XOMA LTD /DE/
Form 424B3
December 19, 2011

PROSPECTUS

Shares of Common Stock

DOMESTICATION IN DELAWARE

XOMA Ltd. is an exempted company incorporated under the laws of Bermuda. We are proposing to change our jurisdiction of incorporation by discontinuing from Bermuda and continuing and domesticating as a corporation incorporated under the laws of the State of Delaware (the "Domestication"). To effect the Domestication, we will file a notice of discontinuance with the Bermuda Registrar of Companies and file a certificate of incorporation and a certificate of corporate domestication with the Secretary of State of the State of Delaware, under which we will be domesticated and continue as a Delaware corporation with the name "XOMA Corporation" (we refer to the domesticated Delaware entity as "XOMA Delaware"). On the effective date of the Domestication, each of our currently issued and outstanding common shares will automatically convert by operation of law, on a one-for-one basis, into shares of XOMA Delaware common stock. Under Bermuda law and our current bye-laws, we do not need shareholder approval of the Domestication, and our shareholders do not have statutory dissenters' rights of appraisal as a result of the Domestication.

We are not asking you for a proxy and you are requested not to send us a proxy. No shareholder action is required to effect the Domestication. See "The Domestication—No Vote or Dissenters' Rights of Appraisal in the Domestication."

Our common shares are currently listed on The NASDAQ Global Market under the symbol "XOMA." We will seek, and expect to receive, approval from The NASDAQ Global Market to trade the common stock of XOMA Delaware under the same symbol after the Domestication.

Investing in the common stock of XOMA Delaware involves risks. See "Risk Factors" beginning on page 6 of this prospectus.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus will not be filed with the Bermuda Registrar of Companies. Neither the Bermuda Monetary Authority nor the Bermuda Registrar of Companies accepts any responsibility for XOMA's financial soundness or the correctness of any of the statements made or opinions expressed in this prospectus.

Prospectus dated December 16, 2011

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No person has been authorized to give any information or any representation concerning us or the Domestication (other than as contained in this prospectus) and, if any such other information or representation is given or made, you should not rely on it as having been authorized by us. You should not assume that the information contained or incorporated by reference in this prospectus is accurate as of any date other than the date on the front cover of this prospectus or the date of the incorporated document, as applicable.

FORWARD-LOOKING STATEMENTS

Certain statements contained herein related to the anticipated size of clinical trials, the anticipated timing of initiation of clinical trials, the expected availability of clinical trial results, the sufficiency of our cash resources and the amounts of certain revenues and certain costs in comparison to prior years, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things, clinical trials may not reach their anticipated size if trials are not initiated or due to enrollment issues such as unavailability of patients, competing product candidates or unanticipated safety issues; the timing of initiation of or availability of results of clinical trials may be delayed or may never occur as a result of actions or inaction by regulators or our present or future collaboration partners, complications in the design, implementation or third-party approval of clinical trials, complications in the collection or interpretation of statistical data or unanticipated safety issues; the period for which our cash resources are sufficient could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated, if anticipated revenue or cost sharing arrangements do not materialize, or if funds are not otherwise available on acceptable terms; and our revenues may be lower than anticipated, and our costs may be higher than expected, due to actions or inactions by our present or future collaboration partners, unanticipated safety issues or unavailability of additional licensing or collaboration opportunities. These and other risks, including those related the generally unstable nature of current economic and financial market conditions; the results of discovery research and preclinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the Food and Drug Administration, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative or licensing relationships; the ability of collaborators, licensees and other third parties to meet their obligations and their discretion in decision-making; our ability to meet the demands of the United States government agency with which we have entered our government contracts; competition; market demand for products; scale-up, manufacturing and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in “Risk Factors.” We undertake no obligation to publicly update any forward-looking statements, regardless of any new information, future events or other occurrences. We advise you, however, to consult any additional disclosures we make in our reports to the Securities and Exchange Commission (the “SEC”) on Forms 10-K, 10-Q and 8-K.

WHERE YOU CAN FIND MORE INFORMATION

We are required to file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any documents filed by us at the SEC’s public reference room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. Our filings with the SEC are also available to the public through the SEC’s Internet site at http://www.sec.gov.

We have filed with the SEC a registration statement on Form S-4 relating to the securities covered by this prospectus. This prospectus is a part of the registration statement and does not contain all of the information in the registration statement. Whenever a reference is made in this prospectus to a contract or other document of ours, please be aware that the reference is only a summary and that you should refer to the exhibits that are a part of the registration statement for a copy of the contract or other document. You may review a copy of the registration statement at the SEC’s public reference room in Washington, D.C., as well as through the SEC’s Internet site.

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SUMMARY

This summary provides an overview of selected information. Because this is only a summary, it may not contain all of the information that may be important to you in understanding the Domestication. You should carefully read this entire prospectus, including the section entitled "Risk Factors." See the section of this prospectus entitled "Where You Can Find More Information." Unless the context otherwise requires, in this prospectus, the terms "the Company," "XOMA," "we," "us" and "our" refer to XOMA Ltd. as it currently exists under Bermuda law and will continue under Delaware law after the Domestication, and the terms "XOMA Bermuda" and "XOMA Delaware" refer to the Company prior to and after the Domestication, respectively.

XOMA Ltd.

We are currently a Bermuda exempted company and a leader in the discovery, development and manufacture of therapeutic antibodies designed to treat autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases. We discover, develop and manufacture therapeutic antibodies for our own proprietary pipeline as well as through license and collaborative agreements with pharmaceutical and biotechnology companies and under our contracts with the U.S. government. Our proprietary product pipeline includes:

- Gevokizumab (formerly referred to as XOMA 052), an antibody that inhibits interleukin-1 beta, which we plan to enter into Phase 3 clinical development in non-infectious uveitis affecting the intermediate and/or posterior segments of the eye. We are developing gevokizumab in collaboration with Les Laboratoires Servier.

- XOMA 3AB, a combination of three antibodies to prevent and treat botulism poisoning caused by exposure to botulinum neurotoxin Type A, which is in a Phase 1 clinical trial sponsored by the National Institute of Allergy and Infectious Diseases of the National Institutes of Health.

- A preclinical pipeline with candidates in development for autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases.

We have a premier antibody discovery and development platform that incorporates a collection of antibody phage display libraries and proprietary Human Engineering™, affinity maturation, Bacterial Cell Expression (BCE) and manufacturing technologies. BCE is a key biotechnology for the discovery and manufacturing of antibodies and other proteins. To date, more than 60 pharmaceutical and biotechnology companies have signed BCE licenses, and a number of licensed product candidates are in clinical development.

We have a fully integrated product development platform, extending from pre-clinical science and clinical development to scale-up development and manufacturing.

Our principal executive offices are located at 2910 Seventh Street, Berkeley, California 94710, and we maintain a registered office located at Clarendon House, 2 Church Street, Hamilton HM 11, Bermuda. Our telephone number at our principal executive offices is (510) 204-7200.

The Domestication

We intend to change our jurisdiction of incorporation from Bermuda to Delaware, and we refer to this change as the "Domestication." We will effect the Domestication by filing in Delaware a certificate of corporate domestication and a certificate of incorporation of XOMA Delaware, and by filing in Bermuda a notice of discontinuance and a copy of the certified copy of the certificate of corporate domestication of XOMA Bermuda issued by the Secretary of State of

the State of Delaware. The Domestication does not require shareholder approval. We anticipate that the Domestication will become effective on or about December 31, 2011, upon receipt of the certificate of discontinuance from the Bermuda Registrar of Companies, which we expect will provide that the effective time of the discontinuance of XOMA Bermuda under the Companies Act 1981 of Bermuda is the effective time of XOMA Delaware's domestication and continuance in Delaware under Delaware law (we refer to the latest of these effective times as the "Effective Time"). See "Description of Capital Stock—Effective Time" below.

Comparison of Shareholder Rights

The Domestication will change our jurisdiction of incorporation from Bermuda to Delaware and, as a result, our organizational documents will change and will be governed by Delaware law rather than Bermuda law. There are differences between the governing corporate law of XOMA Bermuda and XOMA Delaware. For example, under Bermuda law, holders of an aggregate of not less than 20% in par value of a company's issued share capital have the right to apply to the Supreme Court of Bermuda for an annulment of any amendment of the memorandum of association adopted by shareholders at any general meeting, other than an amendment that alters or reduces a company's share capital as provided under Bermuda law. No similar right is available under Delaware law. Also, while class actions and derivative actions are generally not available to shareholders under Bermuda law, such actions are generally available under Delaware law. Additionally, there are differences between the new organizational documents of XOMA Delaware and the current organizational documents of XOMA Bermuda. For example, while our current bye-laws contain provisions regarding "business combinations" and "interested shareholders" that will be substantially similar in effect to the provisions of Section 203 of the Delaware General Corporation Law, the new XOMA Delaware by-laws will not contain provisions similar to the business combination provisions in our current bye-laws. However, our stockholders will have substantially similar voting rights because the provisions of Section 203 will apply upon effectiveness of the Domestication.

We describe these and other changes in more detail under "Description of Capital Stock—Differences between the Governing Corporate Law and Organizational Documents for XOMA Bermuda and XOMA Delaware" below. However, our business, assets and liabilities on a consolidated basis, as well as our board of directors, executive officers, principal business locations and fiscal year, will be the same upon completion of the Domestication as they are prior to the Domestication.

Share Exchange

We are authorized to issue up to 92,666,666 common shares, $0.0075 par value per share, as well as up to 1,000,000 preference shares, $0.05 par value per share, of which 210,000 have been designated as Series A Preference Shares (the "Series A Preference Shares"). As of December 8, 2011, we had 35,080,413 common shares outstanding and no Series A Preference Shares outstanding.

In the Domestication, each common share of XOMA Bermuda that is issued and outstanding immediately prior to the Effective Time will automatically convert by operation of law into one share of common stock of XOMA Delaware. Similarly, outstanding options, warrants and other rights to acquire XOMA Bermuda shares will become options, warrants or rights to acquire the corresponding stock of XOMA Delaware. It is not necessary for shareholders of XOMA Bermuda who currently hold share certificates to exchange their existing share certificates for certificates of shares of common stock of XOMA Delaware. See "The Domestication—Domestication Share Conversion" below.

Reasons for the Domestication

Our board of directors believes that the Domestication will, among other things:

- Provide legal, administrative and other similar efficiencies, as well as provide a basis for further efficiencies in the event we undertake to simplify our overall corporate structure;

- Reduce our exposure to the potential consequences of certain types of punitive or potentially adverse tax legislation that have been proposed from time to time;

- Relocate our jurisdiction of organization to one that has a body of law more familiar to our officers, our employees, our board of directors and many of our shareholders; and

- Reduce our exposure to other potentially adverse or prejudicial actions based on our being a non-US company, such as “blacklisting” of our common shares by certain pension funds or legislation restricting certain types of transactions.

Risk Factors

An investment in the common shares of XOMA Bermuda as well as in the common stock of XOMA Delaware will involve risks. Please review the section entitled "Risk Factors" beginning on page 6 of this prospectus.

Material U.S. Federal Income Tax Consequences of the Domestication

See "Material U.S. Federal Income Tax Consequences of the Domestication" for more information.

No Vote or Dissenters' Rights of Appraisal in the Domestication

Under Bermuda and Delaware law and our current bye-laws, we do not need shareholder approval of the Domestication, and our shareholders do not have statutory dissenters' rights of appraisal or any other appraisal rights as a result of the Domestication. See "The Domestication—No Vote or Dissenters' Rights of Appraisal in the Domestication."

Summary Financial Data

	Nine Months Ended September 30,		Year Ended December 31,		
Consolidated statement of operations data:	2011	2010	2010	2009	2008
(In thousands, except per share amounts)					
Total revenues	$48,349	$24,041	$33,641	$98,430	$67,987
Operating costs and expenses:					
Research and development	51,479	58,278	77,413	58,131	82,576
Selling, general and administrative	18,779	16,776	23,250	23,736	24,145
Restructuring costs	-	-	82	3,603	-
(Loss) income from operations	(21,909)	(51,013)	(67,104)	12,960	(38,734)
Other (expense) income, net	916	32	(1,625)	(6,683)	(6,894)
Income tax expense (benefit), net	15	17	27	5,727	(383)
Net (loss) income	$(21,008)	$(50,998)	$(68,756)	$550	$(45,245)
Basic and diluted net (loss) income per common share	$(0.69)	$(2.87)	$(3.69)	$0.05	$(5.11)

Consolidated balance sheet data:	As of September 30, 2011
(In thousands)	
Cash and cash equivalents	$45,707
Working capital	41,529
Total assets	77,185
Long-term liabilities	35,105
Accumulated deficit	(874,318)
Shareholders' equity	21,661

RISK FACTORS

Any investment in our securities involves a high degree of risk, including the risks described below. The risks and uncertainties described below are not the only risks and uncertainties we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of the following risks actually occur, our business, financial condition and results of operations could suffer. As a result, the trading price of our shares could decline, perhaps significantly, and you could lose all or part of your investment. The risks discussed below also include forward-looking statements and our actual results may differ substantially from those discussed in these forward-looking statements. See the section entitled "Forward-Looking Statements."

RISKS RELATING TO THE CHANGE IN OUR PLACE OF INCORPORATION

The Domestication may result in adverse tax consequences for you.

If you are a U.S. holder (as defined in "Material U.S. Federal Income Tax Consequences of the Domestication" below) of our common shares or warrants, you may be subject to U.S. federal income tax as a result of the Domestication unless you make a timely election on your filing with the Internal Revenue Service ("IRS") as described below. If you are a non-U.S. holder (as defined in "Material U.S. Federal Income Tax Consequences of the Domestication" below) of our common shares or warrants, you may become subject to withholding tax on any dividends paid on the common shares of XOMA Delaware subsequent to the Effective Time. Please read the following information which provides more details on the potential tax consequences of the Domestication.

If you are a U.S. holder who owns $50,000 or more of XOMA Bermuda common shares, but less than 10% of the total combined voting power of all classes of our shares entitled to vote at general meetings of the Company on the day of the Domestication, you must generally recognize gain (but not loss) with respect to such common stock of XOMA Delaware received in the Domestication, even if you continue to hold your stock and have not received any cash as a result of the Domestication. As an alternative to recognizing gain, however, such U.S. holder may elect to include in income the "all earnings and profits amount," as the term is defined in Treasury Regulation Section 1.367(b)-2(d), attributable to its common shares in XOMA Bermuda. The income so included pursuant to this election generally is treated as dividend income. We do not expect that XOMA Bermuda's cumulative earnings and profits will be greater than zero through the day of the Domestication. Therefore, the making of an election to include the person's share of the "all earnings and profits amount" into income as a dividend generally would be advantageous to U.S. holders who would otherwise recognize gain with respect to the conversion of the XOMA Bermuda common shares in the Domestication. WE STRONGLY URGE EACH SUCH U.S. HOLDER TO READ CAREFULLY OUR DESCRIPTIONS OF THE ELECTION IN "MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES OF THE DOMESTICATION" BELOW, STARTING ON PAGE 117 OF THIS PROSPECTUS, AS WELL AS TO CONSULT ITS OWN TAX ADVISOR.

If a U.S. holder owns XOMA Bermuda common shares with 10% or more of the total combined voting power of all classes of our shares entitled to vote at general meetings of the Company on the day of the Domestication, such U.S. holder will be required to pay taxes on a deemed dividend equal to the "all earnings and profits amount" attributable to its common shares in XOMA Bermuda, whose cumulative earnings and profits, as noted above, are not expected to be greater than zero through the day of the Domestication. A U.S. holder's ownership of XOMA Bermuda warrants will be taken into account in determining whether such U.S. holder owns 10% or more of the total combined voting power of all classes of our shares. Complex attribution rules apply in determining whether a U.S. holder owns 10% or more of the total combined voting power of all classes of our shares for U.S. federal tax purposes. EACH U.S. HOLDER IS STRONGLY URGED TO CONSULT ITS OWN TAX ADVISOR.

If we were a passive foreign investment company ("PFIC") at any time during a U.S. holder's holding period of our common shares or warrants, such U.S. holder may be required to recognize gain on the exchange of its XOMA Bermuda common shares or warrants for XOMA Delaware common stock or warrants and subject to complex rules applicable to a shareholder of PFIC. While we believe that we are not a PFIC at any time prior to the Domestication, there is no assurance that the IRS would agree to our position. See "Material U.S. Federal Income Tax Consequences of the Domestication."

Additionally, the Domestication will cause non-U.S. holders to become subject to U.S. withholding taxes on any dividends or other payments in respect of the common stock of XOMA Delaware after the Domestication.

For a more detailed description of the material U.S. federal income tax consequences associated with the Domestication, please read "Material U.S. Federal Income Tax Consequences of the Domestication" starting on page 117 of this prospectus. WE STRONGLY URGE YOU TO CONSULT WITH YOUR OWN TAX ADVISOR.

Currently, your rights as a shareholder of XOMA arise under Bermuda law as well as our existing Bermuda memorandum of continuance and bye-laws. Upon effectiveness of the Domestication, your rights as a stockholder of XOMA will arise under Delaware law as well as our new Delaware certificate of incorporation and by-laws.

Upon effectiveness of the Domestication, the rights of stockholders of XOMA Delaware will arise under the new certificate of incorporation and by-laws of XOMA Delaware as well as Delaware law. Those new organizational documents and Delaware law contain provisions that differ in some respects from those in our current organizational documents and Bermuda law and, therefore, some of your rights as a stockholder of XOMA Delaware could differ from the rights you currently possess as a shareholder of XOMA Bermuda. For example, under Bermuda law, holders of an aggregate of not less than 20% in par value of a company's issued share capital have the right to apply to the Supreme Court of Bermuda for an annulment of any amendment of the memorandum of association adopted by shareholders at any general meeting, other than an amendment that alters or reduces a company's share capital as provided under Bermuda law. No similar right is available under Delaware law. Also, while class actions and derivative actions are generally not available to shareholders under Bermuda law, such actions are generally available under Delaware law. This change could increase the likelihood that we become involved in costly litigation, which could have a material adverse effect on us. Additionally, there are differences between the new organizational documents of XOMA Delaware and the current organizational documents of XOMA Bermuda. For example, while our current bye-laws contain provisions regarding "business combinations" and "interested shareholders" that will be substantially similar in effect to the provisions of Section 203 of the Delaware General Corporation Law ("DGCL"), the new XOMA Delaware by-laws will not contain provisions similar to the business combination provisions in our current bye-laws. However, our stockholders will have substantially similar voting rights because the provisions of Section 203 of the DGCL will apply upon effectiveness of the Domestication. There can be no assurance that the rights afforded by Section 203 of the DGCL will not be changed or rescinded by the Delaware legislature or courts in the future.

For a more detailed description of your rights as a stockholder of XOMA Delaware and how they may differ from your rights as a shareholder of XOMA Bermuda, please see "Description of Capital Stock—Differences between the Governing Corporate Law and Organizational Documents for XOMA Bermuda and XOMA Delaware" in this prospectus. Forms of the new certificate of incorporation and by-laws of XOMA Delaware are attached as Appendix A and Appendix B to this prospectus, and we urge you to read them.

RISKS RELATING TO OUR BUSINESS

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

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

continue to spend, substantial funds in connection with:

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

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

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

- operations will generate meaningful funds,
- additional agreements for product development funding can be reached,
- strategic alliances can be negotiated, or
- adequate additional financing will be available for us to finance our own development on acceptable terms, or at all.

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

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

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

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

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

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

We have experienced significant losses and, as of September 30, 2011, we had an accumulated deficit of $874.3 million.

For the three and nine months ended September 30, 2011, we had net losses of approximately $6.5 million or $0.20 per common share (basic and diluted) and $21.0 million or $0.69 per common share (basic and diluted), respectively. For the three and nine months ended September 30, 2010, we had net losses of approximately $13.6 million or $0.69 per common share (basic and diluted) and $51.0 million or $2.87 per common share (basic and diluted), respectively.

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

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

We are authorized to issue, without shareholder approval, 1,000,000 preference shares, of which none were issued and outstanding as of December 8, 2011, which may give other shareholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common shares. In April of 2011, the 2,959 Series B convertible preference shares previously issued to Genentech were converted by Genentech into 254,560 common shares. In addition, we are authorized to issue, generally without shareholder approval, up to 92,666,666 common shares, of which 35,080,413 were issued and outstanding as of December 8, 2011. If we issue additional equity securities, the price of our common shares may be materially and adversely affected.

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

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

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

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

On February 4, 2011, we entered into an At Market Issuance Sales Agreement (the "2011 ATM Agreement") with McNicoll, Lewis & Vlak LLC ("MLV"), under which we may sell common shares from time to time through the MLV, as our agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through December 8, 2011, we sold a total of 5,271,572 common shares under this agreement for aggregate gross proceeds of $11.3 million.

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

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

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

There can be no assurance that the market price of our common shares will not decline below its present market price or that there will be an active trading market for our common shares. The market prices of biotechnology companies have been and are likely to continue to be highly volatile. Fluctuations in our operating results and general market conditions for biotechnology stocks could have a significant impact on the volatility of our common share price. We have experienced significant volatility in the price of our common shares. From January 1, 2011 through December 8, 2011, our share price has ranged from a high of $7.71 to a low of $1.36. Factors contributing to such volatility include, but are not limited to:

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

- announcements of new collaborations,
- failure to enter into collaborations,

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

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

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

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

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

- our future filings will be delayed,
- our preclinical and clinical studies will be successful,

- we will be successful in generating viable product candidates to targets,
- we will be able to provide necessary additional data,

- results of future clinical trials will justify further development, or

- we will ultimately achieve regulatory approval for any of these product candidates.

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

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

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

In June of 2011, Novartis announced that an advisory committee of the FDA voted in favor of the overall efficacy but not the overall safety of Ilaris® (canakinumab), a fully-human monoclonal antibody that, like gevokizumab, targets

IL-1 beta, to treat gouty arthritis attacks in patients who cannot obtain adequate relief with non-steroidal anti-inflammatory drugs or colchicine. Novartis also stated that in two pivotal Phase 3 studies of canakinumab in gouty arthritis patients, a higher percentage of patients had adverse events with canakinumab than with the standard treatment for gouty arthritis, and more serious adverse events were reported by patients treated with canakinumab compared to patients receiving the standard treatment. In August of 2011, Novartis announced that the FDA had issued a Complete Response letter requesting additional information, including clinical data to evaluate the benefit risk profile of canakinumab in refractory gouty arthritis patients. We have not yet determined what impact, if any, these developments may have on the development of gevokizumab.

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

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

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

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

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

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

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. State regulations may also affect our proposed products.

The FDA has substantial discretion in both the product approval process and manufacturing facility approval process and, as a result of this discretion and uncertainties about outcomes of testing, we cannot predict at what point, or whether, the FDA will be satisfied with our or our collaborators' submissions or whether the FDA will raise questions which may be material and delay or preclude product approval or manufacturing facility approval. As we accumulate additional clinical data, we will submit it to the FDA, and such data may have a material impact on the FDA product approval process.

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

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

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

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

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

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

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

commercialize our technologies, products or services.

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

Even if products in which we have an interest receive approval in the future, they may not be accepted in the marketplace. In addition, we or our collaborators or licensees may experience difficulties in launching new

products, many of which are novel and based on technologies that are unfamiliar to the healthcare community. We have no assurance that healthcare providers and patients will accept such products, if developed. For example, physicians and/or patients may not accept a product for a particular indication because it has been biologically derived (and not discovered and developed by more traditional means) or if no biologically derived products are currently in widespread use in that indication. Similarly, physicians may not accept a product if they believe other products to be more effective or more cost-effective or are more comfortable prescribing other products.

Safety concerns may also arise in the course of on-going clinical trials or patient treatment as a result of adverse events or reactions. For example, in February of 2009, the EMA announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and EMD Serono Inc., the company that marketed RAPTIVA® in Canada ("EMD Serono") announced that, in consultation with Health Canada, the Canadian health authority ("Health Canada"), it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia Pty Ltd, the company that marketed RAPTIVA® in Australia ("Merck Serono Australia"), following a recommendation from the Therapeutic Goods Administration, the Australian health authority ("TGA"), announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.

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

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

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

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

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

- In April of 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA®. In April of 1999, March of 2003, and January of 2005, the companies amended the agreement. In October of 2003, RAPTIVA® was approved by the FDA for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy and, in September of 2004, Merck Serono announced the product's approval in the European Union. In January of 2005, we entered into a restructuring of our collaboration agreement with Genentech which ended our existing cost

and profit sharing arrangement related to RAPTIVA® in the United States and entitled us to a royalty interest on worldwide net sales. In February of 2009, the EMA announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and EMD Serono announced that, in consultation with Health Canada, it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia, following a recommendation from the TGA, announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.

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

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

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

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

- We have licensed our bacterial cell expression technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to over 60 companies. As of December 8, 2011, we were aware of two antibody products manufactured using this technology that have received FDA approval, Genentech's LUCENTIS® (ranibizumab injection) for treatment of neovascular wet age-related macular degeneration and UCB's CIMZIA® (certolizumab pegol) for treatment of Crohn's disease and rheumatoid arthritis. In the third quarter of 2009, we sold our LUCENTIS® royalty interest to Genentech. In the third quarter of 2010, we sold our CIMZIA® royalty interest.

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

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

- In September of 2006, we entered into an agreement with Taligen Therapeutics, Inc. ("Taligen") which formalized an earlier letter agreement, which was signed in May of 2006, for the development and cGMP manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement which provided that we would not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provided that we would conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate ("Avecia"). The letter agreement also provided that, subject to payment by Taligen of approximately $1.7 million, we would grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license under our owned project innovations. We received $0.6 million as the first installment under the payment terms of the letter agreement but not the two additional payments totaling approximately $1.1 million to which we were entitled upon fulfillment of certain obligations. In May of 2009, the matter was resolved by agreement of the parties in a manner that had no further impact on our financial position.

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

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

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

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

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

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

Gevokizumab

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

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

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

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

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

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

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

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

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

XOMA 3AB

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

- In May of 2006, the U.S. Department of Health & Human Services ("DHHS") awarded Cangene Corporation ("Cangene") a five-year, $362.0 million contract under Project Bioshield. The contract requires Cangene to manufacture and supply 200,000 doses of an equine heptavalent botulism anti-toxin to treat individuals who have been exposed to the toxins that cause botulism. In May of 2008, Cangene announced significant

product delivery under this contract. In March of 2010, this contract was extended for an additional two years, until May of 2013. In June of 2011, Cangene announced that DHHS will exercise options under the supply contract which are expected to increase the total contract to $423.0 million and to extend the delivery schedule to 2018.

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

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

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

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

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

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

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

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

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

We may not be able to successfully operate in any foreign market. We believe that, because the pharmaceutical industry is global in nature, international activities will be a significant part of our future business activities and that, when and if we are able to generate income, a substantial portion of that income will be derived from product

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sales and other activities outside the United States. Foreign regulatory agencies often establish standards different from those in the United States, and an inability to obtain foreign regulatory approvals on a timely basis could put us at a competitive disadvantage or make it uneconomical to proceed with a product or product candidate's development. International operations and sales may be limited or disrupted by:

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

We are subject to foreign currency exchange rate risks.

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

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

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

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

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our collaboration and development partners hold and are in the process of applying for a number of patents in the United States and abroad to protect our product candidates and important processes and also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the mere issuance of a patent is not conclusive as to its validity or its enforceability. The United States Federal Courts or

equivalent national courts or patent offices elsewhere may invalidate our patents or find them unenforceable. In addition, the laws of foreign countries may not protect our intellectual property rights effectively or to the same extent as the laws of the United States. If our intellectual property rights are not adequately protected, we may not be able to commercialize our technologies, products, or services, and our competitors could commercialize our technologies, which could result in a decrease in our sales and market share that would harm our business and operating results. Specifically, the patent position of biotechnology companies generally is highly uncertain and involves complex legal and factual questions. The legal standards governing the validity of biotechnology patents are in transition, and current defenses as to issued biotechnology patents may not be adequate in the future. Accordingly, there is uncertainty as to:

- whether any pending or future patent applications held by us will result in an issued patent, or that if patents are issued to us, that such patents will provide meaningful protection against competitors or competitive technologies,

- whether competitors will be able to design around our patents or develop and obtain patent protection for technologies, designs or methods that are more effective than those covered by our patents and patent applications, or

- the extent to which our product candidates could infringe on the intellectual property rights of others, which may lead to costly litigation, result in the payment of substantial damages or royalties, and/or prevent us from using technology that is essential to our business.

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

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require licenses from others in order to develop and commercialize certain potential products incorporating our technology or we may become involved in litigation to determine the proprietary rights of others. These licenses, if required, may not be available on acceptable terms, and any such litigation may be costly and may have other adverse effects on our business, such as inhibiting our ability to compete in the marketplace and absorbing significant management time.

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

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

We may be required to engage in litigation or other proceedings to protect our intellectual property. The cost to us of this litigation, even if resolved in our favor, could be substantial. Such litigation could also divert management's attention and resources. In addition, if this litigation is resolved against us, our patents may be declared invalid, and we could be held liable for significant damages. In addition, we may be subject to a claim that we are infringing another party's patent. If such claim is resolved against us, we or our collaborators may be enjoined from developing, manufacturing, selling or importing products, processes or services unless we obtain a license from the other party.

Such license may not be available on reasonable terms, thus preventing us from using these products, processes or services and adversely affecting our revenue.

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

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

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

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

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

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

The business and financial condition of pharmaceutical and biotechnology companies are also affected by the efforts of governments, third-party payors and others to contain or reduce the costs of healthcare to consumers. In the United States and various foreign jurisdictions there have been, and we expect that there will continue to be, a number of legislative and regulatory proposals aimed at changing the healthcare system, such as proposals relating to the reimportation of drugs into the U.S. from other countries (where they are then sold at a lower price) and government control of prescription drug pricing. The pendency or approval of such proposals could result in a decrease in our share price or limit our ability to raise capital or to obtain strategic collaborations or licenses.

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

The testing, marketing and sales of medical products entails an inherent risk of allegations of product liability. In the event of one or more large, unforeseen awards of damages against us, our product liability insurance may not provide adequate coverage. A significant product liability claim for which we were not covered by insurance would have to be paid from cash or other assets. To the extent we have sufficient insurance coverage, such a claim

would result in higher subsequent insurance rates. In addition, product liability claims can have various other ramifications including loss of future sales opportunities, increased costs associated with replacing products, and a negative impact on our goodwill and reputation, which could also adversely affect our business and operating results.

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

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

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

On April 8, 2011, four complaints were filed in the United States District Court for the Eastern District of Michigan. The cases are captioned: Muniz v. Genentech, et al., 5:11-cv-11489-JCO-RSW; Tifenthal v. Genentech, et al., 2:11-cv-11488-DPH-LJM; Blair v. Genentech, et al., 2:11-cv-11463-SFC-MJH; and Marsh v. Genentech, et al., 2:11-cv-11462-RHC-MKM. The complaints allege the same claims against Genentech, us and others and seek the same types of damages as the complaints filed in the Superior Court of Alameda County, California referenced

above. All four cases have been transferred to the United States District Court for the Western District of Michigan. On October 26, 2011, the Court granted the Motions to Dismiss filed by Genentech and the Company in all four actions. Plaintiffs have filed a Notice of Appeal in each case. Even though Genentech has agreed to indemnify us in connection with these matters, there can be no assurance that these or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such liabilities.

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

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

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

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

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

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

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

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. We had approximately 240 employees as of December 8, 2011. We may require additional experienced executive, accounting, research and development, legal, administrative and other personnel from time to time in the future. There is intense competition for the services of these personnel, especially in California. Moreover, we expect that the high cost of living in the San Francisco Bay Area, where our headquarters and manufacturing facilities are located, may impair our ability to attract and retain employees in the future. If we do

not succeed in attracting new personnel and retaining and motivating existing personnel, our operations may suffer and we may be unable to implement our current initiatives or grow effectively.

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

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

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

In February of 2003, we adopted a new shareholder rights agreement (to replace the shareholder rights agreement that had expired), which could make it considerably more difficult or costly for a person or group to acquire control of us in a transaction that our Board of Directors opposes. We intend to keep this agreement in place following the Domestication.

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

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

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

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

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

MARKET VALUE OF COMMON SHARES

Our common shares trade on The NASDAQ Global Market under the symbol "XOMA". All references to numbers of common shares and per-share information in this prospectus have been adjusted retroactively to reflect our reverse split of our common shares effective August 18, 2010. The following table sets forth the quarterly range of high and low reported sale prices of our common shares on The NASDAQ Global Market for the periods indicated:

	Price Range	
	High	Low
Year Ended December 31, 2009		

First Quarter	$14.10	$5.55
Second Quarter	20.10	6.00
Third Quarter	16.20	10.65
Fourth Quarter	12.60	9.45
Year Ended December 31, 2010		
First Quarter	$11.70	$6.00
Second Quarter	12.60	6.15
Third Quarter	6.45	2.45
Fourth Quarter	7.48	2.24
Year Ended December 31, 2011		
First Quarter	$7.71	$2.77
Second Quarter	3.49	2.17
Third Quarter	2.45	1.38
Fourth Quarter (through December 8, 2011)	1.86	1.36

On December 8, 2011, there were 2,313 shareholders of record of our common shares, one of which was Cede & Co., a nominee for Depository Trust Company ("DTC"). All of the common shares held by brokerage firms, banks and other financial institutions as nominees for beneficial owners are deposited into participant accounts at DTC and are therefore considered to be held of record by Cede & Co. as one shareholder.

THE DOMESTICATION

General

XOMA Bermuda will effect the Domestication by filing a notice of discontinuance with the Bermuda Registrar of Companies and filing a certificate of corporate domestication and a certificate of incorporation of XOMA Delaware with the Secretary of State of the State of Delaware. The Domestication does not require the approval of any of the shareholders of XOMA Bermuda. Under Bermuda and Delaware law, the domestication of XOMA Bermuda in Delaware is deemed effective upon the filing of the certificate of corporate domestication and the certificate of incorporation with the Secretary of State of the State of Delaware. In addition, XOMA Delaware must file with the Bermuda Registrar of Companies a copy of the certified copy of the certificate of corporate domestication of XOMA Bermuda issued by the Secretary of State of the State of Delaware within 30 days of the date of the issuance of the certified copy by the Secretary of State of the State of Delaware. Upon making this filing in Bermuda, the Bermuda Registrar of Companies will issue a certificate of discontinuance and, at that time, we shall cease to be registered as a company in Bermuda. We intend to file the copy of the certified copy of the certificate of corporate domestication with the Bermuda Registrar of Companies on the same day the certified copy is issued by the Secretary of State of the State of Delaware.

In connection with the Domestication, XOMA Delaware will adopt new by-laws, which, together with the new certificate of incorporation filed in Delaware, will be the organizational documents of XOMA Delaware after the Domestication.

Background and Reasons for the Domestication

We are a leader in the discovery and development of therapeutic antibodies. We discover, develop and manufacture novel antibody therapeutics for our own proprietary pipeline as well as through license and collaborative agreements with pharmaceutical and biotechnology companies, and under our contracts with the U.S. government. We were originally incorporated in Delaware in 1981 and became a Bermuda company effective December 31, 1998, when we completed a shareholder-approved corporate reorganization, changing our legal domicile from Delaware to Bermuda and our name to XOMA Ltd.

Our board of directors believes that the Domestication will, among other things:

- Provide legal, administrative and other similar efficiencies, as well as provide a basis for further efficiencies in the event we undertake to simplify our overall corporate structure;

- Reduce our exposure to the potential consequences of certain types of punitive or potentially adverse tax legislation that have been proposed from time to time;

- Relocate our jurisdiction of organization to one that has a body of law more familiar to our officers, our employees, our board of directors and many of our shareholders; and

- Reduce our exposure to other potentially adverse or prejudicial actions based on our being a non-US company, such as “blacklisting” of our common shares by certain pension funds or legislation restricting certain types of transactions.

Because all of our officers are currently based in the United States and substantially all of our operations are currently conducted from the United States, we do not derive any significant U.S. tax benefits from our status as a non-U.S. company.

For many years, Delaware has been a leader in adopting, implementing and interpreting comprehensive and flexible corporate laws that are responsive to the legal and business needs of corporations.

In December of 2010, our management proposed to our board of directors to initiate an analysis of a change in our jurisdiction of incorporation from Bermuda to a US or other non-US jurisdiction, and our board approved

such an analysis. In May of 2011, our management presented an initial proposal to the audit committee of our board of directors to change our jurisdiction of incorporation to the State of Delaware, and the committee preliminarily concurred with such proposal and directed management to analyze the effects of certain variations on the proposed structure. In June of 2001, our management presented to the audit committee of our board of directors the results of this further analysis and received the committee's approval to present its proposal to change our jurisdiction of incorporation to the State of Delaware to our full board of directors. In July of 2011, our management presented its proposal to our board of directors and obtained authorization to continue to pursue a change in our jurisdiction of incorporation from Bermuda to Delaware. In October of 2011, our board of directors approved the Domestication.

Effects of the Domestication

The Companies Act 1981 of Bermuda, as amended (the "Companies Act") permits a Bermuda exempted company to discontinue from Bermuda and continue in an appointed jurisdiction (which includes Delaware) as if it had been incorporated under the laws of that other jurisdiction. The Companies Act and our current bye-laws authorize our board of directors to discontinue XOMA Bermuda to a jurisdiction outside of Bermuda (in this case, Delaware) without a shareholder vote. Consequently, we are not asking for your vote or soliciting proxies with respect to the Domestication. The Companies Act does not provide shareholders with statutory rights of appraisal in relation to a discontinuance under the Companies Act.

Section 388 of the DGCL provides that an entity organized in a country outside the United States may become domesticated as a corporation in Delaware by filing in Delaware a certificate of incorporation and a certificate of corporate domestication stating, among other things, that the domestication and the certificate of incorporation have been approved as provided in the organizational documents of the non-U.S. entity. Section 388 does not provide any separate approval requirements for a domestication. The DGCL also does not provide stockholders with statutory rights of appraisal in connection with a domestication under Section 388.

Under Section 132I of the Companies Act, our discontinuance from Bermuda and continuance in Delaware will not be deemed to operate to create a new legal entity or prejudice or affect our continuity as an existing corporation. Similarly, Section 388 of the DGCL provides that, upon domesticating in Delaware:

- XOMA Delaware shall be deemed to be the same entity as XOMA Bermuda, and the domestication shall constitute a continuation of the existence of XOMA Bermuda in the form of XOMA Delaware;

- all rights, privileges and powers, as well as all property, of XOMA Bermuda shall remain vested in XOMA Delaware;

- all debts, liabilities and duties of XOMA Bermuda shall remain attached to XOMA Delaware and shall be enforceable against XOMA Delaware to the same extent as if originally incurred by it; and

    - the domestication shall not be deemed a dissolution of XOMA Bermuda.

No Change in Business, Locations, Fiscal Year or Employee Plans

The Domestication will effect a change in our jurisdiction of incorporation, and other changes of a legal nature, including changes in our organizational documents, which are described in this prospectus. The business, assets and liabilities of XOMA and its subsidiaries on a consolidated basis, as well as our principal locations and fiscal year, will be the same upon effectiveness of the Domestication as they are prior to the Domestication.

Upon effectiveness of the Domestication, all of our obligations will continue as outstanding and enforceable obligations of XOMA Delaware.

All XOMA Bermuda employee benefit plans and agreements will be continued by XOMA Delaware. We expect to amend any and all of our share-based benefit plans in accordance with their terms as may be necessary to provide that XOMA Delaware common stock will be issued upon the exercise of any options or the payment of any other share-based awards granted under the plans, and otherwise to reflect appropriately the substitution of XOMA

Delaware common stock for XOMA Bermuda common shares in connection with the plans, following the Domestication.

No Change in Management or Our Board of Directors

Our executive officers will be the executive officers of XOMA Delaware upon effectiveness of the Domestication. Our current executive officers include John Varian (Interim Chief Executive Officer), Patrick J. Scannon, M.D., Ph.D. (Executive Vice President and Chief Scientific Officer), Fred Kurland (Vice President, Finance and Chief Financial Officer), Christopher J. Margolin (Vice President, General Counsel and Secretary) and Paul Rubin, M.D. (Vice President, Clinical Development and Chief Medical Officer).

Our board of directors will continue as the board of directors of XOMA Delaware following the Domestication. Our current board of directors is comprised of W. Denman Van Ness, John Varian, Patrick J. Scannon, M.D., Ph.D., William K. Bowes, Jr., Peter Barton Hutt, Timothy P. Walbert and Jack L. Wyszomierski.

In addition, neither the members nor the chairpersons of our Audit Committee, Compensation Committee or Nominating and Governance Committee will change upon effectiveness of the Domestication, nor will our Lead Independent Director's status change.

Domestication Share Conversion

In the Domestication, each of our currently issued and outstanding common shares will automatically convert by operation of law, on a one-for-one basis, into shares of XOMA Delaware common stock. Consequently, upon the effectiveness of the Domestication, each holder of a XOMA Bermuda common share will instead hold a share of XOMA Delaware common stock representing the same proportional equity interest in XOMA Delaware as that shareholder held in XOMA Bermuda and representing the same class of shares. The number of shares of XOMA Delaware common stock outstanding immediately after the Domestication will be the same as the number of common shares of XOMA Bermuda outstanding immediately prior to the Domestication.

XOMA Delaware will not issue new stock certificates to XOMA Delaware stockholders who currently hold any of our share certificates. A shareholder who currently holds any of our share certificates will receive a new stock certificate only upon any future transaction in XOMA Delaware common stock that requires the transfer agent to issue stock certificates in exchange for existing share certificates. It is not necessary for shareholders of XOMA Bermuda to exchange their existing share certificates for share certificates of XOMA Delaware. Until surrendered and exchanged, each certificate evidencing XOMA Bermuda common shares will be deemed for all purposes of the Company to evidence the identical number of shares of XOMA Delaware common stock. Holders of uncertificated common shares of XOMA Bermuda immediately prior to the Domestication will continue as holders of uncertificated common stock of XOMA Delaware upon effectiveness of the Domestication.

Similarly, outstanding options and warrants to acquire XOMA Bermuda common shares will become options or warrants to acquire common stock of XOMA Delaware. XOMA Delaware will not issue new options or warrants to acquire XOMA Delaware common stock until such future transaction that requires the issuance of options or warrants to acquire XOMA Delaware common stock in exchange for existing options or warrants to acquire XOMA Bermuda shares. Until surrendered and exchanged, each option or warrant to acquire XOMA Bermuda common shares will be deemed for all purposes of the Company to evidence an option or warrant to acquire the identical number of shares of XOMA Delaware common stock.

Comparison of Shareholder Rights

Upon effectiveness of the Domestication, the rights of stockholders of XOMA Delaware will arise under the new certificate of incorporation and by-laws of XOMA Delaware as well as Delaware law. Those organizational documents and Delaware law contain provisions that differ in some respects from those in our current organizational documents and Bermuda law and, therefore, some of your rights as a stockholder of XOMA Delaware could differ from the rights you currently possess as a shareholder of XOMA Bermuda. For example, under Bermuda law, holders of an aggregate of not less than 20% in par value of a company's issued share capital have the right to apply to

the Supreme Court of Bermuda for an annulment of any amendment of the memorandum of association adopted by shareholders at any general meeting, other than an amendment that alters or reduces a company's share capital as provided in the Companies Act. No similar right is available under Delaware law. Also, while class actions and derivative actions are generally not available to shareholders under Bermuda law, such actions are generally available under Delaware law. Additionally, there are differences between the new organizational documents of XOMA Delaware and the current organizational documents of XOMA Bermuda. For example, while our current bye-laws contain provisions regarding "business combinations" and "interested shareholders" that will be substantially similar in effect to the provisions of Section 203 of the DGCL, the new XOMA Delaware by-laws will not contain provisions similar to the business combination provisions in our current bye-laws. However, our stockholders will have substantially similar voting rights because the provisions of Section 203 will apply upon effectiveness of the Domestication. For a more detailed description of your rights as a stockholder of XOMA Delaware and how they may differ from your rights as a shareholder of XOMA Bermuda, please see "Description of Capital Stock—Differences between the Governing Corporate Law and Organizational Documents for XOMA Bermuda and XOMA Delaware" in this prospectus.

No Vote or Rights of Appraisal in the Domestication

Under the Companies Act and our current bye-laws, shareholder approval of the Domestication is not required, and our shareholders do not have statutory rights of appraisal or any other appraisal rights of their shares as a result of the Domestication. Nor does Delaware law provide for any such rights. We are not asking you for a proxy and you are requested not to send us a proxy. No shareholder vote or action is required to effect the Domestication.

SELECTED HISTORICAL FINANCIAL INFORMATION

The following table contains our selected financial information including consolidated statement of operations and consolidated balance sheet data for the years 2006 through 2010 and for the three and nine months ended September 30, 2010 and September 30, 2011. The selected financial information for the years 2006 through 2010 has been derived from our audited consolidated financial statements. The selected financial information for the three and nine months ended September 30, 2010 and 2011 has been derived from our unaudited consolidated financial statements. The selected financial information should be read in conjunction with the financial statements and supplementary data and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this prospectus. The data set forth below is not necessarily indicative of the results of future operations.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Consolidated Statement of Operations Data				
Total revenues (1)	$16,229	$10,897	$48,349	$24,041
Total operating costs and expenses	23,147	27,542	70,258	75,054
Restructuring costs	—	—	—	—
Loss from operations	(6,918)	(16,645)	(21,909)	(51,013)
Other income, net (2)	375	3,013	916	32
Net loss before taxes	(6,543)	(13,632)	(20,993)	(50,981)
Income tax expense (benefit), net (3)	—	1	15	17
Net loss	$(6,543)	$(13,633)	$(21,008)	$(50,998)
Basic and diluted net (loss) income per common share	$(0.20)	$(0.69)	$(0.69)	$(2.87)

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(In thousands, except per share amounts)				
Consolidated Statement of Operations Data					
Total revenues (1)	$33,641	$98,430	$67,987	$84,252	$29,498
Total operating costs and expenses	100,663	81,867	106,721	86,796	70,182
Restructuring costs	82	3,603	—	—	—
(Loss) income from operations	(67,104)	12,960	(38,734)	(2,544)	(40,684)
Other income (expense), net (2)	(1,625)	(6,683)	(6,894)	(9,782)	(11,157)
Net (loss) income before taxes	(68,729)	6,277	(45,628)	(12,326)	(51,841)
Income tax expense (benefit), net (3)	27	5,727	(383)	—	—
Net (loss) income	$(68,756)	$550	$(45,245)	$(12,326)	$(51,841)
Basic and diluted net (loss) income per common share	(3.69)	$0.05	$(5.11)	$(1.45)	$(8.10)

	September 30,	December 31,				
	2011	2010	2009	2008	2007	2006
				(In thousands)		
Balance Sheet Data						
Cash and cash equivalents	$45,707	$37,304	$23,909	$9,513	$22,500	$28,002
Short-term investments	—	—	—	1,299	16,067	18,381
Restricted cash	—	—	—	9,545	6,019	4,330

Current assets	61,948	58,880	32,152	38,704	58,088	65,888
Working capital	41,529	23,352	13,474	11,712	34,488	43,221
Total assets	77,185	74,252	52,824	67,173	84,815	91,478
Current liabilities	20,419	35,528	18,678	26,992	23,600	22,667
Long-term liabilities (4)	35,105	15,133	16,620	71,582	60,897	106,984
Redeemable convertible preferences shares, at par value	—	1	1	1	1	1
Accumulated deficit	(874,318)	(853,310)	(784,554)	(785,104)	(739,859)	(727,533)
Total shareholders' equity (net capital deficiency)	21,661	23,591	17,526	(31,401)	318	(38,173)

We have paid no dividends in the past five years.

(1) 2010 includes a non-recurring fee of $4.0 million related to the sale of our CIMZIA® royalty interest. 2009 includes a non-recurring fee of $28.1 million related to the expansion of our collaboration agreement with Takeda Pharmaceutical Company Limited ("Takeda") and a non-recurring fee of $25 million related to the sale of our LUCENTIS® royalty interest to Genentech, Inc., a member of the Roche Group ("Genentech"). 2008 includes a non-recurring fee from Novartis AG ("Novartis") of $13.7 million relating to a restructuring of the existing collaboration agreement. 2007 includes a non-recurring license fee from Pfizer Inc. of $30 million.

(2) 2010 includes a loss associated with the $4.5 million paid in the first quarter of 2010 to the holders of warrants issued in June of 2009, upon modification of the terms.

(3) 2009 includes foreign income tax expense of $5.8 million recognized in connection with the expansion of our existing collaboration with Takeda.

(4) The balance as of December 31, 2008 includes $50.4 million from our term loan with Goldman Sachs Specialty Lending Holdings, Inc. ("Goldman Sachs"), which we repaid in 2009. In May of 2008, the Company entered into a $55 million amended term loan facility with Goldman Sachs, paying off the remaining balance on the term loan completed in November of 2006. In addition, the outstanding principal on our Novartis note was reduced by $7.5 million due to the restructure of our collaboration with Novartis. In 2007, we eliminated the remaining $44.5 million in convertible debt issued in 2006. In 2006, we exchanged convertible senior notes (issued in 2005) for $60 million of 6.5% Convertible SNAPsSM due 2012 and issued an additional $12 million of 6.5% SNAPsSM to the public for cash.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

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

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

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

Our biodefense initiatives currently include a $65.0 million multiple-year contract funded by the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health ("NIH"), to support our ongoing development of anti-botulism antibody product candidates, of which the first, XOMA 3AB, is in a Phase 1 clinical

trial. In October of 2011, we announced a new contract under Contract No. HHSN272201100031C ("NIAID 4") for up to $28.0 million over five years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning, bringing the program's total potential awards to approximately $120 million. We also develop products with premier pharmaceutical companies including Novartis AG ("Novartis") and Takeda Pharmaceutical Company Limited ("Takeda").

We have a premier antibody discovery and development platform that incorporates a collection of antibody phage display libraries and proprietary Human Engineering™, affinity maturation, Bacterial Cell Expression ("BCE") and manufacturing technologies that enhance our ability and that of our collaboration and development partners to discover and develop new therapeutic antibodies. BCE is a key biotechnology for the discovery and manufacturing of antibodies and other proteins. To date, more than 60 pharmaceutical and biotechnology companies have signed BCE licenses, and a number of licensed product candidates are in clinical development. We continue to develop and commercialize additional antibody-related technologies including proprietary display technologies to enable antibody discovery and optimization. Our technologies have contributed to the success of marketed antibody products, including LUCENTIS® (ranibizumab injection) for wet age-related macular degeneration and CIMZIA® (certolizumab pegol) for rheumatoid arthritis and Crohn's disease.

Significant Developments in 2010 and the First Nine Months of 2011

Gevokizumab

- During 2010, XOMA announced positive results from a Phase 2 proof-of-concept clinical trial evaluating XOMA 052 in Behcet's uveitis, demonstrating rapid improvement in vision-threatening disease exacerbations in all seven treated patients despite discontinuation of immunosuppressive drugs such as cyclosporine and/or azathioprine. Follow-up results demonstrated that each of the five patients re-treated with XOMA 052 after they experienced a new uveitis exacerbation responded again to XOMA 052 treatment and maintained their response for several months. The drug appeared to be safe, and no drug-related serious adverse events were reported.

- In August of 2010, we obtained Food and Drug Administration ("FDA") orphan drug status for XOMA 052 for the treatment of Behcet's disease. The designation offers a number of potential incentives, which may include, among others, a seven-year period of U.S. marketing exclusivity from the date of marketing authorization, written guidance on the non-clinical and clinical studies needed to obtain marketing approval, and tax credits for certain clinical research. In October of 2010, XOMA 052 was granted orphan drug status by the European Medicines Agency ("EMA") for the treatment of Behcet's disease. The designation generally provides EU market exclusivity for up to ten years following approval for the given indication. Other potential benefits include protocol assistance, direct access to centralized marketing authorization procedures and financial incentives.

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

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

- In March of 2011, we announced that our Phase 2b trial of gevokizumab in Type 2 diabetes in 421 patients did not achieve the primary endpoint of reduction in hemoglobin A1c ("HbA1c") after six monthly treatments with gevokizumab compared to placebo. Significant decreases were observed in C-reactive protein ("CRP"), a biomarker for the risk of heart attack, stroke and other cardiovascular diseases, in all dose groups versus placebo. In addition,

significant improvements in high-density lipoprotein (“HDL”), or “good” cholesterol, were observed in two of four gevokizumab dose groups versus placebo. Gevokizumab was well-tolerated in this trial, with no serious drug-related adverse events and a safety profile consistent with previous trials.

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

XOMA 3AB

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

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

Preclinical Pipeline

- In June of 2011, we announced our discovery of two new classes of fully-human monoclonal antibodies, XMetA and XMetS, which activate or sensitize the insulin receptor in vivo, each representing a distinct new therapeutic approach to the treatment of patients with diabetes. Studies of XMetA demonstrated that it reduced fasting blood glucose levels and improved glucose tolerance in a mouse model of diabetes. After six weeks of treatment, there was a statistically significant reduction in HbA1c levels, a standard measure of average blood glucose levels over time, in mice treated with XMetA compared to a control group, and there was a statistically significant reduction in elevated non-HDL cholesterol levels. Studies of XMetS showed enhanced insulin sensitivity and statistically significant improvements in fasting blood glucose levels and glucose tolerance in mice treated with XMetS as compared to a control group, and there was a statistically significant reduction in elevated non-HDL cholesterol levels. These data were presented at the American Diabetes Association's 71st Scientific Sessions.

Management Change

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

Financing-Related

- In February of 2010, we completed an underwritten offering of 2.8 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately $21 million.

- In 2010, we sold 1,396,625 common shares through Wm Smith & Co. ("Wm Smith"), under our At Market Issuance Sales Agreement dated July 14, 2009 (the "2009 ATM Agreement"), for aggregate gross proceeds of $9.3 million, and 6,739,476 common shares through Wm Smith and McNicoll, Lewis & Vlak LLC ("MLV") under our At Market Issuance Sales Agreement dated October 26, 2010 (the "2010 ATM Agreement"), for aggregate gross proceeds of

$29.7 million.

- In July of 2010, we entered into a common share purchase agreement with Azimuth Opportunity, Ltd. ("Azimuth") pursuant to which we obtained a committed equity line of credit under which we could sell up to $30 million of our registered common shares to Azimuth. In August of 2010, we sold a total of 3,421,407 common shares under this facility for aggregate proceeds of $14.2 million, representing the maximum number of shares that could be sold under this facility.

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

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

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

Other

- In March of 2010, we received a Staff Determination letter from The NASDAQ Stock Market LLC ("NASDAQ") indicating that we had not regained compliance with the minimum $1.00 per share requirement for continued inclusion on The NASDAQ Global Market, pursuant to NASDAQ Listing Rule 5450(a)(1). On August 18, 2010, the Company effected a reverse split of its common shares in order to regain compliance.

- In August of 2010, we sold our CIMZIA® royalty stream to OrbiMed Advisors, LLC for gross proceeds of $4.0 million, which included the receipt of royalties of $0.3 million earned in the second quarter of 2010 and an additional one-time, non-refundable payment of $3.7 million. We will no longer receive royalties on sales of CIMZIA®.

- In November of 2010, the Company received approximately $1.0 million resulting from four grants awarded in connection with the Company's submission of four qualifying therapeutic discovery projects under the Patient Protection and Affordable Care Act of 2010.

Critical Accounting Estimates

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements and the related disclosures, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following policies to be the most critical to an understanding of our financial condition and results of operations because they require us to make estimates, assumptions and judgments about matters that are inherently uncertain.

Revenue Recognition

Effective January 1, 2010, we early adopted the recently revised accounting guidance on revenue recognition for multiple element arrangements on a prospective basis, which requires us to allocate consideration to all deliverables at

the inception of the arrangement using the relative selling price method. The relative selling price method establishes the relative selling price of a deliverable using a hierarchy, first through vendor-specific objective

evidence ("VSOE"), second through third-party evidence if VSOE is not available and finally, through estimated selling prices if neither VSOE nor third-party evidence is available. Additionally, the revised accounting guidance also refined the criteria for determining when a deliverable should be accounted for as a separate unit of accounting. Based on this guidance, we generally identify separate units of accounting for the multiple element arrangement if the delivered item has value to the customer on a standalone basis. Generally, under the new accounting principle, we will be more likely to separate the units of accounting in multiple element arrangements which may to lead to more accelerated revenue recognition in some cases. Changes in the allocation of the sales price between delivered to undelivered elements might impact the timing of revenue recognition, but would not change the total revenue recognized on any arrangement.

The change in accounting principle for revenue recognition on multiple element arrangements did not have a material impact on our financial results for the year ended December 31, 2010. We anticipate that the effect on the change in accounting principle on subsequent periods will be primarily dependent on the arrangements entered into, the ability to estimate selling prices when VSOE cannot be established and the timing of the delivery of the products and services. Additionally, had the new accounting guidance been applied for the year ended December 31, 2009, there would have been no material impact on the revenue recognized.

License and Collaborative Fees

Revenue from non-refundable license, technology access or other payments under license and collaborative agreements where we have a continuing obligation to perform is recognized as revenue over the expected period of the continuing performance obligation. We estimate the performance period at the inception of the arrangement and reevaluate it each reporting period. This reevaluation may shorten or lengthen the period over which the remaining revenue is recognized. Changes to these estimates are recorded on a prospective basis.

Milestone payments under collaborative and other arrangements are recognized as revenue upon completion of the milestone event, once confirmation is received from the third party and collectability is reasonably assured. This represents the culmination of the earnings process because we have no future performance obligations related to the payment. Milestone payments that require a continuing performance obligation on our part are recognized over the expected period of the continuing performance obligation. Amounts received in advance are recorded as deferred revenue until the related milestone is completed.

Contract Revenue

Contract revenue for research and development involves our providing research and development and manufacturing services to collaborative partners, biodefense contractors or others. Revenue for certain contracts is accounted for by a proportional performance, or output-based, method where performance is based on estimated progress toward elements defined in the contract. The amount of contract revenue and related costs recognized in each accounting period are based on estimates of the proportional performance during the period. Adjustments to estimates based on actual performance are recognized on a prospective basis and do not result in reversal of revenue should the estimate to complete be extended.

In addition, revenue related to certain research and development contracts is billed based on actual costs incurred by XOMA related to the contract, multiplied by full-time equivalent ("FTE") rates plus a mark-up. The FTE rates are developed based on our best estimates of labor, materials and overhead costs. For certain contracts, such as our government contracts, the FTE rates are agreed upon at the beginning of the contract and are subject to review or audit by the contracting party at any time. Under our contracts with NIAID, a part of the NIH, we bill using NIH provisional rates and thus are subject to future audits at the discretion of NIAID's contracting office. These audits can

result in an adjustment to revenue previously reported.

Up-front fees are recognized ratably over the expected benefit period under the arrangement. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement. As of September 30, 2011, we have $1.3 million of deferred up-front fees related to two research and collaboration agreements that are being amortized over a range of one to five years.

Share-Based Compensation

The valuation of share-based compensation awards is determined at the date of grant using the Black-Scholes option pricing model (the "Black-Scholes Model"). This model requires inputs such as the expected term of the option, expected volatility and risk-free interest rate. Further, the forfeiture rate also impacts the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. To establish an estimate of expected term, we consider the vesting period and contractual period of the award and our historical experience of share option exercises, post-vesting cancellations and volatility. To establish an estimate of forfeiture rate, we consider our historical experience of option forfeitures and terminations. The risk-free rate is based on the yield available on United States Treasury zero-coupon issues. We review our valuation assumptions quarterly and, as a result, it is likely we will change our valuation assumptions used to value share-based awards granted in future periods.

Share-based compensation expense is recognized ratably over the requisite service period. If options are granted that include a performance condition, we estimate the probability of the performance condition being achieved on a quarterly basis. If it is determined that it is probable the performance criteria will be achieved, we estimate an implicit service period from grant date to the most likely date of achievement of the performance criteria and record share-based compensation expense ratably over this implicit service period. These estimates require significant judgment and may change in future periods.

Income Taxes

The application of income tax law and regulations is inherently complex. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in our financial statements.

We account for uncertain tax positions in accordance with Accounting Standards Codification Topic 740, Income Taxes ("ASC 740"). 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.

Warrant Liabilities

We have issued warrants to purchase our common shares in connection with financing activities. We account for the warrants as a liability at fair value. The fair value of the warrant liability is estimated using the Black-Scholes Model. The Black-Scholes Model requires inputs such as the expected term of the warrants, share price volatility and risk-free interest rate. These inputs are subjective and generally require significant analysis and judgment to develop. For the estimate of the expected term, we use the full remaining contractual term of the warrant. We base our estimate of expected volatility on our historical volatility. These assumptions are reviewed each reporting period and changes in the estimated fair value of the outstanding warrants are recognized in other income (expense).

Results of Operations

Revenues

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

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

Total revenues for the years ended December 31, 2010, 2009 and 2008, were as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
License and collaborative fees	$2,182	$43,822	$16,366
Contract and other revenue	27,174	25,492	30,473
Royalties	4,285	29,116	21,148
Total revenues	$33,641	$98,430	$67,987

License and Collaborative Fees

License and collaborative fee revenue includes fees and milestone payments related to the out-licensing of our products and technologies. License and collaborative fee revenue increased by $3.4 million and $15.0 million for the three and nine months ended September 30, 2011, respectively, compared to the same periods in 2010. These increases were primarily due to $4.2 million and $15.9 million in revenue recognized in the three and nine months ended September 30, 2011, respectively, related to the collaboration and loan agreements with Servier to jointly develop and commercialize gevokizumab in multiple indications.

License and collaborative fee revenue in 2010 was $2.2 million, compared with $43.8 million in 2009 and $16.4 million in 2008. The primary components of license and collaboration fee revenue in 2010 were four milestone payments recognized for an aggregate amount of $1.2 million, including one milestone from AVEO Pharmaceuticals, Inc. (“AVEO”) for $0.8 million resulting from AVEO’s initiation of a Phase 2 clinical trial to evaluate its AV-299 antibody. In addition, we recognized $1.0 million in up-front fees and annual maintenance fees relating to various out-licensing arrangements.

The primary components of license and collaborative fee revenue in 2009 were $28.1 million in revenue recognized related to the expansion of our collaboration agreement with Takeda in February of 2009 and $14.1 million in total revenue, including ancillary services provided, related to two antibody discovery collaboration agreements entered into with Arana Therapeutics Limited (“Arana”) and The Chemo-Sero-Therapeutic Research Institute, a Japanese research foundation known as Kaketsuken in September and October of 2009. We also recognized $1.6 million of license and collaborative fee revenue in 2009 related to up-front fees, annual maintenance fees and milestone payments from various out-licensing arrangements.

The primary source of license and collaborative fee revenue in 2008 related to the restructuring of our product development collaboration with Novartis, which involved six development programs including the HCD122 program. Under the restructured agreement, we recognized a collaborative fee of $13.7 million in exchange for giving Novartis control over the HCD122 and LFA102 programs, as well as the right to expand the development of these programs into additional indications outside of oncology. We also recognized $1.7 million in up-front fees and annual maintenance fees relating to various out-licensing arrangements. In addition, we recognized four milestone payments totaling $1.0 million, including two milestone payments from Pfizer, Inc. relating to two different products, including the payment of $0.5 million for the initiation of a Phase 3 clinical trial.

The generation of future revenue related to license fees and other collaborative arrangements is dependent on our ability to attract new licensees to our antibody and bacterial cell expression technologies and new collaboration partners. Due to our collaboration agreement with Servier, we expect to experience an increase in these revenues in the fourth quarter of 2011 compared to the fourth quarter of 2010.

Contract and Other Revenue

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Increase (Decrease)	2011	2010	Increase (Decrease)
NIAID	$5,069	$4,803	$266	$17,321	$13,097	$4,224
Servier	5,916	—	5,916	12,590	—	12,590
Takeda	317	263	54	901	3,289	(2,388)
Other	47	667	(620)	665	1,639	(974)
Total revenues	$11,349	$5,733	$5,616	$31,477	$18,025	$13,452

The following table shows the activity in contract and other revenue for the years ended December 31, 2010, 2009 and 2008 (in thousands):

	Year ended December 31,			2009-2010 Increase (Decrease)	2008-2009 Increase (Decrease)
	2010	2009	2008		
NIAID	$21,414	$6,632	$5,487	$14,782	$1,145
Servier	—	—	—	—	—
Takeda	3,568	7,549	4,369	(3,981)	3,180
Merck/Schering-Plough	468	7,586	10,780	(7,118)	(3,194)
Novartis	—	2,459	6,602	(2,459)	(4,143)
Other	1,724	1,266	3,235	458	(1,969)
Total revenues	$27,174	$25,492	$30,473	$1,682	$(4,981)

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

The 2010 increases in revenue from our NIAID 3 and SRI International contracts is due to increased activity under these contracts. Partially offsetting these increases are decreases in revenue from our Schering-Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck & Co., Inc. (referred to herein as “Merck/Schering-Plough”) and Takeda contracts in 2010 as a result of the cessation of certain Merck/Schering-Plough programs in 2009 and certain Takeda programs in both 2009 and 2010. Also, the decrease in revenue from our Manufacturing and Technology Transfer Agreement with Novartis in 2010 was due to the completion of the work

under this agreement in the third quarter of 2009. In addition, revenue related to our NIAID Contract No. HHSN266200600008C/N01-Al-60008 ("NIAID 2") decreased in 2010 due to its completion.

The 2009 decrease in revenue under our Merck/Schering-Plough contract was due to the cessation of certain discovery and development programs under our collaboration agreement in 2009. Also, revenue from our Manufacturing and Technology Transfer Agreement with Novartis decreased in 2009 due to the completion of the work under this agreement in the third quarter of 2009. In addition, revenue from our AVEO contract decreased in 2009 as a result of our nearing the end of the contracted service arrangement.

These decreases in contract and other revenue in 2009 were partially offset by the recognition of $2.8 million of previously deferred revenue in the fourth quarter of 2009 related to the cessation of certain discovery and development programs under our collaboration with Takeda, resulting in an increase in contract revenue recognized related to our collaboration with Takeda.

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

We defer revenue until all requirements under our revenue recognition policy are met. During the first nine months of 2011, we have deferred $12.8 million of revenue from contracts including Servier, NIH, Takeda, Merck/Schering-Plough and AVEO, and we have recognized $16.9 million in revenue. In 2010, we deferred $15.9 million of revenue from contracts including Servier, NIH, Takeda, Merck/Schering-Plough and AVEO, and we recognized $2.8 million in revenue. In 2009, we deferred $16.2 million of revenue from contracts including Takeda, Merck/Schering-Plough and Novartis and recognized $28.4 million in revenue. In 2008, we deferred $17.5 million of revenue from contracts including Merck/Schering-Plough, Takeda and Novartis and recognized $18.4 million in revenue.

The following table shows the activity in deferred revenue for the nine months ended September 30, 2011 and the years ended December 31, 2010, 2009 and 2008 (in thousands):

	Nine Months Ended September 30, 2011	Year ended December 31,		
		2010	2009	2008
Beginning deferred revenue	$18,130	$5,008	$17,213	$18,064
Revenue deferred	12,771	15,949	16,220	17,515
Revenue recognized	(16,879)	(2,827)	(28,425)	(18,366)
Ending deferred revenue	$14,022	$18,130	$5,008	$17,213

In the remainder of 2011, we expect a significant portion of the $14.0 million in deferred revenue will be recognized with the remainder to be earned during 2012 through 2015. Future amounts may be affected by additional consideration received, if any, under existing or any future licensing or other collaborative arrangements as well as changes in the estimated period of obligation or services to be provided under the arrangements.

Royalties

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

Revenue from royalties was $4.3 million in 2010 compared with $29.1 million in 2009 and $21.1 million in 2008. The decrease in royalties in 2010 was primarily due to the sale, during 2009, of our LUCENTIS® royalty interest to Genentech for a total of $25 million, which included the receipt of royalties of $2.7 million recognized in the second quarter of 2009 and an additional one-time, non-refundable payment of $22.3 million in September of

2009. Additionally, the cessation of royalties earned from sales of RAPTIVA® in the second quarter of 2009 further contributed to the decrease in our revenue from royalties. Royalties earned from sales of LUCENTIS® and RAPTIVA® during 2009 were $5.1 million and $1.2 million, respectively, compared to $4.4 million and $6.5 million, respectively, in 2008. We will not receive any further royalties on sales of LUCENTIS® or RAPTIVA®.

Partially offsetting the decreases in revenue from royalties was the sale of our CIMZIA® royalty interest for gross proceeds of $4.0 million in the third quarter of 2010, which included the payment of $0.3 million in royalties received and recognized in the second quarter of 2010. Royalties earned from sales of CIMZIA® were $0.5 million in 2010, compared with $0.5 million in 2009 and $0.1 million in 2008.

Research and Development Expenses

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

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

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

Research and development expenses were $77.4 million in 2010, compared with $58.1 million in 2009 and $82.6 million in 2008. The increase in research and development expenses of $19.3 million in 2010, as compared to 2009, was primarily due to increased spending on gevokizumab related to the Phase 2 clinical program and spending on NIAID 3 due to increased activity under the contract. Partially offsetting these increases in spending were decreases in spending on Merck/Schering-Plough and Takeda-related contract activities due to the cessation of certain discovery and development programs. In addition, there was decreased spending on Novartis-related contract activities due to the completion of work under agreement in the third quarter of 2009.

The decrease in research and development expense of $24.5 million in 2009, as compared to 2008, was primarily a result of our increased focus on cost control. In addition, spending on Novartis and Merck/Schering-Plough/AVEO-related contract activities decreased in 2009 due to our reaching the end of contracted service arrangements, and spending on Merck/Schering-Plough-related contract activities decreased in 2009 due to the cessation of certain discovery and development programs under the collaboration. Spending on gevokizumab decreased in 2009, as compared to 2008, due to the completion of Phase 1 clinical trial enrollment in the second quarter of 2009 slightly offset by an increase in spending in the fourth quarter of 2009 related to the initiation of the Phase 2 clinical program. In addition, spending on XOMA 629 decreased in 2009, as compared to 2008, due to the Company’s decision to suspend development of this product. These decreases were partially offset by increased spending on preclinical antibody discovery programs in several indications, and on our contracts with NIAID 3, Takeda and SRI International.

Research and development expense in 2008 primarily reflects spending on development of gevokizumab, including Phase 1 clinical trials, and to a lesser extent XOMA 629. In addition, we increased spending on our contracts with Novartis, Merck/Schering-Plough, NIAID 3 and Takeda. Research and development expenses also increased in 2008

related to the preclinical development of several antibodies, XOMA 3AB and upgrades made to our manufacturing plant.

We recorded $29.7 million in research and development salaries and employee-related expenses in 2010, compared with $26.8 million in 2009 and $34.4 million in 2008. Included in these expenses for 2010 were $24.1 million for salaries and benefits, $3.3 million for bonus expense and $2.3 million for share-based compensation, which is a non-cash expense. The increase of $2.9 million in 2010, as compared to 2009, was primarily due to higher salaries and related personnel costs in connection with increased manufacturing activities and work related to NIAID 3.

Included in these expenses for 2009 were $22.2 million for salaries and benefits, $2.4 million for bonus expense and $2.2 million for share-based compensation, which is a non-cash expense, compared with $32.1 million, zero and $2.3 million, respectively, in 2008. The $7.6 million decrease in salaries and employee-related expenses in 2009, as compared to 2008, was due to a decrease in salaries and benefits of $9.9 million due to the workforce reduction announced in January of 2009. In addition, share-based compensation decreased by $0.1 million. Partially offsetting this decrease in research and development personnel expense was an increase in bonus expense in 2009 of $2.4 million. In 2008, the Company did not to pay bonuses in efforts to control spending and manage the Company's cash balance.

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

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

The approximate costs associated with these programs for the years ended December 31, 2010, 2009 and 2008 were as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
Earlier stage programs	$52,323	$42,961	$62,872
Later stage programs	25,090	15,170	19,704
Total	$77,413	$58,131	$82,576

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Internal projects	$8,348	17,332	$29,285	$45,856
Collaborative and contract arrangements	7,503	4,013	22,194	12,422
Total	$15,851	$21,345	$51,479	$58,278

The approximate costs related to internal projects and collaborative and contract arrangements for the years ended December 31, 2010, 2009 and 2008 were as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
Internal projects	$58,065	$42,206	$58,468
Collaborative and contract arrangements	19,348	15,925	24,108
Total	$77,413	$58,131	$82,576

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

In 2010, our largest development program (gevokizumab) accounted for more than 30% but less than 40% of our total research and development expense. In 2010, one development program (NIAID) accounted for more than 20% but less than 30% of our total research and development expense, and in 2009 and 2008, one development program (gevokizumab) accounted for more than 20% but less than 30% of our total research and development expense. In 2009, one development program (NIAID) accounted for more than 10% but less than 20% of our total research and development expense, and in 2008 one development program (Novartis) accounted for more than 10% but less than 20% of our total research and development expense. No development program accounted for more than 30% of our total research and development expense in 2009 or 2008.

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

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

Selling, General and Administrative Expenses

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

Selling, general and administrative expenses were $23.3 million in 2010 compared with $23.7 million in 2009 and $24.1 million in 2008. The $0.4 million decrease in selling, general and administrative expenses in 2010 as compared with 2009 was primarily due a net decrease in financing and professional fees of $0.4 million, as well as a decrease in salaries and related personnel costs of $0.4 million. Partially offsetting these decreases was an increase in other expenses of $0.4 million, including an increase in travel-related costs.

The $0.4 million decrease in selling, general and administrative expenses in 2009 as compared with 2008 was primarily related to a decrease in salaries and related personnel costs of $0.6 million, as further discussed below, as well as a decrease in professional fees and other expenses of $1.2 million due to our increased focus on cost control. Partially offsetting these decreases was an increase in fees in 2009 of $1.4 million related to the restructuring negotiations and repayment of the Goldman Sachs term loan.

We recorded salaries and employee-related expenses of $12.3 million in 2010 compared with $12.7 million in 2009 and $13.3 million in 2008. The decrease of $0.4 million in 2010 as compared to 2009 was due to a decrease

in salaries and benefits of $1.2 million primarily due to our continued focus on cost controls. Partially offsetting this decrease in selling, general and administrative personnel expense was an increase in bonus expense in 2010 of $0.4 million as compared to 2009, and an increase in share-based compensation of $0.4 million.

The $0.6 million decrease in salaries and employee-related expenses in 2009 as compared to 2008 primarily due to a decrease in salaries and benefits of $1.5 million primarily due to the workforce reduction announced in January of 2009, and an increase in share-based compensation of $0.4 million. Partially offsetting this decrease in selling, general and administrative personnel expense was an increase in bonus expense in 2009 of $1.3 million. In 2008, the Company did not to pay bonuses in efforts to control spending and manage the Company's cash balance.

We expect selling, general and administrative expenses for 2011 will be comparable to 2010 levels.

Restructuring Charges

In January of 2009, we announced a workforce reduction of approximately 42%. As part of this workforce reduction, we recorded charges of $3.1 million during 2009 related to severance, other termination benefits and outplacement services, which were fully paid by the end of 2009. There were no additional employee-related restructuring charges in connection with this workforce reduction.

As a result of the workforce reduction, in the second quarter of 2009, we vacated one of our leased buildings and recorded a restructuring charge of $0.5 million primarily related to the net present value of the net future minimum lease payments at the cease-use date, less the estimated future sublease income. Effective December of 2010, we entered into a sublease agreement for this building. The remaining liability related to this lease was $0.2 million and $0.4 million at December 31, 2010 and 2009, respectively.

Additionally, as a result of the workforce reduction, we temporarily vacated a building in order to optimize our facility usage. As manufacturing demand increases in the future, we plan to resume operations at this facility. As of December 31, 2010, we performed an analysis of the long-lived assets related to the vacant building, with an approximate net book value of $3.5 million. Based on estimated undiscounted future cash inflows, we have determined that there is no current impairment relating to these assets, and will continue to assess these assets for impairment at each future reporting period.

Other Income (Expense)

Investment and interest income was $8,000 and $36,000 for the three and nine months ended September 30, 2011, respectively, compared to $4,000 and $13,000 for the same periods of 2010. Investment and interest income was $16,000 for the year ended December 31, 2010 compared with $49,000 and $0.9 million for the same periods of 2009 and 2008, respectively. Investment and interest income consists primarily of interest earned on our cash and investment balances. The differences between balances resulted from varying average cash and investment balances and interest rates.

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

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Interest expense and amortization of debt issuance costs are shown below for the years ended December 31, 2010, 2009 and 2008 (in thousands):

	Year ended December 31,		
	2010	2009	2008
Interest expense			
Goldman Sachs term loan	$—	$3,932	$5,095
Novartis note	354	455	1,181
Servier loan		—	—
Other	31	14	—
Total interest expense	$385	$4,401	$6,276
Amortization of debt issuance costs			
Goldman Sachs term loan	$—	$487	$726
Total interest expense	$385	$4,888	$7,002

The decrease in interest expense in 2010 of $4.5 million as compared to 2009 was due to the repayment in full of the Goldman Sachs term loan facility in September of 2009. In addition, interest expense related to the Novartis note decreased by $0.1 million in 2010 due to a decrease in the average interest rate of this note.

The decrease in interest expense of $2.1 million in 2009 compared to 2008 was due to a decrease in interest expense and amortization of debt issuance costs on the Goldman Sachs term loan of $1.4 million. This decrease was due to the repayment in full of the term loan facility in September of 2009, at which point the remaining debt issuance costs of $1.1 million were recognized as part of the loss on debt extinguishment in our consolidated statement of operations for 2009. In addition, interest expense related to the Novartis note decreased by $0.7 million in 2009 due to a decrease in the average principal balance and interest rate of this note.

Interest expense for 2011 is expected to increase compared to 2010 due to the December 2010 execution of a loan agreement with Servier, funded in January of 2011.

Loss on debt extinguishment was $3.6 million in 2009 relating to the repayment of our Goldman Sachs term loan. This loss included a prepayment premium of $2.5 million and the recognition of unamortized debt issuance costs of $1.1 million. In 2008, we recognized a loss on debt extinguishment of $0.7 million reflecting the recognition of the unamortized debt issuance costs related to the original Goldman Sachs term loan, upon refinancing of the loan in May of 2008.

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

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	Increase (Decrease)	2011	2010	Increase Decrease)
Other income						
Gain on revaluation of warrant liabilities	$499	$3,120	$(2,621)	$3,349	$4,811	$(1,462)
Unrealized foreign exchange gain (loss) (1)	760	—	760	(1,114)	—	(1,114)

Realized foreign exchange gain (2)	(1)	(1)	—	555	(3)	558
Unrealized loss on foreign exchange options	(285)	—	(285)	(128)	—	(128)
Warrant modification expense	—	—	—	—	(4,500)	4,500
Other	45	(7)	52	35	(8)	43
Total other income	$1,018	$3,112	$(2,094)	$2,697	$300	$2,397

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

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

The following table shows the activity in other income (expense) for the years ended December 31, 2010, 2009 and 2008 (in thousands):

	Year Ended December 31,				
	2010	2009	2008	2009-2010 Increase (Decrease)	2008-2009 Increase (Decrease)
Other income (expense)					
Gain on warrant revaluation	$2,283	$1,781	$-	$500	$1,782
Unrealized foreign exchange loss	6	—	—	6	—
Realized foreign exchange gain	(7)	(1)	(1)	(6)	—
Unrealized gain on foreign exchange options	—	—	—	—	—
Warrant modification expense	(4,500)	—	—	(4,500)	—
Loss on repayment of debt	—	(3,655)	—	3,645	—
Other	962	20	(98)	942	118
Total other income (expense)	$(1,256)	$(1,801)	$(99)	$587	$(1,745)

Warrant Liabilities

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

In May of 2009, we issued warrants to an institutional investor as part of a registered direct offering. The warrants represented the right to acquire an aggregate of up to 392,157 common shares over a five year period beginning May 15, 2009 at an exercise price of $15.30 per share. In February of 2010, the holders of these warrants agreed to amend the terms of their warrants to remove the provisions that would have required a reduction of the warrant exercise price and an increase in the number of shares issuable on exercise of the warrants each time we sold common shares at a price less than the exercise price of such warrants (the "Eliminated Adjustment Provisions") and the exercise price of these warrants was reduced from $15.30 per share to $0.015 per share.

Prior to amendment, we recorded the warrants issued in May of 2009 as a liability at fair value due to the Eliminated Adjustment Provisions and certain other provisions. At December 31, 2009, the fair value of the warrant liabilities was $2.4 million, estimated using the Monte Carlo Simulation Model ("Simulation Model"). This warrant liability increased to $2.9 million on February 1, 2010 immediately prior to the amendment. This $0.5 million increase was recorded as a loss in other income (expense). Subsequent to amendment of the warrant terms, on February 2, 2010, the fair value of the warrant liability using the Black-Scholes Model was $2.6 million. The $0.3 million decrease in the fair value of the warrant liability was recorded as a gain in other income (expense). In the first quarter of 2010, the holders of these warrants exercised all warrants, acquiring 392,157 common shares for an aggregate exercise price of $5,882.

In June of 2009, we issued warrants to certain institutional investors as part of a registered direct offering. The warrants represent the right to acquire an aggregate of up to 347,826 common shares over a five year period beginning December 11, 2009 at an exercise price of $19.50 per share (after giving effect to our reverse stock split). We have accounted for the warrants issued in June of 2009 as a liability at fair value. In February of 2010, the holders of these warrants agreed to amend the terms of their warrants to remove the Eliminated Adjustment Provisions and we made a cash payment of $4.5 million to these warrant holders, which was recorded in other income (expense). The exercise price of these warrants remained unchanged at $19.50 per share. As of December 31, 2010 all of these warrants were outstanding. Prior to amendment, we recorded the warrants issued in June of 2009 as a liability at fair value due to the Eliminated Adjustment Provisions and certain other provisions. At December 31, 2009, the fair value of the warrant liabilities was $2.4 million, estimated using the Simulation Model. This warrant liability increased to $3.3 million on February 1, 2010 immediately prior to the amendment. This $0.9 million increase was recorded as a loss in other income (expense).

At December 31, 2010, the fair value of the warrant liabilities was $0.8 million, estimated using the Black-Scholes Model. We revalued the warrant liability at September 30, 2011 using the Black-Scholes Model and recorded decreases in the fair value of $0.1 million and $0.6 million for the three and nine months ended September 30, 2011, respectively (primarily due to decreases in the market value of our common shares), as gains in the other income line of our condensed consolidated statement of operations. As of September 30, 2011, all of these warrants were outstanding and the fair value of the warrant liability was $0.1 million.

Income Taxes

Income tax expense was not material for the three and nine months ended September 30, 2011 and 2010 and the year ended December 31, 2010. We recognized $5.7 million in income tax expense in 2009 compared with an income tax benefit of $0.4 million in 2008. Income tax expense in 2009 is primarily related to $5.8 million of foreign income tax expense recognized in connection with the expansion of our existing collaboration with Takeda signed in February of 2009. We were paid a $29 million expansion fee, of which $5.8 million was withheld for payment to the Japanese taxing authority. We also recognized $0.1 million of income tax benefit for 2009 relating to research and development refundable credits, in addition to the $0.4 million in research and development refundable credits recognized in 2008.

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

We have recorded cumulative gross deferred tax assets of $214.3 million and $189.9 million at December 31, 2010 and 2009, respectively, principally attributable to the timing of the deduction of certain expenses associated with certain research and development expenses, net operating loss and other carry-forwards. We also recorded corresponding valuation allowances of $214.3 million and $189.9 million at December 31, 2010 and 2009, respectively, to offset these deferred tax assets, as management cannot predict with reasonable certainty that the deferred tax assets to which the valuation allowances relate will be realized.

As of December 31, 2010, we had federal net operating loss carry-forwards of approximately $149.4 million to offset future taxable income. We also had federal research and development tax credit carry-forwards of approximately $9.5 million. Based on our initial analysis under Section 382 (which subjects the amount of pre-change NOLs and certain other pre-change tax attributes that can be utilized to an annual limitation), we experienced an ownership change in 2009, which would substantially limit the future use of our pre-change NOLs and certain other pre-change tax attributes per year. To the extent we do not utilize our carry-forwards within the applicable statutory carry-forward periods, either because of Section 382 limitations or the lack of sufficient taxable income, the carry-forwards will expire unused.

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

Liquidity and Capital Resources

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

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

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

Working Capital

The increase in working capital is primarily related to the $8.4 million increase in cash and cash equivalents and an $11.0 decrease in deferred revenue – current. The decrease in deferred revenue – current was primarily due to the recognition of $14.9 million during the nine months ended September 30, 2011, related to the $15.0 million license fee received as consideration for the collaboration with Servier, partially offset by deferred revenue related to an adjustment to previously-reported revenue from NIAID resulting from an audit by NIAID's contracting office. This revenue will be recognized upon completion of the review of final audited rates by NIAID's contracting office.

Cash Used in Operating Activities

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

Net cash used in operating activities was $52.5 million for the year ended December 31, 2010, compared with net cash provided by operating activities of $7.4 million for the same period in 2009 and net cash used in operating activities of $33.0 million for the same period in 2008. The $60.0 million change in cash provided by operations in 2009 to cash used in operations in 2010 was primarily due to a decrease in revenue receipts for license and collaborative fees and royalties, and an increase in spending on XOMA 052 related to the Phase 2 clinical program. During 2010, we received one-time cash receipts of $3.7 million related to the sale of our CIMZIA® royalty stream and $4.0 million as final payment under our two antibody discovery collaboration agreements entered into with Arana and Kaketsuken. Comparatively, during 2009, we received one-time cash receipts of $23.2 million related to the expansion of our existing collaboration with Takeda and $22.3 million related to the sale of our LUCENTIS® royalty stream to Genentech. In addition, we received $10.0 million in the second half of 2009 related to our two antibody discovery collaboration agreements entered into with Arana and Kaketsuken.

In addition, receivables and related party and other receivables increased by $13.6 million in 2010 primarily due to the $15.0 million up-front fee in connection with the license and collaboration agreement entered into with Servier in December of 2010. These decreases in cash provided by operations were partially offset by an increase in deferred revenue of $13.1 million, primarily related to the license and collaboration agreement entered into with Servier and an increase in the accounts payable and accrued liabilities balance of $2.7 million due to increased research and development expenses and timing of payments.

We expect net cash used in operating activities to decrease in 2011 as a result of cash flows from our license and collaboration agreement with Servier and our new NIAID contract announced in October of 2011, as well as a

reduction in XOMA 052 phase 2 development costs.

The $40.4 million change in cash used in operations in 2008 to cash provided by operations in 2009 was primarily due to the receipt of $23.2 million in the first quarter of 2009 related to the expansion of our existing collaboration with Takeda, the receipt of $22.3 million in the third quarter of 2009 related to the sale of our LUCENTIS® royalty interest to Genentech and the receipt of $10 million in the second half of 2009 related to two antibody discovery collaboration agreements entered into with Arana and Kaketsuken.

Cash used in operations for 2008 consisted of a net loss of $45.2 million offset by non-cash adjustments of $16.1 million, primarily related to depreciation and share-based compensation. In addition, receivables increased by $4.6 million in 2008 primarily related to work performed on the NIAID 3, Novartis, Merck/Schering-Plough and Takeda contracts, offset by a decrease in work performed on the Merck/Schering-Plough/AVEO contract and accrued liabilities decreased by $3.3 million primarily related to the reversal of the 2008 bonus accrual in the fourth quarter when the Company decided it would not pay 2008 bonuses. These decreases in cash were partially offset by an increase in the accounts payable balance of $3.0 million due to the Company paying vendors on longer terms and an increase in other liabilities of $2.1 million related to the NIAID 2 billing adjustment for which a credit was provided to the NIH to be applied to future work performed on the NIAID 2 contract.

Cash Used in Investing Activities

Net cash used in investing activities was $2.6 million for the nine months ended September 30, 2011, compared with $0.3 million for the same period of 2010, and $0.3 million for the year ended December 31, 2010, compared with net cash provided by investing activities of $10.6 million for the same period in 2009 and $3.2 million for the same period in 2008. Cash used in investing activities for the nine months ended September 30, 2011 and 2010 consisted of fixed asset purchases relating to CMC activity.

Net cash provided by investing activities of $10.6 million in 2009 primarily consisted of a decrease in the restricted cash balance of $9.5 million due to use of the funds for the repayment of our Goldman Sachs term loan in September of 2009. In addition, we received proceeds from maturities of investments of $1.3 million. Net cash provided by investing activities of $3.2 million in 2008 consisted of net sales and maturities of investments of $14.8 million, partially offset by the transfer to restricted cash of $3.5 million relating to our term loan facility with Goldman Sachs and purchases of fixed assets of $8.1 million, primarily relating to lab and production equipment.

Cash Provided by Financing Activities

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

Net cash provided by financing activities was $66.3 million for the year ended December 31, 2010, compared with net cash used in financing activities of $3.6 million for the same period in 2009 and net cash provided by financing activities of $16.8 million for the same period in 2008. Cash provided by financing activities in 2010 related to proceeds received from the issuance of common shares of $70.8 million, including gross proceeds of $21 million from an underwritten offering in February of 2010, $9.3 million from our 2009 ATM Agreement, $14.2 million from our common share purchase agreement with Azimuth in August of 2010, and $29.7 million from our 2010 ATM Agreement. This cash provided by financing activities was partially offset by $4.5 million paid to the holders of warrants issued in June of 2009 upon modification of the terms.

Net cash used in financing activities in 2009 of $3.6 million related to the repayment in full of the Goldman Sachs term loan, including a principal payment of $8.4 million in the second quarter of 2009, repayment of the remaining

outstanding balance of $42.0 million in September of 2009, accrued interest to the date of payment of $2.4 million, and payment of a prepayment premium of $2.5 million. This cash used in financing activities was partially offset by proceeds of $49.3 million received from the issuance of common shares in 2009, including gross proceeds of $26.4 million from an equity line of credit in September of 2009, $22 million from two registered direct offerings in May of 2009 and June of 2009, and $2.8 million from our 2009 ATM Agreement.

Net cash provided by financing activities in 2008 of $16.8 million related to the refinancing of our original loan facility with Goldman Sachs in May of 2008, which netted proceeds of approximately $30.9 million, partially

offset by a principal payment of $8.2 million against the outstanding balance of the original facility with Goldman Sachs in the first quarter of 2008. In addition, principal payments of $4.6 million on the new Goldman Sachs facility and $8.9 million on our Novartis note were made in the fourth quarter of 2008. We also received proceeds of $7.6 million from the issuance of common shares related to draws made on our equity line of credit with Azimuth.

Foreign Exchange Options

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

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

Servier Loan

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

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

The loan discount is amortized under the effective interest method over the expected five-year life of the loan. We recorded non-cash interest expense of $0.3 million and $1.0 million during the three and nine months ended

September 30, 2011, respectively, resulting from the amortization of the loan discount. At September 30, 2011, the net carrying value of the loan was $12.7 million.

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

Equity Line of Credit

In October of 2008, we entered into a common share purchase agreement (the “2008 Purchase Agreement”) with Azimuth, pursuant to which we obtained a committed equity line of credit facility (the “2008 Facility”). From the inception of the 2008 Facility through 2009, we sold a total of 2,815,228 common shares to Azimuth for aggregate gross proceeds of $33.9 million. This included the sale of 2.3 million shares in two transactions in September of 2009. Offering expenses incurred in 2009 related to sales to Azimuth were $0.4 million. At the end of the third quarter of 2009, the 2008 Facility was no longer in effect, and no additional shares can be issued thereunder.

In July of 2010, we entered into a common share purchase agreement (the “2010 Purchase Agreement”) with Azimuth pursuant to which we obtained a committed equity line of credit facility (the “2010 Facility”). In August of 2010, we sold a total of 3,421,407 common shares under the 2010 Facility for aggregate gross proceeds of $14.2 million, representing the maximum number of shares that could be sold under the 2010 Facility. As a result, the 2010 Facility is no longer in effect, and no additional shares can be issued thereunder.

Underwritten Offering

In February of 2010, we completed an underwritten offering of 2.8 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately $21 million, before deducting underwriting discounts and commissions and estimated offering expenses of $1.7 million. The warrants, which represent the right to acquire an aggregate of up to 1.26 million common shares, are exercisable beginning six months and one day after issuance and have a five-year term and an exercise price of $10.50 per share. As of December 31, 2010 all of these warrants were outstanding.

Registered Direct Offerings

In May of 2009, we entered into a definitive agreement with an institutional investor to sell 784,313 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately $10 million, before deducting placement agent fees and estimated offering expenses of $0.8 million, in a registered direct offering. In the first quarter of 2010, the holders of these warrants exercised all warrants, acquiring 392,157 common shares for an aggregate exercise price of $5,882.

In June of 2009, we entered into a definitive agreement with certain institutional investors to sell 695,652 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately $12 million, before deducting placement agent fees and estimated offering expenses of $0.8 million, in a second registered direct offering. In February of 2010, the holders of these warrants agreed to amend the terms of their warrants to remove the Eliminated Adjustment Provisions and we made a cash payment of

$4.5 million to these warrant holders, which was recorded in other income (expense). As of December 31, 2010 all of these warrants were outstanding.

ATM Agreements

In the third quarter of 2009, we entered into the 2009 ATM Agreement, under which we could sell up to 1.7 million of our common shares from time to time through Wm Smith, as our agent for the offer and sale of the common shares.

From the inception of the 2009 ATM Agreement through October of 2010, the Company sold a total of 1.7 million common shares through Wm Smith, constituting all of the shares available for sale under the agreement, for aggregate gross proceeds of $12.2 million, including 1.4 million common shares sold in 2010 for aggregate gross proceeds of $9.3 million. Total offering expenses related to these sales were $0.4 million.

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

On February 4, 2011, we entered into an At Market Issuance Sales Agreement, with MLV, under which we may sell common shares from time to time through the MLV, as our agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to our prior approval. From the inception of the 2011 ATM Agreement through September 30, 2011, we sold a total of 3,603,422 common shares under this agreement for aggregate gross proceeds of $8.5 million. Total offering expenses incurred related to sales under the 2011 ATM Agreement from inception to September 30, 2011 were $0.3 million. From October 1, 2011 through December 8, 2011, 1,668,150 additional common shares were sold through MLV for aggregate gross proceeds of $2.8 million. Total offering expenses related to these sales from October 1, 2011 to December 8, 2011 were approximately $0.1 million.

Net proceeds from the sale of shares under the 2008 Purchase Agreement, the 2010 Purchase Agreement, the 2009 ATM Agreement, the 2010 ATM Agreement, the 2011 ATM Agreement, registered direct offerings and other equity offerings were used to continue development of our gevokizumab product candidate and for other working capital and general corporate purposes. We also used certain of these proceeds to repay the Goldman Sachs term loan in September of 2009. As of December 8, 2011, there were approximately $88.7 million of gross proceeds available for issuance pursuant to the above-mentioned registration statement.

* * *

We have incurred significant operating losses and negative cash flows from operations since our inception. At September 30, 2011, we had an accumulated deficit of $874.3 million, cash and cash equivalents of $45.7 million and working capital of $41.6 million. During the remainder of 2011, we expect to continue using our cash and cash equivalents to fund ongoing operations. Additional licensing, antibody discovery and development collaboration

agreements, government funding and financing arrangements may positively impact our cash balances. Based on our cash reserves and anticipated spending levels, revenue from collaborations including the gevokizumab collaboration agreement with Servier, funding from the loan agreement with Servier, biodefense contracts and licensing transactions and other sources of funding that we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development

programs and further reduce personnel-related costs. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

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

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

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

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

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

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

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

Foreign Currency Risk

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

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

elsewhere in this prospectus for additional information of the foreign exchange option contracts. Our derivative financial instruments are recorded in the consolidated balance sheets at fair value as of the balance sheet dates.

BUSINESS

Overview

XOMA is a biopharmaceutical company focused on the discovery, development and manufacture of therapeutic antibodies designed to treat autoimmune, cardio-metabolic, infectious, inflammatory and oncological diseases. Our proprietary development pipeline includes gevokizumab (formerly referred to as XOMA 052), an antibody that inhibits interleukin-1 beta ("IL-1 beta") which is expected to advance into Phase 3 development for the treatment of non-infectious uveitis affecting the intermediate and/or posterior segments of the eye; XOMA 3AB, a biodefense anti-botulism product candidate comprised of a combination, or cocktail, of antibodies which is in Phase 1 development to assess its safety, tolerability and pharmacokinetic profile; and preclinical antibody discovery programs in several indications, including autoimmune, cardio-metabolic, inflammatory, and oncological diseases. We have a fully integrated product development platform, extending from preclinical science and clinical development to scale-up development and manufacturing.

We have entered into a license and collaboration agreement with Les Laboratoires Servier ("Servier"), to jointly develop and commercialize gevokizumab in multiple indications. Gevokizumab is designed to inhibit the pro-inflammatory cytokine IL-1 beta that is believed to be a primary trigger of pathologic inflammation in multiple diseases. Under the terms of the agreement, Servier has worldwide rights to diabetes and cardiovascular disease indications and rights outside the U.S. and Japan to Behcet's uveitis and other inflammatory disease and oncology indications. XOMA retains development and commercialization rights for Behcet's uveitis and other inflammatory disease and oncology indications in the U.S. and Japan, and has an option to reacquire rights to diabetes and cardiovascular disease indications from Servier in these territories. Should we exercise our option to reacquire rights to the diabetes and cardiovascular disease indications in the U.S. and Japan, we will be required to pay Servier an option fee and partially reimburse their incurred development expenses.

Our biodefense initiatives currently include a $65.0 million multiple-year contract funded by the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health ("NIH"), to support our ongoing development of anti-botulism antibody product candidates, of which the first, XOMA 3AB, is in a Phase 1 clinical trial. This contract is the third that NIAID has awarded us for the development of botulinum antitoxins. In October of 2011, we announced that we had been awarded a fourth contract for up to $28.0 million over five years to develop broad-spectrum antitoxins for the treatment of human botulism poisoning, bringing the program's total potential awards to approximately $120 million. We also develop products with premier pharmaceutical companies including Novartis AG ("Novartis") and Takeda Pharmaceutical Company Limited ("Takeda").

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

Strategy

We are advancing a pipeline of biologic products using our proven expertise, technologies and capabilities from antibody discovery through product development. We seek to expand our pipeline by developing proprietary products and technologies, providing contract services to government agencies responsible for biodefense and entering into licensing and collaborative arrangements with pharmaceutical and biotechnology companies. The principal elements of our strategy are to:

- Focus on advancing gevokizumab, our lead product candidate. Using our proprietary antibody technologies, capabilities and expertise, we discovered gevokizumab, an antibody that inhibits IL-1 beta. gevokizumab has the potential to address the underlying inflammatory causes of a wide range of unmet medical needs by targeting IL-1 beta, a cytokine that triggers inflammatory pathways in the body. In 2010, we announced positive results from a Phase 2 proof-of-concept clinical trial evaluating gevokizumab in Behcet's uveitis, demonstrating rapid improvement in vision-threatening disease exacerbations in all seven treated patients despite discontinuation of immunosuppressive drugs such as cyclosporine and/or azathioprine. The drug was well-tolerated in this trial, and no drug-related serious adverse events were reported.

In August of 2010, we obtained Food and Drug Administration ("FDA") orphan drug status for gevokizumab for the treatment of Behcet's disease. The designation offers a number of potential incentives, which may include, among others, a seven-year period of U.S. marketing exclusivity from the date of marketing authorization, written guidance on the non-clinical and clinical studies needed to obtain marketing approval, and tax credits for certain clinical research. In October of 2010, gevokizumab was granted orphan drug status by the European Medicines Agency ("EMA") for the treatment of Behcet's disease. The designation generally provides EU market exclusivity for up to ten years following approval for the given indication. Other potential benefits include protocol assistance, direct access to centralized marketing authorization procedures and financial incentives.

In December of 2010, we entered into an agreement with Servier to jointly develop and commercialize gevokizumab in multiple indications, which provided for a non-refundable upfront payment of $15.0 million that we received in January of 2011. In connection with this agreement, Servier will fully fund the first $50.0 million of future gevokizumab global clinical development and chemistry and manufacturing controls ("CMC") expenses, and 50% of further expenses, for the Behcet's uveitis indication, which is expected to advance into Phase 3 development in 2011.

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

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

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

Servier and we are in the process of implementing an expanded gevokizumab clinical development plan. The plan includes a global Phase 3 trial in non-infectious uveitis affecting the intermediate and/or posterior segments of the eye, including Behçet's uveitis ("NIU") and a Phase 3 trial outside the U.S. in Behçet's uveitis. Based on the timing of anticipated regulatory interactions to discuss the planned Phase 3 program, we anticipate initiating the NIU Phase 3 trial in the second quarter of 2012. In addition, we announced a proof-of-concept clinical program to identify additional conditions that may respond to treatment with gevokizumab. We expect that these trials will be designed to meet the FDA ophthalmology requirement that at least 300 patients be treated for at least six months at the to-be-marketed dose. We also expect to have preliminary top-line results from the NIU Phase 3 trial approximately 18

to 24 months after initiation. Also, Servier plans to advance gevokizumab into Phase 2 development for cardiovascular disease in 2012. Servier has agreed to include the NIU Phase 3 trial under the terms of the collaboration agreement for Behcet's uveitis discussed above so long as input from the European Medicines Agency enables the results of the trial to be included in regulatory submissions in the EU. Based upon the timing of anticipated regulatory interactions we anticipate initiating the NIU Phase 3 trial in the second quarter of 2012.

- Continue building our biodefense business. To date, we have been awarded four contracts, totaling up to approximately $120 million, from NIAID, to support our ongoing development of XOMA 3AB and additional product candidates for the treatment of botulism poisoning. In addition, our biodefense programs include two subcontracts with SRI International totaling $4.3 million, funded through NIAID, for the development of antibodies to neutralize H1N1 and H5N1 influenza viruses and the virus that causes severe acute respiratory syndrome ("SARS"). We will continue to seek further opportunities to work with government and other institutions.

In May of 2011, NIAID informed us that it was initiating a Phase 1 trial of XOMA 3AB, a novel formulation of three antibodies designed to prevent and treat botulism poisoning. This double-blind, dose-escalation study in approximately 24 healthy volunteers is designed to assess the safety and tolerability, and determine the pharmacokinetic profile, of XOMA 3AB.

- Advancing our proprietary preclinical pipeline candidates. We will continue to develop our proprietary preclinical pipeline, which includes candidates in development for autoimmune, cardio-metabolic, infectious, inflammatory, and oncological diseases.

In June of 2011, we announced our discovery of two new classes of fully-human monoclonal antibodies which activate or sensitize the insulin receptor in vivo, each representing a distinct new therapeutic approach to the treatment of patients with diabetes. Separate studies of XMetA, our lead product candidate in the first such class, and XMetS, our lead product candidate in the second such class, demonstrated that they reduced fasting blood glucose levels and improved glucose tolerance in mouse models of diabetes These data were presented at the American Diabetes Association's 71st Scientific Sessions.

- Generate collaboration and licensing revenue. We have generated significant revenue from collaborations and licensing related to our proprietary technologies, including our phage display libraries, BCE, Human Engineering, and Targeted Affinity Enhancement ("TAE™") technologies. Historically, we have established technology collaborations with several companies to provide access to multiple proprietary antibody discovery and optimization technologies. In addition, we have licensed our BCE technology to more than 60 companies in exchange for license, milestone and other fees, royalties and complementary technologies, and a number of licensed product candidates are in clinical development. We believe we can continue to generate revenue from our proprietary technologies in the future.

Proprietary Products

As part of our strategy, we are focusing our technology and resources on advancing our emerging proprietary pipeline. Below is a summary of our proprietary products:

- Gevokizumab is a potent monoclonal antibody with the potential to improve the treatment of patients with a wide variety of inflammatory diseases. Gevokizumab binds strongly to IL-1 beta, a pro-inflammatory cytokine involved in the development of Behcet's uveitis, Type 2 diabetes, cardiovascular disease, rheumatoid arthritis, gout and other diseases. By binding to IL-1 beta, gevokizumab inhibits the activation of the IL-1 receptor, thereby preventing the cellular signaling events that produce inflammation. Gevokizumab is a humanized IgG2 antibody. Based on its binding properties, specificity for IL-1 beta and half-life in the body, gevokizumab may provide convenient dosing of once per month or less frequently.

In December of 2010, we entered into an agreement with Servier to jointly develop and commercialize gevokizumab in multiple indications.

- XOMA 3AB is a multi-antibody product designed to neutralize the most potent of the botulinum toxins, Type A, which causes paralysis and is a bioterrorism threat. Our anti-botulism program has been expanded to include additional product candidates and is the first of its kind to combine multiple human antibodies in each product candidate to target a broad spectrum of the most toxic botulinum toxins, including the three most toxic serotypes of botulism, Types A, B and E. The antibodies are designed to bind to each toxin and enhance the clearance of the toxin from the body. The use of multiple antibodies increases the likelihood of clearing the harmful toxins by providing specific protection against each toxin type. In contrast to existing agents that treat botulism, XOMA uses advanced human monoclonal antibody technologies in an effort to achieve superior safety, potency and efficacy, and avoid life-threatening immune reactions associated with animal-derived products.

XOMA 3AB is currently in a Phase 1 study funded and conducted by NIAID. We have a history of successfully providing contract services to the U.S. government for the development of anti-botulinum neurotoxin antibodies.

- Preclinical Product Pipeline: We are pursuing additional opportunities to further broaden our preclinical product pipeline. These include internal discovery programs, product development collaborations with other pharmaceutical and biotechnology companies and evaluation of product in-licensing, in-kind product trades and acquisition opportunities.

Partnership Products

Historically, XOMA has provided contract research and development services for world-class organizations, such as Novartis, Takeda, and Schering Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck & Co. (referred to herein as “Merck/Schering-Plough”), in pursuit of new antibody products. In more recent years, we have been evolving our business focus from a service provider model to a proprietary product development model. However, we will continue to capitalize on collaborative partnership arrangements as opportunities arise. Below is the current status of such collaborations:

- Therapeutic Antibodies with Takeda: Since 2006, Takeda has been a collaboration partner for therapeutic monoclonal antibody discovery and development against multiple targets selected by them. In February of 2009, we expanded our existing collaboration to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. In the first quarter of 2010, we received a $1.0 million payment from Takeda for achieving a pre-established, pre-clinical milestone under our collaboration agreement and may receive potential milestones and royalties on sales of antibody products in the future.

- Therapeutic Antibodies with Novartis: In November of 2008, we restructured our product development collaboration with Novartis. Under the restructured agreement, Novartis received control over the two ongoing programs under the original product development collaboration entered into in 2004 with Novartis (then Chiron Corporation). In exchange, we recognized $13.7 million in revenue in 2008 and may, in the future, receive milestones and double-digit royalty rates for the programs and options to develop or receive royalties from four additional programs.

- Therapeutic Antibodies with Merck/Schering-Plough: Merck/Schering-Plough has been a collaboration partner since 2006 for therapeutic monoclonal antibody discovery and development against multiple targets selected by them. In January of 2011, we successfully completed the contract services we had agreed to perform under the

collaboration agreement with Merck/Schering-Plough.

Technology Licenses and Royalties

Technology Licenses

Below is a summary of certain proprietary technologies owned by us and available for licensing to other companies:

- Antibody discovery technologies: XOMA uses human antibody phage display libraries in its discovery of therapeutic candidates, and we offer access to multiple libraries, including novel libraries developed internally, as part of our collaboration business. We believe that access to multiple libraries offers a number of benefits to XOMA and its collaboration partners, because it enables use of libraries best suited to the needs of a particular discovery project to increase the probability of technical and business success in finding rare and unique functional antibodies directed to targets of interest.

- Bacterial Cell Expression: The production or expression of antibodies using bacteria is an enabling technology for the discovery and selection, as well as the development and manufacture, of recombinant protein pharmaceuticals, including diagnostic and therapeutic antibodies for commercial purposes. Genetically engineered bacteria are used in the recombinant expression of target proteins for biopharmaceutical research and development. Reasons include the relative simplicity of gene expression in bacteria as well as many years of experience culturing such species as E. coli in laboratories and manufacturing facilities. XOMA scientists have developed bacterial expression technologies for producing antibodies and other recombinant protein products.

We have granted more than 60 licenses to biotechnology and pharmaceutical companies to use our patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. Bacterial antibody expression is also a key technology used in multiple systems for high-throughput screening of antibody domains. Expression of antibodies by phage display technology, for example, depends upon the expression and secretion of antibody domains from bacteria as properly folded, functional proteins.

Many licensees of our bacterial cell expression technology have developed, or are in the process of developing, antibodies for which we may be entitled to future milestone payments and royalties on product sales. Under the terms of our license agreement with Pfizer Inc. (“Pfizer”), signed in 2007, we received an up-front cash payment of $30 million and from 2008 through December 8, 2011 we received milestone payments relating to five undisclosed product candidates, including a payment of $0.5 million for the initiation of a Phase 3 clinical trial. We may also be eligible for additional milestone payments aggregating up to $6.2 million relating to these five product candidates and low single-digit royalties on future sales of all products subject to this license. In addition, we may receive potential milestone payments aggregating up to $1.7 million for each additional qualifying product candidate. Our right to milestone payments expires on the later of the expiration of the last-to-expire licensed patent or the tenth anniversary of the effective date. Our right to royalties expires upon the expiration of the last-to-expire licensed patent.

Current licensees include but are not limited to the following entities:

Active Biotech AB	Centocor Ortho Biotech (now a member of Johnson & Johnson)	MorphoSys AG
Affimed Therapeutics AG	Crucell Holland B.V. (now a member of Johnson & Johnson)	Novartis AG

Affitech AS	Dompe, s.p.a.	Pfizer Inc.
Applied Molecular Evolution, Inc. (now a subsidiary of Eli Lilly and Company)	Dyax Corp. Eli Lilly and Company	Takeda Pharmaceutical Company Ltd.

Aventis Pharma Deutschland GmbH (Hoechst) (now Sanofi-Aventis)	Genentech, Inc. (now a member of the Roche Group)	The Medical Research Council
Bayer Healthcare AG	Invitrogen Corp.	UCB S.A.
BioInvent International AB	Merck & Co., Inc.	Verenium Corp.
	Mitsubishi Tanabe Pharma Corp.	Wyeth Pharmaceuticals Division (now a member of Pfizer Inc.)

These licenses are sometimes associated with broader agreements which may include expanded license rights, cell line development and process development.

- Human Engineering™: HE™ is a proprietary humanization technology that allows modification of non-human monoclonal antibodies to reduce or eliminate detectable immunogenicity and make them suitable for medical purposes in humans. The technology uses a unique method developed by us, based on analysis of the conserved structure-function relationships among antibodies. The method defines which residues in a non-human variable region are candidates to be modified. The result is a HE™ antibody with preserved antigen binding, structure and function, and with eliminated or greatly reduced immunogenicity. Human Engineering™ technology was used in development of gevokizumab and is used in the development of certain other antibody products.

- Targeted Affinity Enhancement™: TAE™ is a proprietary technology involving the assessment and guided substitution of amino acids in antibody variable regions, enabling efficient optimization of antibody binding affinity and selectivity modulation. TAE™ generates a comprehensive map of the effects of amino acid mutations likely to impact binding. The technology is utilized by XOMA scientists and has been licensed to a number of our collaborators.

We also have access to certain intellectual property rights and services that augment our existing integrated antibody technology platform and development capabilities and further compress product development timelines. This broad antibody technology platform and expertise is available for building our antibody product pipeline as well as those of our collaborators.

Proprietary Product Summary:

The following table describes important information related to the products we are currently developing:

Program	Description	Indication	Status	Developer
Gevokizumab	HE™ antibody to IL-1 beta	Non-infectious uveitis, Behcet's uveitis, Type 2 diabetes, Type 1 diabetes, and cardio-metabolic diseases	Planned Phase 3 for non-infectious uveitis in 2012 and planned Phase 2 for Behcet's uveitis, Type 2 diabetes, Type 1 diabetes, and cardio-metabolic diseases in 2012	XOMA (in collaboration with Servier)
XOMA 3AB	Therapeutic antibodies to multiple Type A botulinum neurotoxins	Botulism poisoning	Phase 1	XOMA (NIAID-funded)
XMetA, XMetS	Fully human monoclonal antibodies	Diabetes, metabolic disorders	Preclinical	XOMA
Multiple preclinical programs	Fully human monoclonal antibodies to undisclosed disease targets	Autoimmune, cardio-metabolic, infectious, inflammatory, and oncological diseases	Preclinical	XOMA

Partnership Product Summary:

The following table describes important information related to certain products that we are currently developing or have developed in the past, for which we may earn royalties on product sales in the future:

Program	Description	Indication	Status	Developer
HCD 122 and LFA 102	Fully human antibody to CD40 and HE™ antibody to prolactin receptor	Hematologic tumors; other undisclosed diseases	Phase 1 and 2; Phase 1	Novartis (fully-funded)
Therapeutic antibodies	Fully human monoclonal antibodies to undisclosed disease targets	Undisclosed	Preclinical	Takeda (fully-funded)
Therapeutic antibodies	HE™ monoclonal antibody to HGF	Non-small cell lung cancer; solid tumors and multiple myeloma	Phase 2; Phase 1	AVEO (fully-funded)

Licensed Product Summary:

The following table describes important information related to certain products developed under licenses with us, for which we earn or may earn royalties on product sales in the future:

Program	Description	Indication	Status	Developer
Various products in development by Pfizer	Various monoclonal antibodies to undisclosed disease targets	Undisclosed diseases	Various phases of clinical and preclinical development	Pfizer
Various products in development by other licensees	Various monoclonal antibodies to undisclosed disease targets	Undisclosed diseases	Various phases of clinical and preclinical development	Various licensees

Financial and Legal Arrangements of Product Collaborations, Licensing and Other Arrangements

Collaboration and Licensing Agreements

Servier

We have entered into a license and collaboration agreement with Servier, to jointly develop and commercialize gevokizumab in multiple indications, which provides for a non-refundable upfront payment of $15 million that was received by us in January of 2011. Under the terms of the agreement, Servier has worldwide rights to diabetes and cardiovascular disease indications and rights outside the U.S. and Japan to Behcet's uveitis and other inflammatory and oncology indications. XOMA retains development and commercialization rights for Behcet's uveitis and other inflammatory disease and oncology indications in the U.S. and Japan, and has an option to reacquire rights to diabetes and cardiovascular disease indications from Servier in these territories (the "Cardiometabolic Indications Option"). Should we exercise the Cardiometabolic Indications Option, we will be required to pay Servier an option fee and partially reimburse their incurred development expenses.

Under this agreement, Servier will fully fund activities to advance the global clinical development and future commercialization of gevokizumab in diabetes and cardiovascular related diseases. Also, Servier will fund $50 million of future gevokizumab global clinical development and chemistry and manufacturing controls ("CMC") expenses and 50% of further expenses for the Behcet's uveitis indication. We will also be responsible for manufacturing gevokizumab throughout clinical development and launch. Servier has agreed to include the NIU Phase 3 trial under the terms of the collaboration agreement for Behcet's uveitis discussed above so long as input from the European Medicines Agency enables the results of the trial to be included in regulatory submissions in the EU.

In addition, under the agreement, we are eligible to receive a combination of Euro- and US Dollar ("USD")-denominated, development and sales milestones for multiple indications aggregating to a potential maximum of approximately $470 million when converted at the date of contract execution using the December 31, 2010 Euro to USD exchange rate (the "12/31/10 Exchange Rate"), if XOMA reacquires diabetes and cardiovascular rights in the U.S. and Japan. If XOMA does not reacquire these rights, then the milestone payments aggregate to a potential maximum of approximately $770 million converted using the 12/31/10 Exchange Rate. Servier's obligation to pay development and commercialization milestones will continue for so long as Servier is developing or selling products under the agreement.

We are also eligible to receive royalties on gevokizumab sales, which are tiered based on sales levels and range from a mid-single digit to up to a mid-teens percentage rate. Our right to royalties with respect to a particular product and country will continue for so long as such product is sold in such country.

The collaboration will be carried out and managed by committees mutually established by the parties. In general, in the event of any disputes, each party will have decision-making authority over matters relating to its areas of responsibility and territory, but neither party will have unilateral decision-making rights if the decision would have a material adverse impact on the other party's rights in its territory. The agreement contains customary termination rights relating to matters such as material breach by either party, safety issues and patents. Servier also has a unilateral right to terminate the agreement on a country-by-country basis or in its entirety on 6 months' notice.

We have also entered into a loan agreement with Servier, which provides for an advance of up to €15 million. The loan was fully funded in January of 2011, with the proceeds converting to approximately $19.5 million. The loan is secured by an interest in XOMA's intellectual property rights to all gevokizumab indications worldwide, excluding certain rights in the U.S. and Japan. The loan matures in 2016; however, after a specified period prior to final

maturity, the loan is to be repaid (i) at Servier's option, by applying up to a significant percentage of any milestone or royalty payments owed by Servier under our collaboration agreement and (ii) using a significant percentage

of any upfront, milestone or royalty payments we receive from any third party collaboration or development partner for rights to gevokizumab in the U.S. and/or Japan. In addition, the loan becomes immediately due and payable upon certain customary events of default. At September 30, 2011, the outstanding principal balance under this loan was $20.4 million using the September 30, 2011 Euro to USD exchange rate. Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations for further information regarding our loan agreement with Servier.

NIAID

In March of 2005, we were awarded a $15 million competitive bid contract from NIAID to develop three anti-botulinum neurotoxin monoclonal antibodies. Under this contract, we created production cell lines using our proprietary antibody expression systems, built Master and Manufacturer's Working Cell Banks, developed production processes and produced initial quantities of the three antibodies. The contract was performed over an 18-month period and was fully funded with federal funds from NIAID under Contract No. HHSN266200500004C ("NIAID 1"). Final acceptance of the project was received in October of 2006.

In July of 2006, we were awarded a $16.3 million NIAID contract under Contract No. HHSN266200600008C/N01-Al-60008 ("NIAID 2") to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. Under this contract, we created and produced XOMA 3AB, an innovative injectable product comprised of three anti-type A botulinum neurotoxin monoclonal antibodies. This work was complete in the third quarter of 2010.

In September of 2008, we were awarded a third NIAID contract for $65 million under Contract No. HHSN272200800028C ("NIAID 3") to continue development of our anti-botulinum antibody product candidates, including XOMA 3AB and additional product candidates. As part of the contract, we have developed, evaluated and produced the clinical supplies to support an IND filing with the FDA for XOMA 3AB and have conducted preclinical studies required to support human clinical trials. In May of 2011, NIAID informed us that it was initiating a Phase 1 trial of XOMA 3AB.

In October of 2011, we announced that we had been awarded a fourth NIAID contract for up to $28.0 million over five years under Contract No. HHSN 272201100031C ("NIAID 4") to develop broad-spectrum antitoxins for the treatment of human botulism poisoning.

SRI International

In the third quarter of 2009, we began work on two biodefense subcontract awards from SRI International, including a $2.1 million award to develop novel antibody drugs against the virus that causes SARS and a $2.2 million award to develop a novel antibody, known as F10, that has been shown to neutralize group 1 influenza A viruses, including the H1N1 and H5N1 strains. The subcontract awards were funded through NIAID.

Takeda

In November of 2006, we entered into a fully funded collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development under which we agreed to discover and optimize therapeutic antibodies against multiple targets selected by Takeda. Takeda agreed to make up-front, annual maintenance and milestone payments to us, fund our research and development and manufacturing activities for preclinical and early clinical studies and pay royalties on sales of products resulting from the collaboration. Takeda is responsible for clinical trials and commercialization of drugs after an IND submission and is granted the right to manufacture once a product enters into

Phase 2 clinical trials. In the first quarter of 2010, a discovery and development program with Takeda under this collaboration was discontinued following the analysis of research data. The termination resulted in the recognition of the remaining unamortized balance in deferred revenue of $1.1 million in the first quarter of 2010, as no continuing performance obligations exist. Separately, we received a $1.0 million payment from Takeda for achieving a pre-established, preclinical milestone under the only currently active discovery and development program with Takeda. We recognized this milestone payment in revenue in the first quarter of 2010.

We have completed a technology transfer and do not expect to perform any further contract research and development services under this program.

Under the terms of this agreement, we may receive milestone payments aggregating up to $20.75 million relating to one undisclosed product candidate and low single-digit royalties on future sales of all products subject to this license. In addition, in the event Takeda were to develop additional future qualifying product candidates under the terms of our agreement, we would be eligible for milestone payments aggregating up to $20.75 million for each such qualifying product candidate. Our right to milestone payments expires on the later of the receipt of payment from Takeda of the last amount to be paid under the agreement or the cessation of all research and development activities with respect to all program antibodies, collaboration targets and/or collaboration products. Our right to royalties expires on the later of 13.5 years from the first commercial sale of each royalty-bearing discovery product or the expiration of the last-to-expire licensed patent.

In February of 2009 we expanded our existing collaboration to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. We may receive milestones of up to $3.25 million per discovery product candidate and low single-digit royalties on future sales of all antibody products subject to this license. Our right to milestone payments expires on the later of the receipt of payment from Takeda of the last amount to be paid under the agreement or the cessation of all research and development activities with respect to all program antibodies, collaboration targets and/or collaboration products. Our right to royalties expires on the later of 10 years from the first commercial sale of such royalty-bearing discovery product, or the expiration of the last-to-expire licensed patent.

Novartis

In November of 2008, we restructured our product development collaboration with Novartis, which involves six development programs including the HCD122 program. HCD122, which is a fully human anti-CD40 antagonist antibody, intended as a treatment for B-cell mediated diseases, including malignancies and autoimmune diseases, is currently recruiting patients for a Phase 1/2 lymphoma trial. The antibody has a dual mechanism of action that involves inhibition of CD40-ligand mediated growth and survival while recruiting immune effector cells to kill CD40-expressing tumor cells through a process known as antibody-dependent cellular cytotoxicity (ADCC). CD40, a member of the tumor necrosis factor, or TNF, family of antigens, is a cell surface antigen expressed in B-cell malignancies and involved in a broad variety of immune and inflammatory responses.

Under the restructured agreement, Novartis made a payment to us of $6.2 million in cash; reduced our existing debt by $7.5 million; will fully fund all future research and development expenses; may pay potential milestones of up to $14 million and royalty rates ranging from 10% to 20% for two ongoing product programs, HCD122 and LFA 102; and has provided us with options to develop or receive royalties on four additional programs. In exchange, Novartis has control over the HCD122 and LFA 102 programs, as well as the right to expand the development of these programs into additional indications outside of oncology. As part of the agreement, Novartis paid us for all project costs incurred after July 1, 2008. Our right to milestone payments expires at such time as no collaboration product or former collaboration product is being developed or commercialized anywhere in the world and no royalty-style payments on these products are due. Our right to royalty-style payments expires on the later of the expiration of any licensed patent covering each product or 20 years from the launch of each product that is produced from a cell line provided to Novartis by XOMA.

The collaboration between XOMA and Novartis (then Chiron Corporation) began in 2004 with the signing of an exclusive, worldwide, multi-product agreement to develop and commercialize multiple antibody products for the treatment of cancer. We shared expenses and revenue, generally on a 70-30 basis, with our share being 30

percent. Financial terms included initial payments to us in 2004 totaling $10 million and a note agreement, secured by our interest in the collaboration, to fund up to 75 percent of our share of expenses beginning in 2005. The secured note agreement with Novartis, which was executed in May of 2005, is due and payable in full in June of 2015. At September 30, 2011, the outstanding principal balance under this note agreement totaled $13.9 million and, pursuant to the terms of the arrangement as restructured in November of 2008, we will not make any additional borrowings on the Novartis note. In the first quarter of 2007, the mutual obligations of XOMA and Novartis to work together on an exclusive basis in oncology expired, except with respect to existing collaborative product development projects.

In December of 2008, we entered into a Manufacturing and Technology Transfer Agreement with Novartis, effective July 1, 2008. Under this agreement, XOMA was engaged by Novartis to perform research and development, process development, manufacturing and technology transfer activities with respect to the ongoing product programs now controlled by Novartis under the restructured product development collaboration. The work performed by XOMA under this agreement, which was fully funded by Novartis, was completed in the third quarter of 2009.

Arana

In September of 2009, we entered into an antibody discovery collaboration with Arana Therapeutics Limited ("Arana"), a wholly-owned subsidiary of Cephalon, Inc., involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data management systems. Arana agreed to pay us a fee of $6.0 million, of which we received $4.0 million in the third quarter of 2009 and $2.0 million in the third quarter of 2010. Also, we may be entitled to future milestone payments, aggregating up to $3.0 million per product, and low single-digit royalties on product sales. Our right to milestone payments expires on the later of the receipt of payment from Arana of the last amount to be paid under the agreement, the cessation by Arana of the use of all research and development technologies or the cessation by Arana of the exercise of the patent rights granted to them. Our right to royalties expires five years from the first commercial sale of each royalty-bearing product.

Kaketsuken

In October of 2009, we entered into an antibody discovery collaboration with The Chemo-Sero-Therapeutic Research Institute, a Japanese research foundation known as Kaketsuken, involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data management systems. Kaketsuken agreed to pay us a fee of $8.0 million, of which we received $6.0 million in the fourth quarter of 2009 and $2.0 million in the fourth quarter of 2010. Also, we may be entitled to future milestone payments, aggregating up to $0.2 million per product, and low single-digit royalties on product sales. Our right to milestone payments expires upon the receipt of payment from Kaketsuken of the last amount to be paid pursuant to the agreement. Our right to royalties expires 15 years from the first commercial sale of each royalty-bearing product.

Merck/Schering-Plough/AVEO Pharmaceuticals, Inc. ("AVEO")

In April of 2006, we entered into an agreement with AVEO to utilize our HE™ technology to humanize AV-299, AVEO's novel anti-HGF antibody, under which AVEO paid us an up-front license fee and development milestones. In addition, we will receive royalties on sales of products resulting from the agreement. Under this agreement we created four Human Engineered™ versions of the original AV-299, all of which met design goals and from which AVEO selected one as its lead development candidate. In September of 2006, as a result of the successful humanization of AV-299, we entered into a second agreement with AVEO to manufacture and supply AV-299 in support of early clinical trials. Under the agreement, we created AV-299 production cell lines, conducted process and assay development, and performed Good Manufacturing Practices ("cGMP") manufacturing activities. AVEO retains all development and commercialization rights to AV-299 and may be required to pay XOMA annual maintenance fees, additional development milestone payments aggregating up to $6.3 million and low single-digit royalties on product sales in the future. Our right to milestone payments expires upon full satisfaction of all financial obligations of AVEO pursuant to the agreement. Our right to royalties expires on the later of 15 years from the first commercial sale of each royalty-bearing product or the expiration of the last-to-expire licensed patent. In the third quarter of 2010, the Company received a $0.8 million milestone payment related to AVEO's initiation of a Phase 2 clinical trial to evaluate AV-299 for the treatment of non-small cell lung cancer. The Company recognized this milestone payment as revenue

in the third quarter of 2010.

In April of 2007, Merck/Schering-Plough entered into a research, development and license agreement with AVEO concerning AV-299 and other anti-HGF molecules. In connection with the aforementioned license agreement, AVEO assigned its entire right, title and interest in, to and under its manufacturing agreement with XOMA to Merck/Schering-Plough. In the third quarter of 2010, AVEO regained its worldwide rights from Merck/Schering-Plough to develop and commercialize AV-299 and other anti-HGF molecules.

Merck/Schering-Plough

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

UCB

Celltech Therapeutics Ltd., now UCB Celltech, a branch of UCB, utilized our bacterial cell expression technology under license in the development of CIMZIA® for the treatment of moderate-to-severe Crohn's disease in adults who have not responded to conventional therapies and for the treatment of moderate-to-severe rheumatoid arthritis in adults. The license provides for a low-single digit royalty on sales of CIMZIA® in countries where our bacterial cell expression technology is patented, which includes the U.S. and Canada, until the expiration of the last-to-expire licensed patent. In August of 2010, we sold our royalty interest in CIMZIA® to OrbiMed Advisors, LLC for gross proceeds of $4.0 million. We no longer receive royalties on sales of CIMZIA®.

Genentech

In April of 1996, we entered into a collaboration agreement with Genentech, Inc., a wholly-owned member of the Roche Group (referred to herein as "Genentech") for the development of RAPTIVA®. In March of 2003, we entered into amended agreements which called for us to share in the development costs and called for Genentech to finance our share of development costs via a convertible subordinated loan. Under the loan agreement, upon FDA approval of the product, which occurred in October of 2003, we elected to pay $29.6 million of the development loan in convertible preference shares, which are convertible into approximately 0.3 million common shares at a price of $116.25 per common share.

In January of 2005, we restructured our arrangement with Genentech on RAPTIVA® under which we were entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA® in all indications. The previous cost and profit sharing arrangement for RAPTIVA® in the U.S. was discontinued and Genentech was responsible for all operating and development costs associated with the product. In the first half of 2009, RAPTIVA® was withdrawn from the commercial drug markets and royalties ceased.

Genentech utilized our bacterial cell expression technology under license in the development of LUCENTIS® for the treatment of neovascular wet age-related macular degeneration. LUCENTIS® was approved by the FDA in June of 2006 and in the European Union in January of 2007. We were entitled to receive a low-single digit royalty on worldwide sales of LUCENTIS®. In the third quarter of 2009, we sold our LUCENTIS® royalty interest to Genentech for $25 million, including royalty revenue from the second quarter of 2009. We no longer receive royalties on sales of LUCENTIS®.

Financing Agreements

Underwritten Offering

In February of 2010, we completed an underwritten offering of 2.8 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately $21 million. As of December 8, 2011, all of these warrants were outstanding.

Registered Direct Offerings

In May of 2009, we entered into a definitive agreement with an institutional investor to sell 784,313 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately $10 million, before deducting placement agent fees and estimated offering expenses of $0.8 million, in a registered direct offering. The investor purchased the units at a price of $12.75 per unit. The warrants, which represent the right to acquire an aggregate of up to 392,157 common shares, were exercisable at any time on or after May 15, 2009 and prior to May 20, 2014 at an exercise price of $15.30 per share. In February of 2010, the holders of these warrants agreed to amend the terms of their warrants to remove the provisions that would have required a reduction of the warrant exercise price and an increase in the number of shares issuable on exercise of the warrants each time we sold common shares at a price less than the exercise price of such warrants (the "Eliminated Adjustment Provisions") and the exercise price of these warrants was reduced from $15.30 per share to $0.015 per share. In the first quarter of 2010, the holders of these warrants exercised all warrants, acquiring 392,157 common shares for an aggregate exercise price of $5,882.

In June of 2009, we entered into a definitive agreement with certain institutional investors to sell 695,652 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately $12 million, before deducting placement agent fees and estimated offering expenses of $0.8 million, in a second registered direct offering. The investor purchased the units at a price of $17.25 per unit. The warrants, which represent the right to acquire an aggregate of up to 347,826 common shares, are exercisable at any time on or prior to December 10, 2014 at an exercise price of $19.50 per share. In February of 2010, the holders of these warrants agreed to amend the terms of their warrants to remove the Eliminated Adjustment Provisions and we made a cash payment of $4.5 million to these warrant holders, which was recorded in other income (expense). The exercise price of these warrants remained unchanged at $19.50 per share. As of December 8, 2011, all of these warrants were outstanding.

ATM Agreements

In the third quarter of 2009, we entered into an At Market Issuance Sales Agreement (the "2009 ATM Agreement"), under which we could sell up to 1.7 million of our common shares from time to time through Wm Smith & Co. ("Wm Smith"), as our agent for the offer and sale of the common shares. Wm Smith could sell these common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, as amended (the "Securities Act"), including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith could also sell the common shares in privately negotiated transactions, subject to our approval. We paid Wm Smith a commission equal to 3% of the gross proceeds of all common shares sold through it as sales agent under the 2009 ATM Agreement but in no event less than $0.02 per share. Shares sold under the 2009 ATM Agreement were sold pursuant to a prospectus which formed a part of our registration statement on Form S-3 (File No. 333-148342) (the "Previous Registration Statement") filed with the U.S. Securities and Exchange Commission (the "SEC") on December 26, 2007 and declared effective by the SEC on May 29, 2008. From the inception of the 2009 ATM Agreement through October of 2010, the Company sold a total of 1.7 million common shares through Wm Smith, constituting all of the shares available for sale under the agreement, for aggregate gross proceeds of $12.2 million, including 1.4 million common shares sold in 2010 for aggregate gross proceeds of $9.3 million. Total offering expenses related to these sales were $0.4 million.

In the third quarter of 2010, we entered into an At Market Issuance Sales Agreement (the "2010 ATM Agreement"), with Wm Smith and McNicoll, Lewis & Vlak LLC (the "Agents"), under which we could sell common shares from time to time through the Agents, as our agents for the offer and sale of the common shares, in an aggregate amount not to

exceed the amount that can be sold under the Previous Registration Statement. The Agents could sell the common shares by any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. The Agents could also sell the common shares in privately negotiated transactions, subject to our prior approval. We paid the Agents, collectively, a commission equal to 3% of the gross proceeds of the sales price of all common shares sold through them as sales agents under the 2010 ATM Agreement. From the inception of the 2010 ATM Agreement through May of 2011, we sold a total of 7,560,862 common shares under this agreement for aggregate gross proceeds of $34.0 million,

including 821,386 common shares sold in 2011 for aggregate gross proceeds of $4.4 million. Total offering expenses incurred related to sales under the 2010 ATM Agreement from inception to May of 2011 were $1.0 million, including $0.1 million incurred in 2011. In May of 2011, the 2010 ATM Agreement expired by its terms, and there will be no further issuances under this facility.

On February 4, 2011, we entered into an At Market Issuance Sales Agreement (the "2011 ATM Agreement"), with McNicoll, Lewis & Vlak LLC ("MLV"), under which we may sell common shares from time to time through MLV, as our agent for the offer and sale of the common shares, in an aggregate amount not to exceed the amount that can be sold under our registration statement on Form S-3 (File No. 333-172197) filed with the SEC on February 11, 2011 and amended on March 10, 2011 and June 3, 2011, which was declared effective by the SEC on June 6, 2011. MLV may sell the common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act, including without limitation sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. MLV may also sell the common shares in privately negotiated transactions, subject to our prior approval. We will pay MLV a commission equal to 3% of the gross proceeds of the sales price of all common shares sold through it as sales agent under the 2011 ATM Agreement. From the inception of the 2011 ATM Agreement through September 30, 2011, we sold a total of 3,603,422 common shares under this agreement for aggregate gross proceeds of $8.5 million. Total offering expenses incurred related to sales under the 2011 ATM Agreement from inception to September 30, 2011 were $0.3 million. From October 1, 2011 through December 8, 2011, 1,668,150 additional common shares were sold through MLV for aggregate gross proceeds of $2.8 million. Total offering expenses related to these sales from October 1, 2011 to December 8, 2011 were approximately $0.1 million.

Equity Line of Credit

In July of 2010, we entered into a common share purchase agreement (the "Purchase Agreement") with Azimuth Opportunity Ltd. ("Azimuth"), pursuant to which we obtained a committed equity line of credit facility (the "Facility") under which we could sell up to $30 million of our registered common shares to Azimuth over a 12-month period, subject to certain conditions and limitations. The Purchase Agreement provided that we could determine, in our sole discretion, the timing, dollar amount and floor price per share of each draw down under the Facility, subject to certain conditions and limitations and that the number and price of shares sold in each draw down were generally to be determined by a contractual formula designed to approximate fair market value, less a discount. The Purchase Agreement also provided that from time to time and in our sole discretion, we could grant Azimuth the right to exercise one or more options to purchase additional common shares during each draw down pricing period for the amount of shares based upon the maximum option dollar amount and the option threshold price specified by us. We also agreed to issue 111,111 common shares to Azimuth upon execution of the agreement relating to the Facility, in consideration of Azimuth's execution and delivery of that agreement. Shares under the Facility and the shares we agreed to issue to Azimuth upon execution of the agreement relating to the Facility were sold pursuant to a prospectus which forms a part of a registration statement declared effective by the SEC on May 29, 2008. In August of 2010, we sold a total of 3,421,407 common shares under the Facility for aggregate gross proceeds of $14.2 million, representing the maximum number of shares that could be sold under the Facility. As a result, the Facility is no longer in effect, and no additional shares can be issued thereunder.

Research and Development

Our research and development expenses currently include costs of personnel, supplies, facilities and equipment, consultants, third party costs and other expenses related to preclinical and clinical testing. Research and development expenses were $15.9 million and $51.5 million for the three and nine months ended September 30, 2011, respectively, compared with $21.3 million and $58.3 million for the same periods of 2010. Research and development expenses

were $77.4 million in 2010, compared with $58.1 million in 2009 and $82.6 million in 2008.

Our research and development activities can be divided into those related to our internal projects and those related to collaborative and contract arrangements, which are reimbursed by our customers. For the three and nine months ended September 30, 2011, research and development expenses relating to internal projects were $8.3 million and $29.3 million, respectively, compared to $17.3 million and $45.9 million for the same periods of 2010. In 2010, research and development expenses related to internal projects were $58.1 million compared with $42.2 million in 2009 and $58.5 million in 2008. In 2010, research and development expenses related to collaborative and

contract arrangements were $19.3 million compared with $15.9 million in 2009 and $24.1 million in 2008. Refer to Management's Discussion and Analysis of Financial Condition and Results of Operations- Research and Development Expenses for further information regarding our research and development expenses.

Competition

The biotechnology and pharmaceutical industries are subject to continuous and substantial technological change. Competition in the areas of recombinant DNA-based and antibody-based technologies is intense and expected to increase as new technologies emerge and established biotechnology firms and large chemical and pharmaceutical companies continue to advance in the field. A number of these large pharmaceutical and chemical companies have enhanced their capabilities by entering into arrangements with or acquiring biotechnology companies or entering into business combinations with other large pharmaceutical companies. Many of these companies have significantly greater financial resources, larger research and development and marketing staffs and larger production facilities than ours. Moreover, certain of these companies have extensive experience in undertaking preclinical testing and human clinical trials. These factors may enable other companies to develop products and processes competitive with or superior to ours. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later. As a result, we may not be able to track development of competitive products, particularly at the early stages. There can be no assurance that developments by others will not render our products or technologies obsolete or uncompetitive.

Without limiting the foregoing, we are aware of the following competitors for the products and candidates shown in the table below. This table is not intended to be representative of all existing competitors in the market:

Product/Candidate	Competitors
Gevokizumab	Abbott
	Biovitrum AB
	Eli Lilly and Company
	Lux Biosciences, Inc.
	MedImmune
	Novartis AG
	Regeneron Pharmaceuticals, Inc.
	Santen Pharmaceutical Co., Ltd.
XOMA 3AB	Cangene Corporation
	Emergent BioSolutions, Inc.

Regulatory

Our products are subject to comprehensive preclinical and clinical testing requirements and to approval processes by the FDA and by similar authorities in other countries. Our products are primarily regulated on a product-by-product basis under the United States Food, Drug and Cosmetic Act and Section 351(a) of the Public Health Service Act. Most of our human therapeutic products are or will be classified as biologic products. Approval of a biologic for commercialization requires licensure of the product and the manufacturing facilities. The review of therapeutic biologic products is carried out by the FDA's Center for Drug Evaluation and Research, the body that also reviews

drug products.

The FDA regulatory process is carried out in several phases. Prior to beginning human clinical testing of a proposed new biologic product, an IND is filed with the FDA. This document contains scientific information on the proposed product, including results of testing of the product in animal and laboratory models. Also included is information on manufacturing the product and studies on toxicity in animals and a clinical protocol outlining the initial investigation in humans.

The initial stage of clinical testing, Phase 1, ordinarily encompasses safety, pharmacokinetic and pharmacodynamic evaluations. Phase 2 testing encompasses investigation in specific disease states designed to provide preliminary efficacy data and additional information on safety. Phase 3 studies are designed to further establish clinical safety and efficacy and to provide information allowing proper labeling of the product following approval. Phase 3 studies are most commonly multi-center, randomized, placebo-controlled trials in which rigorous statistical methodology is applied to clinical results. Other designs may also be appropriate in specific circumstances.

Following completion of clinical trials, a BLA is submitted to the FDA to request marketing approval. Internal FDA committees are formed that evaluate the application, including scientific background information, animal and laboratory efficacy studies, toxicology, manufacturing facility and clinical data. During the review process, a dialogue between the FDA and the applicant is established in which FDA questions are raised and additional information is submitted. During the final stages of the approval process, the FDA generally requests presentation of clinical or other data before an FDA advisory committee, at which point, some or all of such data may become available. Also, during the later stages of review, the FDA conducts an inspection of the manufacturing facility to establish that the product is made in conformity with good manufacturing practice. If all outstanding issues are satisfactorily resolved and labeling established, the FDA issues a license for the product and for the manufacturing facility, thereby authorizing commercial distribution.

The FDA has substantial discretion in both the product approval process and the manufacturing approval process. It is not possible to predict at what point, or whether, the FDA will be satisfied with our submissions or whether the FDA will raise questions which may delay or preclude product approval or manufacturing facility approval. As additional clinical data is accumulated, it will be submitted to the FDA and may have a material impact on the FDA product approval process. Given that regulatory review is an interactive and continuous process, we have adopted a policy of limiting announcements and comments upon the specific details of the ongoing regulatory review of our products, subject to our obligations under the securities laws, until definitive action is taken. There can be no assurance any of the products we have under development will be developed successfully, obtain the requisite regulatory approval or be successfully manufactured or marketed.

In Europe, most of our human therapeutic products are or will be classified as biological medicinal products which are assessed through a centralized procedure by the EMA. The EMA coordinates the evaluation and supervision of medicinal products throughout the European Union and the European Economic Area. The assessment of the Marketing Authorization Application (“MA”) is carried out by a Rapporteur and a Co-Rapporteur appointed by the Committee for Medicinal Products for Human Use (“CHMP”), which is the expert scientific committee of the EMA.

The Rapporteur and Co-Rapporteur are drawn from the CHMP membership representing member states of the European Union. In addition to their responsibility for undertaking scientific assessments of an application for a MA, the Rapporteur and the Co-Rapporteur liaise with the applicant on behalf of the CHMP in an effort to provide answers to queries raised by the CHMP. Their assessment report(s) is circulated to and considered by the full CHMP membership, leading to the production ultimately of a CHMP opinion which is transmitted to the applicant and the European Commission. The final decision on the grant of a MA is made by the European Commission as the licensing authority of the European Community (“Community”). Under Community law, a positive decision issued by the European Commission represents the grant of a MA. Such an authorization allows a medicinal product to be placed on the European market. Upon the grant of an MA in the European Union, certain member states require pricing approval before the product can be placed into commercial distribution.

Under Community law, the applicant may request grant of a MA under exceptional circumstances if comprehensive data on the efficacy and safety of the drug, under normal conditions of use cannot be provided because its intended indications are encountered so rarely (such as in the case of a medicinal product intended for treating an orphan

disease) that comprehensive evidence cannot reasonably be collected, the present state of scientific knowledge will not allow comprehensive information to be collected, or it would be against generally accepted medical ethics to collect comprehensive information. The Rapporteur, Co-Rapporteur and the other CHMP members will assess the justification/data submitted for exceptional circumstances as part of the overall assessment of the benefit/risk of the application. It is up to the CHMP, during the review, to ultimately decide on whether grant of a MA under exceptional circumstances is justified on the evidence before them. Approval under exceptional circumstances is subject to a requirement for specific procedures related to safety and results of its use and is reviewed annually

to reassess the risk-benefit balance of the product. Once approval is granted, the product can be marketed under the single European MA in all member states of the European Union and the European Economic Area. Consistent with the single MA, the labeling for Europe is identical throughout all member states except that all labeling must be translated into the local language of the country of intended importation and in relation to the content of the so called "blue box" on the outer packaging in which locally required information may be inserted.

Orphan drugs are those intended for use in rare diseases or conditions. As a result of the high cost of development and the low return on investment for rare diseases, governments provide regulatory and commercial incentives for the development of drugs for small disease populations. In the United States, the term ''rare disease or condition'' means any disease or condition which affects less than 200,000 persons in the United States. Applications for United States orphan drug status are evaluated and granted by the Office of Orphan Products Development ("OOPD") of the FDA. In the United States, orphan drugs are subject to the standard regulatory process for marketing approval but are exempt from the payment of user fees for licensure, receive market exclusivity for a period of seven years and some tax benefits, and are eligible for OOPD grants. In Europe, orphan medicinal products are those intended for the diagnosis, prevention or treatment of a life-threatening or chronically debilitating condition affecting not more than five in 10,000 persons in the Community. The EMA's Committee for Orphan Medicinal Products ("COMP") reviews applications seeking orphan designation. If the European Commission agrees with a positive assessment made by COMP, then the product will receive a positive designation through adoption of a decision by the European Commission. Orphan medicinal products are exempt from fees for protocol assistance and scientific advice from the Scientific Advice Working Party during development, reduction or exemption of MA and other fees, and ten-year market exclusivity upon granting of a MA in respect of the approved clinical indication. Moreover, manufacturers may be eligible for grants or other financial incentives from the Community and Member States programs.

Patents and Trade Secrets

Patent and trade secret protection is important to our business and our future will depend in part on our ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of others. As a result of our ongoing activities, we hold and have filed applications for a number of patents in the United States and internationally to protect our products and important processes. We also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the patent position of biotechnology companies generally is highly uncertain and no consistent policy regarding the breadth of allowed claims has emerged from the actions of the U.S. Patent and Trademark Office ("Patent Office") with respect to biotechnology patents. Accordingly, no assurance can be given that our patents will afford protection against competitors with similar technologies, or others will not obtain patents claiming aspects similar to those covered by our patent applications.

We have established a portfolio of patents in the U.S. and Europe for our gevokizumab program, the longest of which expires in 2027. U.S. Patent Nos. 7,531,166 and 7,582,742 cover gevokizumab and other antibodies and antibody fragments with similar binding properties for IL-1 beta, as well as nucleic acids, expression vectors and production cell lines for the manufacture of such antibodies and antibody fragments. U.S. Patent Nos. 7,744,865, 7,744,866 and 7,943,121 relate to additional IL-1 beta binding antibodies and binding fragments. U.S. Patent No. 7,695,718 relates to methods of treating Type 2 diabetes with high affinity antibodies and antibody fragments that bind to IL-1 beta, including gevokizumab. U.S. Patent No. 7,695,717 relates to methods of treating certain IL-1 related inflammatory diseases, including rheumatoid arthritis and osteoarthritis, with gevokizumab and other antibodies and antibody fragments with similar binding properties for human interleukin-1 beta (IL-1 beta). U.S. Patent No. 7,829,093 relates to methods of treating diabetes mellitus Type 1 with gevokizumab or other IL-1 beta antibodies and fragments having similar binding properties. U.S. Patent No. 7,829,094 relates to methods of treating certain cancers with gevokizumab or other IL-1beta antibodies and fragments having similar binding properties, with the cancer being selected from

multiple myeloma, acute myelogenous leukemia and chronic myelogenous leukemia. U.S. Patent No. 7,988,968 relates to methods of treating certain IL-1beta related coronary conditions, including myocardial infarction, with gevokizumab or other IL-1beta antibodies and fragments having similar binding properties, Also, the European Patent Office granted a patent for gevokizumab, as well as nucleic acids, expression vectors and production cell lines for the manufacture of gevokizumab.

We have exclusively in-licensed a portfolio of patents and applications covering anti-botulinum toxin antibodies from the Regents of the University of California. These include U.S. Patent Nos. 7,700,738 and 7,999,079, covering certain XOMA 3AB antibodies, the longest of which expire in 2026.

We have established a portfolio of patents related to our bacterial expression technology, including claims to novel promoter sequences, secretion signal sequences, compositions, methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products, and improved methods and cells for expression of recombinant protein products. U.S. Patent Nos. 5,576,195 and 5,846,818 are related to DNA encoding a pectate lyase signal sequence, recombinant vectors, host cells and methods for production and externalization of recombinant proteins. U.S. Patent Nos. 5,595,898, 5,698,435 and 5,618,920 relate to secretable immunoglobulin chains, DNA encoding the chains and methods for their recombinant production. U.S. Patent Nos. 5,693,493, 5,698,417 and 6,204,023 relate to methods for recombinant production/secretion of functional immunoglobulin molecules. U.S. Patent Nos. 7,094,579, 7,396,661, 7,972,811 and 7,977,068 relate to particular eukaryotic signal sequences and their use in methods for prokaryotic expression of polypeptides and for preparing polypeptide display libraries. U.S. Patent No. 6,803,210 relates to improved bacterial host cells that are deficient in one or more of the active transport systems for an inducer of an inducible promoter, such as arabinose for an araB promoter, and methods for the use of such cells for the production of recombinant proteins. Most of the more important European patents in this portfolio expired in July of 2008 or earlier.

We have also established a portfolio of patents related to our mammalian expression technology, including U.S. Patent Nos. 7,192,737, 7,993,915 and 7,794,976, which relate to methods of producing recombinant proteins using particular vectors, including expression vectors comprising multiple copies of a transcription unit encoding a polypeptide separated by at least one selective marker gene.

We have established a portfolio of patents related to our Human Engineering™ technology, including U.S. Patent No. 5,766,886, directed to methods of modifying antibody variable domains to reduce immunogenicity. We believe that our patented Human Engineering™ technology provides an attractive alternative to other humanization technologies.

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require certain licenses from others in order to develop and commercialize certain potential products incorporating our technology. There can be no assurance that such licenses, if required, will be available on acceptable terms.

Where appropriate, we also rely on trade secrets to protect aspects of our technology. However, trade secrets are difficult to protect. We protect our proprietary technology and processes, in part, by confidentiality agreements with our employees, consultants and collaborators. These parties may breach these agreements, and we may not have adequate remedies for any breach. Our trade secrets may otherwise become known or be independently discovered by competitors. To the extent that we or our consultants or collaborators use intellectual property owned by others, we may have disputes with our collaborators or consultants or other third parties as to the rights in related or resulting know-how and inventions.

International Operations

We believe that, because the pharmaceutical industry is global in nature, international activities will be a significant part of our future business activities and that, when and if we are able to generate income, a substantial portion of that income may be derived from product sales and other activities outside the United States.

A number of risks are inherent in international operations. Foreign regulatory agencies often establish standards different from those in the United States. An inability to obtain foreign regulatory approvals on a timely basis could have an adverse effect on our international business, financial condition and results of operations. International operations may be limited or disrupted by the imposition of government controls, export license requirements, political or economic instability, trade restrictions, changes in tariffs, restrictions on repatriating profits, taxation or difficulties in staffing and managing international operations. In addition, our business, financial condition and results of operations may be adversely affected by fluctuations in currency exchange rates. There can be no assurance that we will be able to successfully operate in any foreign market.

Financial information regarding the geographic areas in which we operate is included in Note 12 to the December 31, 2010 Financial Statements: Concentration of Risk, Segment and Geographic Information.

Concentration of Risk

In the first nine months of 2011, Servier and NIAID accounted for 59% and 36% of our total revenue, neither of which represents a related party to XOMA. These key customers accounted for 45% and 52% of the accounts receivable balance at September 30, 2011. The loss of one or more of these customers could have a material adverse effect on our business and financial condition.

In 2010, NIAID, UCB, and Takeda each accounted for more than 10% of our total revenue, none of which represents a related party to XOMA. These key customers accounted for 87% of our total revenue in 2010 and NIAID was responsible for 23% of the accounts receivable balance at December 31, 2010. Servier accounted for an additional 72% of the accounts receivable balance at December 31, 2010. The loss of one or more of these customers could have a material adverse effect on our business and financial condition.

In 2009, Takeda and Genentech each accounted for more than 10% of our total revenue, none of which represents a related party to XOMA. These key customers accounted for 65% of our total revenue in 2009, but were not responsible for any of the accounts receivable balance at December 31, 2009. NIAID, Arana, and Kaketsuken accounted for 90% of the accounts receivable balance at December 31, 2009. In 2008, Genentech, Novartis, and Merck/Schering-Plough each provided more than 10% of our total revenue, none of which represent a related party to XOMA.

Organization

We were incorporated in Delaware in 1981 and became a Bermuda exempted company effective December 31, 1998, when we completed a shareholder-approved corporate reorganization, changing our legal domicile from Delaware to Bermuda and our name to XOMA Ltd. When referring to a time or period before December 31, 1998, or when the context so requires, the terms “Company” and “XOMA” refer to XOMA Corporation, a Delaware corporation and the predecessor of XOMA Ltd.

Employees

As of December 8, 2011, we employed approximately 240 full-time employees, none of which are unionized, at our facilities, principally in Berkeley, California. Our employees are primarily engaged in clinical, process development, research and product development, and in executive, business development, finance and administrative positions. We consider our employee relations to be excellent.

Properties

Our corporate headquarters and development and manufacturing facilities are located in Berkeley and Emeryville, California. We currently lease five buildings, and space in a sixth building, for which we have a sublease tenant under contract through May of 2014. These buildings house our research and development laboratories, manufacturing facilities and office space. A separate pilot scale manufacturing facility is owned by us. Our building leases expire in the period from 2012 to 2014 and total minimum lease payments due from October of 2011 until expiration of the leases are $10.0 million. We have the option to renew our lease agreements for periods ranging from three to ten years.