Servier and thereafter, all accrued and unpaid interest shall be due and payable at the end of each six-month period. The loan matures in 2016; however, after a specified period prior to final maturity, the loan is to be repaid (i) at Servier's option, by applying up to a significant percentage of any milestone or royalty payments owed by Servier under the Company's collaboration agreement and (ii) using a significant percentage of any upfront, milestone or royalty payments the Company receives from any third-party collaboration or development partner for rights to gevokizumab in the U.S. and/or Japan. In addition, the loan becomes immediately due and payable upon certain customary events of default. At September 30, 2013 and December 31, 2012, the outstanding principal balance under this loan was $20.3 million and $19.8 million, respectively, using the Euro to US Dollar exchange rates of 1.3520 and 1.3215, respectively. For the three and nine months ended September 30, 2013, the Company recorded unrealized foreign exchange losses of $0.8 million and $0.5 million, respectively, related to the re-measurement of the loan, compared to an unrealized foreign exchange loss of $0.4 million and an unrealized foreign exchange gain of $0.1 million, for the same periods in 2012.

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 $0.4 million and $1.2 million in the three and nine months ended September 30, 2013, respectively, and $0.4 million and $1.1 million in the three and nine months ended September 30, 2012, respectively, resulting from the amortization of the loan discount. At September 30, 2013 and December 31, 2012, the net carrying value of the loan was $15.8 million and $14.2 million, respectively. For the three and nine months ended September 30, 2013, the Company recorded unrealized foreign exchange gains of $0.2 million and $0.1 million, respectively, related to the re-measurement of the loan discount, compared to an unrealized foreign exchange gain of $0.1 million and an unrealized foreign exchange loss of $0.1 million, respectively, for the same periods in 2012.

The Company believes 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 $0.4 million and $1.2 million of related non-cash revenue during the three and nine months ended September 30, 2013, respectively, and $0.4 million and $1.1 million during the three and nine months ended September 30, 2012, respectively.

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General Electric Capital Corporation Term Loan

In December 2011, the Company entered into a loan agreement (the "GECC 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 the Company, and upon execution of the GECC Loan Agreement, GECC funded the Term Loan. As security for its obligations under the GECC Loan Agreement, the Company granted a security interest in substantially all of its existing and after-acquired assets, excluding its intellectual property assets (such as those relating to its gevokizumab and anti-botulism products). The Term Loan accrued interest at a fixed rate of 11.71% per annum and was to be repaid over a period of 42 consecutive equal monthly installments of principal and accrued interest and was due and payable in full on June 15, 2015. The Company incurred debt issuance costs of approximately $1.3 million in connection with the Term Loan and was required to pay a final payment fee equal to $500,000 on the maturity date, or such earlier date as the Term Loan is paid in full. The debt issuance costs and final payment fee were being amortized and accreted, respectively, to interest expense over the term of the Term Loan using the effective interest method.

In connection with the GECC Loan Agreement, the Company issued to GECC unregistered warrants that 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 exercisable immediately and have a five-year term. 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 was recorded as a discount to the debt obligation and was being amortized over the term of the loan using the effective interest method.

In September 2012, The Company entered into an amendment to the GECC Loan Agreement providing for an additional term loan in the amount of $4.6 million, increasing the term loan obligation to $12.5 million (the "Amended Term Loan") and providing for an interest-only monthly repayment period following the effective date of the amendment through March 1, 2013, at a stated interest rate of 10.9% per annum. Thereafter, the Company is obligated to make monthly principal payments of $347,222, plus accrued interest, over a 27-month period commencing on April 1, 2013, and through June 15, 2015, at which time the remaining outstanding principal amount of $3.1 million, plus accrued interest, is due. The Company incurred debt issuance costs of approximately $0.2 million and are required to make a final payment fee in the amount of $875,000 on the date upon which the outstanding principal amount is required to be repaid in full. This final payment fee replaced the original final payment fee of $500,000. The debt issuance costs and final payment fee are being amortized and accreted, respectively, to interest expense over the term of the Amended Term Loan using the effective interest method.

In connection with the amendment, on September 27, 2012 the Company issued to GECC unregistered stock purchase warrants, which entitle GECC to purchase up to an aggregate of 39,346 shares of XOMA common stock at an exercise price equal to $3.54 per share. These warrants are exercisable immediately and have a five-year term. The warrants' fair value of $0.1 million was recorded as a discount to the debt obligation and is being amortized over the term of the loan using the effective interest method. The warrants are classified in permanent equity on the condensed consolidated balance sheets.

The Amended Term Loan does not change the remaining terms of the GECC Loan Agreement. The GECC 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 GECC Loan Agreement contains customary events of default that entitle GECC to cause any or all of the indebtedness under the GECC 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.

The Company may prepay the Amended Term Loan voluntarily 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 after the effective date of the loan amendment, 2% in the second year and 1% thereafter, with certain exceptions. The Company will also be required to pay the $875,000 final payment fee in connection with any voluntary or mandatory prepayment. On the effective date of the loan amendment, the Company paid an accrued final payment fee in the amount of $0.2 million relating to the original final payment fee of $500,000.

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At September 30, 2013 and December 31, 2012, the outstanding principal balance under the Amended Term Loan was $10.4 million and $12.5 million, respectively.

Interest Expense

Interest expense and amortization of debt issuance costs and discounts, recorded as other expense in the condensed consolidated statements of comprehensive loss for the three and nine months ended September 30, 2013 and 2012 are shown below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Interest expense				
Servier loan	$547	$558	$1,600	$1,583
GECC term loan	508	475	1,584	1,298
Novartis note	90	99	272	298
Other	14	12	39	32
Total interest expense	$1,159	$1,144	$3,495	$3,211

Other Financings

Underwritten Offering

On August 23, 2013, the Company completed an underwritten public offering of 8,736,187 shares of its common stock, including 1,139,502 shares of its common stock that were issued upon the exercise of the underwriters' 30-day over-allotment option to purchase additional shares, at a public offering price of $3.62 per share. Total gross proceeds from the offering were approximately $31.6 million, before deducting underwriting discounts and commissions and estimated offering expenses totaling approximately $2.2 million.

8. Income Taxes

The Company recognized $15,000 of income tax benefit relating to refundable credits for the three and nine months ended September 30, 2013, compared to $0.1 million during the same period of 2012. 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.

Accounting Standards Codification Topic 740, Income Taxes ("ASC 740") 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 the Company's historical operating performance and carry-back potential, it has determined that total deferred tax assets should be fully offset by a valuation allowance.

9. Stock-based Compensation

In the first nine months of 2013, the Board of Directors of the Company approved grants under the Company's Long Term Incentive Plan for an aggregate of 1,144,403 stock options and an aggregate of 958,385 RSUs to certain employees and the directors of the Company. The stock options vest monthly over four years for employees and one year for directors of the Company, 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 U.S. 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.

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The fair value of the stock options granted was estimated based on the following weighted average assumptions for three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Dividend yield	0 %	0 %	0 %	0 %
Expected volatility	92 %	92 %	92 %	92 %
Risk-free interest rate	1.43%	0.72 %	0.87%	1.05 %
Expected term	5.6 years	5.6 years	5.6 years	5.6 years

Stock option activity for the nine months ended September 30, 2013 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, 2012	6,788,383	$ 8.99	7.36	$ 1,531
Granted	1,144,403	$ 3.10		
Exercised	(297,149)	$ 1.75		
Forfeited, expired or cancelled	(129,296)	$ 17.88		
Options outstanding at September 30, 2013	7,506,341	$ 8.23	7.01	$ 8,262
Options exercisable at September 30, 2013	4,817,306	$ 11.13	6.03	$ 4,050

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 nine months ended September 30, 2013 is summarized below:

	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested balance at December 31, 2012	1,459,853	$ 2.75
Granted	958,385	$ 2.96
Vested	(419,760)	$ 2.99
Forfeited	(45,434)	$ 2.29
Unvested balance at September 30, 2013	1,953,044	$ 2.63

The following table shows total stock-based compensation expense included in the condensed consolidated statements of comprehensive loss for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012

Research and development	$474	$1,304	$1,904	$1,984
Selling, general and administrative	753	818	2,042	1,384
Total stock-based compensation expense	$1,227	$2,122	$3,946	$3,368

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

Forward Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, which are subject to the "safe harbor" created by those sections. Forward-looking statements are based on our management's beliefs and assumptions and on information currently available to them. In some cases you can identify forward-looking statements by words such as "may," "will," "should," "could," "would," "expects "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements. Examples of these statements include, but are not limited to, statements regarding: the implications of interim or final results of our clinical trials, the progress of our research programs, including clinical testing, the extent to which our issued and pending patents may protect our products and technology, our ability to identify new product candidates, the potential of such product candidates to lead to the development of commercial products, our anticipated timing for initiation or completion of our clinical trials for any of our product candidates, our future operating expenses, our future losses, our future expenditures for research and development, and the sufficiency of our cash resources. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us and described in Part II, Item 1A of this Quarterly Report on Form 10-Q and our other filings with the SEC. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from those we expect. Except as required by law, we assume no obligation to update these forward-looking statements, whether as a result of new information, future events or otherwise.

The following discussion and analysis should be read in conjunction with the unaudited financial statements and notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q and with the audited consolidated financial statements and related notes thereto included as part of our Annual Report on Form 10-K for the year ended December 31, 2012.

Overview

XOMA discovers and develops innovative antibody-based therapeutics. Our lead drug candidate, gevokizumab, is a potent, fully humanized monoclonal antibody with unique allosteric modulating properties that binds to the inflammatory cytokine interleukin-1 beta ("IL-1 beta"). We believe, by targeting IL-1 beta, gevokizumab has the potential to address the underlying inflammatory causes of a wide range of diseases that have been identified as unmet medical needs.

Together with our development partner, Les Laboratoires Servier ("Servier"), we initiated three Phase 3 clinical trials evaluating gevokizumab for the treatment of non-infectious uveitis ("NIU") involving the intermediate and/or posterior segment of the eye and Behçet's uveitis, a severe subset of NIU. XOMA is responsible for all of the clinical study sites in the United States, and Servier is responsible for all of the clinical study sites outside of the United States. These studies are known as the EYEGUARD™ program, which includes EYEGUARD-A (patients with acute NIU), EYEGUARD-B (patients with Behçet's uveitis), and EYEGUARD-C (patients with NIU controlled with corticosteroids, with or without immunosuppressive medications). As of September 30, 2013, we have over 60 of the targeted 70 clinical sites up and running in the U.S. where we are working to accelerate enrollment, and we are working closely with SERVIER to identify ways to expedite the site activation process outside the United States. We anticipate disclosing the top-line results of the EYEGUARD studies in 2014.

In October 2013, we announced three-month results from our gevokizumab Phase 2 clinical study in patients with erosive osteoarthritis of the hand ("EOA") who also have C-reactive protein ("CRP") levels greater than or equal to 2.5 mg/L. The three-month results demonstrated that gevokizumab has a clinical effect on the target patient population. The study will continue on a blinded basis until all patients receive the full six months of treatment. We will review the six-month results along with the three-month results from our gevokizumab Phase 2 clinical EOA study in patients who do not have elevated CRP levels, at which time we will make final decisions regarding a potential Phase 3 program in EOA.

In June 2013, we launched a pilot study in inflammatory pyoderma gangrenosum ("PG"), and in tandem, treated two patients with generalized pustular psoriasis ("GPP") under compassionate use protocols. PG and GPP are two rare diseases classified as neutrophilic dermatoses. In October 2013, we selected PG as the next indication for Pivotal clinical development based on compelling results from the pilot study. We will request a meeting with the FDA to review the data and discuss the requirements to move gevokizumab into a pivotal Phase 3 program in this indication.

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Two additional studies are being conducted in collaboration with the United States National Institutes of Health ("NIH"). In March 2013, we announced that a gevokizumab study in patients with non-infectious anterior scleritis had opened for enrollment at the National Eye Institute ("NEI"), and in August 2013, we announced a gevokizumab clinical study in patients with inflammatory autoimmune inner ear disease ("AIED") will be run by the North Shore-Long Island Jewish Health System in collaboration with the National Institute on Deafness and Other Communication Disorders.

Separately, Servier instituted its own active development program for gevokizumab beyond the NIU and Behçet's uveitis Phase 3 program. In 2012, Servier initiated a gevokizumab Phase 2 study in patients with acute coronary syndrome, a cardiovascular disease. Servier also began testing gevokizumab in a variety of small clinical studies, including polymyositis/dermatomyositis and Schnitzler syndrome. Servier indicated these are the first studies in an extensive multi-indication exploratory program it expects to be conducting.

Our proprietary preclinical pipeline includes classes of antibodies that activate, sensitize or deactivate the insulin receptor in vivo, which we have named XMet. This portfolio of antibodies represents potential new therapeutic approaches to the treatment of diabetes and several diseases that have insulin involvement, which we believe may be orphan drug opportunities.

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.

Our biodefense initiatives include XOMA 3AB, a biodefense anti-botulism product candidate comprised of a combination of three antibodies. XOMA 3AB is directed against botulinum toxin serotype A and has been developed through funding from the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the NIH. All volunteers have been enrolled and dosed with XOMA 3AB in a Phase 1 clinical trial sponsored by NIAID. In January 2012, we announced 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 produce these antibodies through an outside manufacturer.

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 Phase 2 clinical development by Novartis for the potential treatment of breast or prostate cancer and hematological malignancies, respectively.

Significant Developments in the First Nine Months of 2013

Gevokizumab

- In January 2013, we announced preliminary top-line data from an interim analysis of our Phase 2 proof-of-concept study to evaluate the safety and efficacy of gevokizumab for the treatment of moderate-to-severe inflammatory acne. Preliminary data from the 125-patient trial demonstrated clear activity according to the Investigator's Global Assessment ("IGA") parameter. Gevokizumab was well-tolerated in this trial, with no significant differences in adverse events between gevokizumab and placebo and no serious drug-related adverse events were reported.

- In April 2013, the NEI opened a non-infectious, active, anterior scleritis trial for patient enrollment. The open-label single-arm Phase 1/2 study is designed to assess the safety and potential efficacy of gevokizumab in patients experiencing non-infectious, active, anterior scleritis, which is the inflammation of the sclera.

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In May 2013, we announced we had initiated a second clinical study in inflammatory osteoarthritis of the hand based upon our findings that patients who met all of the eligibility criteria for our original study were not able to participate due to the requirement C-reactive protein (CRP) levels must be greater than or equal to 2.5 mg/L. This second study has the same design and eligibility requirements with the exception that participants with a CRP level of less than 2.5 mg/L may enroll. The study is capturing the same pain and functional endpoints as the primary study, yet the design does not include radiographic/MRI images of the affected joints.

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- In June 2013, we opened enrollment in an open-label pilot study to determine gevokizumab's potential to treat acute inflammatory PG. In October 2013, we announced that we will be requesting a meeting with the FDA to review the data and discuss the requirements to move gevokizumab into a pivotal Phase 3 program in this indication. Our decision is the result of data generated from our open-label pilot study in PG.

- In June 2013, Servier launched its own independent proof-of-concept clinical program to evaluate the safety and efficacy of gevokizumab in indications different from ours. The first such studies are in polymyositis/dermatomyositis and Schnitzler syndrome.

- In July 2013, we announced the completion of patient enrollment in our Phase 2 proof-of-concept study in EOA.

- In August 2013, we announced that a gevokizumab clinical study in patients with AIED will be run by the North Shore-Long Island Jewish Health System in collaboration with the National Institute on Deafness and Other Communication Disorders.

Perindopril Franchise

- In July 2013, we transferred U.S. development and commercialization rights to the perindopril franchise to Symplmed. Under the terms of the arrangement, we received a minority equity position in Symplmed and up to double-digit royalties on sales of the first fixed-dose combination containing perindopril arginine and amlodipine besylate, if it is approved by the FDA. We recorded the minority equity position in the other assets line of our condensed consolidated balance sheets. Symplmed, under a sublicense agreement, assumes U.S. marketing responsibilities for ACEON (perindopril erbumine), and we continue to manage and be reimbursed for sales and distribution within its established commercial infrastructure until the ACEON New Drug Application ("NDA") is transferred to Symplmed. We also continue to record gross ACEON sales in the contracts and other revenue line of our condensed consolidated statements of comprehensive loss until the ACEON NDA is transferred. Following the ACEON NDA transfer, Symplmed will pay us single-digit royalties on sales of ACEON.

Management Addition

- On March 18, 2013, the Company announced Tom Klein has joined the Company as Vice President, Chief Commercial Officer, a newly created position reporting to John Varian, Chief Executive Officer.

Financing

- In August 2013, we completed an underwritten public offering of 8,736,187 share of our common stock for gross proceeds of $31.6 million, before deducting underwriting discounts and commissions and estimated offering expenses totaling approximately $2.2 million.

Results of Operations

Revenues

Total revenues for the three and nine months ended September 30, 2013 and 2012, were as follows (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
License and collaborative fees	$1,574	$1,127	$ 447	$2,578	$4,665	$ (2,087)

Contract and other	4,738	6,124	(1,386)	20,339	21,725	(1,386)
Total revenues	$6,312	$7,251	$ (939)	$22,917	$26,390	$ (3,473)

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 increase in license and collaborative fee revenue for the three months ended September 30, 2013, as compared to the same period of 2012, was due primarily to a $0.6 million increase in milestone payments. The decrease in license and collaborative fee revenue for the nine months ended September 30, 2013, as compared to the same period of 2012, was due primarily to a $2.2 million decrease in licensing fees from two licensing contracts, partially offset by a $0.2 million increase in milestone payments. 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 license and collaboration fee revenue in the remainder of 2013 to be comparable to 2012 levels.

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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 Servier and NIAID. The following table shows the activity in contract and other revenue for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
Servier	$1,399	$3,461	$ (2,062)	$11,882	$10,715	$ 1,167
NIAID	2,614	2,074	540	6,770	9,106	(2,336)
Other	725	589	136	1,687	1,904	(217)
Total contract and other	$4,738	$6,124	$ (1,386)	$20,339	$21,725	$ (1,386)

The decrease in revenue from Servier for the three months ended September 30, 2013, as compared to the same period of 2012, is due primarily to our collaboration with Servier meeting the initial $50 million cap of fully reimbursable NIU costs during the third quarter of 2013. Servier and XOMA will each pay 50% of remaining NIU clinical development and CMC costs. The increase in revenue from Servier for the nine months ended September 30, 2013, as compared to the same period of 2012, is due primarily to an increase in reimbursable clinical development activity with Servier. This increase is partially offset by a decrease in NIAID revenue due primarily to decreased activity under NIAID Contract No. HHSN272200800028C ("NIAID 3") and the recognition of $2.0 million in revenue during the first quarter of 2012 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.

Based on expected levels of revenue generating activity related to our Servier and NIAID contracts, we expect contract and other revenue in the remainder of 2013 to be comparable to 2012 levels.

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, other third-party costs and expenses related to preclinical and clinical testing.

Research and development expenses were $18.2 million and $51.9 million for the three and nine months ended September 30, 2013, respectively, compared with $18.4 million and $52.7 million, respectively, for the same periods of 2012. The decrease of $0.2 million for the three months ended September 30, 2013, as compared to the same period in 2012, was due primarily to the absence of fixed dose combination ("FDC") clinical trial costs in Q3 2013, a decrease in internal facility costs as a result of the 2012 streamlining of operations, and a decrease in employee compensation costs, partially offset by higher internal proprietary project costs and professional service fees. The decrease of $0.8 million for the nine months ended September 30, 2013, as compared to the same period in 2012, was due primarily to decreases in FDC clinical trial costs, and internal facility costs as a result of the 2012 streamlining of operations, partially offset by increases in employee compensation costs and higher external manufacturing activity and internal proprietary project costs.

Salaries and related personnel costs are a significant component of research and development expenses. We recorded $6.4 million and $20.6 million in research and development salaries and employee-related expenses for the three and nine months ended September 30, 2013, respectively, as compared with $6.8 million and $19.8 million for the same periods of 2012. The decrease of $0.4 million for the three months ended September 30, 2013, as compared to the same period of 2012, was due primarily to a $0.8 million decrease in stock-based compensation, partially offset by a $0.4 million increase in salaries and benefits as a result of an increase in headcount. The increase of $0.8 million for the nine months ended September 30, 2013, as compared to the same period of 2012, is due primarily to a $0.9 million increase in salaries and benefits, the result of an increase in headcount.

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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, of which we expect to further decrease in 2013 due to our streamlining objective to utilize a contract manufacturing organization, which was implemented in 2012. Later-stage programs include clinical testing, regulatory affairs and manufacturing clinical supplies. The costs associated with these programs approximate the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Earlier stage programs	$10,310	$8,954	$28,429	$27,066
Later stage programs	7,888	9,455	23,476	25,636
Total	$18,198	$18,409	$51,905	$52,702

Our research and development activities also can be divided into those related to our internal projects and those projects related to collaborative and contract arrangements. The costs related to internal projects versus collaborative and contract arrangements approximate the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Internal projects	$10,915	$8,426	$30,892	$23,860
Collaborative and contract arrangements	7,283	9,983	21,013	28,842
Total	$18,198	$18,409	$51,905	$52,702

For the three and nine months ended September 30, 2013, the gevokizumab program, for which we incurred the largest amount of expense, accounted for more than 40% but less than 50% of our total research and development expenses. A second development programs, XMet, accounted for more than 20% but less than 30% of our total research and development expenses and a third development program, NIAID, accounted for more than 10% but less than 20% of our total research and development expenses. All remaining development programs accounted for less than 10% of our total research and development expenses for the three and nine months ended September 30, 2013. For the three and nine months ended September 30, 2012, the gevokizumab program accounted for more than 40% but less than 50% of our total research and development expenses, NIAID accounted for more than 20% but less than 30% of our total research and development expenses, and XMet accounted for more than 10% but less than 20% of our total research and development expenses. All remaining development programs accounted for less than 10% of our total research and development expenses for the three and nine months ended September 30, 2012.

We expect our research and development spending in the remainder of 2013 to increase compared to 2012 levels due primarily to our ongoing global Phase 3 clinical program for gevokizumab for the NIU indications, under our license and collaboration agreement with Servier, and our ongoing Phase 2 proof-of-concept program.

Future research and development spending also may be impacted by potential new licensing or collaboration 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 $5.2 million and $13.4 million for the three and nine months ended September 30, 2013, respectively, compared with $4.7 million and $12.9 million for the same periods of 2012. The $0.5 million increase for the three months ended September 30, 2013, as compared to the same period of 2012, was due primarily to a $1.1 million increase in professional service fees, partially offset by a $0.4 million decrease in severance expense. The $0.5 million increase for the nine months ended September 30, 2013, as compared to the same period of 2012, was due primarily to a $0.7 million increase in stock-based compensation, partially offset by a $0.4 million decrease in severance expense.

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Streamlining and Restructuring Charges

In January 2012, we implemented a streamlining of operations, which resulted in a restructuring plan 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 resulted 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.

In connection with the streamlining of operations, we incurred restructuring charges in the first nine months of 2012 of $2.0 million related to severance, other termination benefits and outplacement services, $2.2 million related to the impairment and accelerated depreciation of various assets and leasehold improvements, and $0.7 million related to moving and other facility charges. In the first nine months of 2013, we have incurred $0.2 million in restructuring charges related to facility costs and do not expect to incur additional significant restructuring charges during the remainder of 2013 related to these streamlining activities.

Other Income (Expense)

Interest Expense

Interest expense and amortization of debt issuance costs and discounts are shown below for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
Interest expense						
Servier loan	$547	$558	$ (11)	$1,600	$1,583	$ 17
GECC term loan	508	475	33	1,584	1,298	286
Novartis note	90	99	(9)	272	298	(26)
Other	14	12	2	39	32	7
Total interest expense	$1,159	$1,144	$ 15	$3,495	$3,211	$ 284

The increase in interest expense of $0.3 million for the nine months ended September 30, 2013, as compared to the same period of 2012 was due primarily to an increase in the principal of the GECC term loan, which was amended in September 2012.

Other Expense

Other expense primarily consisted of unrealized (losses) gains. The following table shows the activity in other expense for the three and nine months ended September 30, 2013 and 2012 (in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2013	2012	Increase (Decrease)	2013	2012	Increase (Decrease)
Other expense:						
Unrealized foreign exchange (loss) gain [1]	$(322)	$(318)	$ (4)	$(57)	$96	$ (153)

Unrealized gain (loss) on foreign exchange options	7	(110)	117	(184)	(721)	537
Other	183	8	175	333	83	250
Total other expense	$(132)	$(420)	$ 288	$92	$(542)	$ 634

(1) Unrealized foreign exchange gain (loss) for the three and nine months ended September 30, 2013 and 2012 primarily relates to the re-measurement of the €15 million Servier loan.

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 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. 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 December 31, 2012, the fair value of the warrant liability was estimated to be $15.0 million using the Black-Scholes Model. We revalued the warrant liability at September 30, 2013 using the Black-Scholes Model and recorded the $25.7 million increase in the fair value as a loss in the revaluation of contingent warrant liabilities line of our condensed consolidated statements of comprehensive loss. We also reclassified $1.6 million from contingent warrant liabilities to equity on our condensed consolidated balance sheets due to the exercise of warrants. As of September 30, 2013, 13,673,183 of these warrants were outstanding and had a fair value of $39.1 million. This increase in liability is due primarily to the increase in the market value of our common stock at September 30, 2013 compared to December 31, 2012.

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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. In June 2009, we issued warrants to certain institutional investors as part of a registered direct offering. These 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 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. Due to these provisions, we are required to account for the warrants issued in February 2010 and June 2009 as liabilities at fair value. As of September 30, 2013, all of these warrants were outstanding and had an aggregate fair value of approximately $0.1 million.

The following table provides a summary of the changes in fair value of contingent warrant liabilities for the nine months ended September 30, 2013 (in thousands):

Contingent warrant liabilities	September 30, 2013
Balance at December 31, 2012	15,001
Reclassification of contingent warrant liability to equity upon exercise of warrants	(1,585)
Net increase in fair value of contingent warrant liabilities upon revaluation	25,746
Balance at September 30, 2013	39,162

Income Taxes

We recognized $15,000 of income tax benefit relating to refundable credits for the three and nine months ended September 30, 2013, compared to $0.1 million during the same period of 2012.

Accounting Standards Codification Topic 740, Income Taxes ("ASC 740") 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 do not expect the unrecognized tax benefits to change significantly over the next twelve months. We will recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of September 30, 2013, we have not accrued interest or penalties related to uncertain tax positions.

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Liquidity and Capital Resources

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

	September 30, 2013	December 31, 2012	Change
Cash and cash equivalents	$ 73,988	$ 45,345	$28,643
Short-term investments	$ -	$ 39,987	$(39,987)
Working Capital	$ 58,779	$ 72,004	$(13,225)

	Nine Months Ended September 30,		
	2013	2012	Change
Net cash used in operating activities	$(38,602)	$(29,432)	$(9,170)
Net cash provided by (used in) investing activities	38,931	(18,633)	57,564
Net cash provided by financing activities	28,314	41,920	(13,606)
Net increase in cash, cash equivalents and short-term investments	$28,643	$(6,145)	$34,788

Working Capital

The decrease in working capital was due primarily to an $11.3 million decrease in cash, cash equivalents, and short-term investments and a $2.5 million reclassification of principal and accrued interest on our interest bearing obligations from long-term to short-term.

Cash Used in Operating Activities

Net cash used in operating activities was $38.6 million for the nine months ended September 30, 2013, compared with $29.4 million for the same period in 2012. Net cash used in operating activities was $9.2 million higher in the first nine months of 2013 due primarily to an increase in external manufacturing costs and spending on internal proprietary projects.

Cash Provided by (Used in) Investing Activities

Net cash provided by investing activities was $38.9 million for the nine months ended September 30, 2013, compared with net cash used in investing activities of $18.6 million for the same period of 2012. The $57.6 million change in cash provided by investing activities was due primarily to the maturity of $40.0 million in short-term investments during the first nine months of 2013 and the purchase of $17.0 million in short-term investments during the first nine months of 2012.

Cash Provided by Financing Activities

Net cash provided by financing activities was $28.3 million for the nine months ended September 30, 2013, compared with $41.9 million for the same period of 2012. Cash provided by financing activities in the first nine months of 2013 related to net proceeds received from the issuance of common stock of $29.4 million in the August 2013 public offering, $0.6 million of net proceeds received from employee stock purchases, and $0.4 million of net proceeds from the exercise of warrants. These net proceeds were partially offset by $2.1 million of principal payments on our loan with GECC. Cash provided by financing activities in the first nine months of 2012 related to net proceeds received from the issuance of common stock and warrants of $36.2 million in the March 2012 public offering, net proceeds of

$3.2 million received from the issuance of common stock under the 2011 ATM Agreement, and net loan proceeds of $4.4 million received from GECC, partially offset by $2.1 million of principal payments on our loan with GECC.

Net proceeds received during the first nine months of 2013 and 2012 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 operation