XOMA LTD /DE/
Form 10-Q
May 10, 2007
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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, 2007

Commission File No. 0-14710

XOMA Ltd.

(Exact name of registrant as specified in its charter)

Bermuda **(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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated filer ¨

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 07, 2007**

Common shares US$.0005 par value	**131,690,515**

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

XOMA Ltd.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

	March 31, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,513	$ 28,002
Short-term investments	16,068	18,381
Restricted cash	1,619	4,330
Receivables	9,204	13,446
Prepaid expenses	1,370	1,061
Debt issuance costs	254	668
Total current assets	46,028	65,888
Property and equipment, net	22,818	22,434
Debt issuance costs long-term	913	2,661
Deposits and Other	495	495
Total assets	$ 70,254	$ 91,478
LIABILITIES AND SHAREHOLDERS EQUITY (NET CAPITAL DEFICIENCY)		
Current liabilities:		
Accounts payable	$ 4,328	$ 4,186
Accrued liabilities	5,916	7,086
Accrued interest	360	1,794
Deferred revenue	7,359	9,601
Total current liabilities	17,963	22,667
Deferred revenue long-term	11,528	8,768
Convertible debt long-term		46,823
Interest bearing obligation long-term	46,686	51,393
Total liabilities	76,177	129,651
Commitments and contingencies		
Shareholders equity (net capital deficiency):		
Preference shares, $.05 par value, 1,000,000 shares authorized		
Series A, 210,000 designated, no shares issued and outstanding		
Series B, 8,000 designated, 2,959 shares issued and outstanding; aggregate liquidation preference of $29.6 million	1	1
Common shares, $.0005 par value, 210,000,000 shares authorized, 131,670,777 and 105,454,389 shares outstanding at March 31, 2007 and December 31, 2006, respectively	66	53

Additional paid-in capital	737,471	689,315
Accumulated comprehensive loss	(1)	(9)
Accumulated deficit	(743,460)	(727,533)
Total shareholders equity (net capital deficiency)	(5,923)	(38,173)
Total liabilities and shareholders equity (net capital deficiency)	$ 70,254	$ 91,478

See accompanying notes to condensed consolidated financial statements.

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XOMA Ltd.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited, in thousands, except per share amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenues:		
License and collaborative fees	$ 4,418	$ 654
Contract and other revenue	4,359	3,094
Royalties	3,475	1,856
Total revenues	12,252	5,604
Operating costs and expenses:		
Research and development (including contract related of $3,562 and $1,939, respectively)	15,929	12,181
General and administrative	4,909	5,053
Total operating costs and expenses	20,838	17,234
Loss from operations	(8,586)	(11,630)
Other income (expense):		
Investment and interest income	601	457
Interest expense	(7,933)	(9,426)
Other expense	(10)	(4)
Net loss	$ (15,928)	$ (20,603)
Basic and diluted net loss per common share	$ (0.14)	$ (0.23)
Shares used in computing basic and diluted net loss per common share	116,196	87,943

See accompanying notes to condensed consolidated financial statements.

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XOMA Ltd.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cash flows from operating activities:		
Net loss	$ (15,928)	$ (20,603)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,482	1,160
Common shares contributed to 401(k) and management incentive plans	1,321	1,088
Share-based compensation expense	762	390
Accrued interest on convertible notes and other interest bearing obligations	(1,433)	(871)
Revaluation of embedded derivative	6,101	8,018
Interest paid on conversion of convertible debt	(5,172)	
Amortization of discount, premium and issuance costs of convertible debt	394	232
Amortization of premium on short-term investments	(3)	16
Loss on disposal/retirement of property and equipment	14	4
Other non-cash adjustments	(1)	(2)
Changes in assets and liabilities:		
Receivables and related party receivables	4,242	(815)
Prepaid expenses	(309)	(381)
Accounts payable	142	(1,399)
Accrued liabilities	(1,171)	(1,227)
Deferred revenue	518	737
Net cash used in operating activities	(9,041)	(13,653)
Cash flows from investing activities:		
Proceeds from sales/maturities of investments	9,225	8,360
Purchase of investments	(6,900)	(9,391)
Transfer of restricted cash	2,711	
Purchase of property and equipment	(1,879)	(3,412)
Net cash provided by (used in) investing activities	3,157	(4,443)
Cash flows from financing activities:		
Proceeds from issuance of convertible notes		11,967
Principal payments of long-term debt	(4,707)	
Proceeds from issuance of common shares	102	40
Net cash provided by (used in) financing activities	(4,605)	12,007
Net decrease in cash and cash equivalents	(10,489)	(6,089)
Cash and cash equivalents at the beginning of the period	28,002	20,804
Cash and cash equivalents at the end of the period	$ 17,513	$ 14,715

See accompanying notes to condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

XOMA Ltd. (XOMA or the Company), a Bermuda company, is a biopharmaceutical company that discovers and develops antibodies and other genetically-engineered protein products to treat immunological and inflammatory disorders, cancer and infectious diseases. The Company s products are presently in various stages of development and most are subject to regulatory approval before they can be introduced commercially. The Company receives royalties from Genentech, Inc. (Genentech) on two approved products, RAPTIVA®, for the treatment of moderate-to-severe plaque psoriasis, and LUCENTIS®, for the treatment of neovascular (wet) age-related macular degeneration. XOMA s pipeline includes both proprietary products and collaborative programs at various stages of preclinical and clinical development.

Basis of Presentation

The condensed consolidated financial statements include the accounts of XOMA and its subsidiaries. All significant 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 year ended December 31, 2006, filed with the SEC on March 8, 2007.

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, 2007, the consolidated results of the Company s operations for the three months ended March 31, 2007 and 2006, and the Company s cash flows for the three months then ended. The condensed consolidated balance sheet amounts at December 31, 2006, have been derived from audited consolidated financial statements. The interim results of operations are not necessarily indicative of the results that may occur for the full fiscal year or future periods.

Critical Accounting Policies

There have been no significant changes in critical accounting policies during the three months ended March 31, 2007, except as noted below, as compared with those previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, filed with the SEC on March 8, 2007.

Income Taxes

The Company accounts for uncertain tax positions in accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FAS 109) The application of income tax law is inherently complex and the laws and regulations in this area are voluminous and are often ambiguous. As such, the Company is required to make many subjective assumptions and judgments regarding the Company s income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in the Company s subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income.

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 and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

In February of 2007, the Company announced that pursuant to the terms of its collaboration agreement with Chiron Corporation (subsequently acquired by Novartis AG (Novartis), entered into in February of 2004, the parties mutual exclusivity obligation to

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conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation has no impact on the existing collaboration projects which have reached the development stage and the parties may continue to collaborate on a non-exclusive basis. Unamortized deferred revenue of $4.3 million, at December 31, 2006, associated with the upfront collaboration fee of $10.0 million was recognized during the first quarter of 2007 due to the change in estimate from five years to three years.

Recent Accounting Pronouncements

In September of 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 provides guidance for using fair value to measure assets and liabilities and responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require or permit assets or liabilities to be measured at fair value and does not expand the use of fair value in any new circumstances. SFAS will be effective beginning with the first annual period after November 15, 2007. The Company is still evaluating what impact, if any, the adoption of this standard will have on its financial position or results of operations.

In February of 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issuance costs. The fair value election is irrevocable and generally made on an instrument by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007, and is required to be adopted by XOMA in the first quarter of fiscal 2008. XOMA is currently determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its financial position or results of operations.

Concentration of Risk

Cash, cash equivalents, short-term investments, restricted cash and accounts receivable are financial instruments, which potentially subject the Company to concentrations of credit risk. The Company maintains money market funds and short-term investments that bear minimal risk. The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the three months ended March 31, 2007, three customers represented 35%, 28% and 13% of total revenues. Two of these customers and two additional customers represented 38%, 21%, 20% and 12% of the $8.4 million billed and unbilled receivables outstanding at March 31, 2007. For the three months ended March 31, 2006, two customers represented 54% and 33% of total revenues and, as of March 31, 2006, there were billed and unbilled receivables of $5.6 million outstanding from these customers representing 60% and 34% of the balance.

Share-Based Compensation

The Company grants qualified and non-qualified share options, shares and other share related awards under various plans to directors, officers, employees and other individuals. To date, share-based compensation issued under these plans consists of qualified and non-qualified incentive share options and shares. Share options are granted at exercise prices of not less than the fair market value of the Company s common shares on the date of grant. Generally, share options granted to employees fully vest four years from the grant date and expire ten years from the date of the grant or three months from the date of termination of employment (longer in case of death or certain retirements). Certain options granted to directors fully vest on the date of grant and certain options may fully vest upon a change of control of the Company. Additionally, the Company has an Employee Share Purchase Plan (ESPP) that allows employees to purchase Company shares at a purchase price equal to 95% of the closing price on the exercise date. For ESPP periods beginning prior to December 31, 2004, the purchase price per common share was 85% of fair market value at the lower of either the first day of the 24 month offering period or the last day of the period. As of March 31, 2007, the Company had approximately 4.9 million common shares reserved for future issuance under its share option plans and ESPP.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R), using the modified prospective transition method.

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The following table shows total share-based compensation expense included in the condensed consolidated statements of operations for the three months ended March 31, 2007 and 2006 (in thousands).

	Three Months Ended March 31, 2007	2006
Research and development	$ 281	$ 156
General and administrative	481	234
Total share-based compensation expense	$ 762	$ 390

Basic and diluted net loss per common share was $0.01 higher for the three months ended March 31, 2007 as a result of SFAS 123R. Basic and diluted net loss per common share was not impacted for the three months ended March 31, 2006 as a result of SFAS 123R. There was no capitalized share-based compensation cost as of March 31, 2007. There were no recognized tax benefits during the three months ended March 31, 2007 and 2006. SFAS 123R had no impact on cash flows from operations or financing.

To estimate the value of an award, the Company uses the Black-Scholes option pricing model. This model requires inputs such as expected life, expected volatility and risk-free interest rate. The forfeiture rate also impacts the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. While estimates of expected life, volatility and forfeiture rate are derived primarily from the Company s historical data, the risk-free rate is based on the yield available on U.S. Treasury zero-coupon issues.

The fair value of share based awards was estimated using a Black-Scholes model with the following weighted-average assumptions for the three months ended March 31, 2007 and 2006.

	Three Months Ended March 31, 2007	2006
Dividend yield	0%	0%
Expected volatility	73%	81%
Risk-free interest rate	4.69%	4.61%
Expected life	5.3years	5.3 years

Share option activity for the three months ended March 31, 2007, is as follows:

	Options	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Options outstanding at December 31, 2006	6,229,864	$ 4.22		
Granted	1,471,800	3.36		
Exercised	(26,668)	1.53		
Forfeited, expired or canceled	(391,493)	5.12		
Options outstanding at March				