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

FORM 10-Q

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

For the quarterly period ended September 30, 2004

Commission File No. 0-14710

XOMA Ltd.

(Exact name of registrant as specified in its charter)

Bermuda
(State or other jurisdiction of
incorporation or organization)

52-2154066
(I.R.S. Employer
Identification No.)

2910 Seventh Street, Berkeley, CA 94710
(Address of principal executive offices, including zip code)

(510) 204-7200
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

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

Class	Outstanding at November 5, 2004
Common shares US\$.0005 par value	85,565,765

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

XOMA Ltd.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2004	December 31, 2003
	(unaudited)	(Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 35,930	\$ 84,812
Short-term investments	468	436
Receivables	370	10,625
Related party receivables	125	94
Prepaid expenses and other	1,335	1,267
	<u>38,228</u>	<u>97,234</u>
Total current assets	38,228	97,234
Property and equipment, net	20,475	21,337
Related party receivables – long-term	76	120
Deposits and other	159	159
	<u>58,938</u>	<u>118,850</u>
Total assets	\$ 58,938	\$ 118,850
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,789	\$ 5,058
Accrued liabilities	13,208	6,163
Notes payable	286	13,343
Capital lease obligations	279	520
Deferred revenue	2,000	90
Convertible note	—	5,284
	<u>18,562</u>	<u>30,458</u>
Total current liabilities	18,562	30,458
Capital lease obligations – long-term	74	272
Deferred revenue – long-term	6,833	—
Interest bearing obligation – long-term	40,641	39,906
	<u>66,110</u>	<u>70,636</u>
Total liabilities	66,110	70,636
Shareholders' equity:		
Preference shares, \$.05 par value, 1,000,000 shares authorized		
Series A, 135,000 designated, no shares issued and outstanding	—	—
Series B, 8,000 designated, 2,959 and 2,959 shares issued and outstanding, respectively. Aggregate liquidation preference of \$29.6 million.	1	1
Common shares, \$.0005 par value, 135,000,000 shares authorized, 85,565,765 and 83,998,697 shares outstanding, respectively	43	42
Additional paid-in capital	653,470	647,534
Accumulated comprehensive income	197	166
Accumulated deficit	(660,883)	(599,529)
	<u>(7,172)</u>	<u>48,214</u>
Total shareholders' equity	(7,172)	48,214
Total liabilities and shareholders' equity	\$ 58,938	\$ 118,850

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenues:				
License and collaborative fees	\$ 530	\$ 12,050	\$ 1,442	\$ 14,125
Contract and other revenue	29	582	65	4,032
Total revenues	559	12,632	1,507	18,157
Operating costs and expenses:				
Research and development	12,562	16,622	38,439	44,108
General and administrative	4,015	3,603	11,538	9,933
Collaboration arrangement	3,857	1,974	12,286	2,245
Total operating costs and expenses	20,434	22,199	62,263	56,286
Loss from operations	(19,875)	(9,567)	(60,756)	(38,129)
Other income (expense):				
Investment and interest income	158	75	452	260
Interest expense	(307)	(449)	(925)	(1,424)
Other income (expense)	(119)	91	(125)	289
Net loss	\$ (20,143)	\$ (9,850)	\$ (61,354)	\$ (39,004)
Basic and diluted net loss per common share	\$ (0.24)	\$ (0.13)	\$ (0.73)	\$ (0.54)
Shares used in computing basic and diluted net loss per common share	85,284	73,224	84,619	72,371

See accompanying notes to condensed consolidated financial statements.

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XOMA Ltd.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Nine months ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net loss	\$ (61,354)	\$ (39,004)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,260	2,941
Common shares contribution to 401(k) and management incentive plans	906	754
Increase in notes to a collaborative partner for cost allocations	—	2,245
Accrued interest on convertible notes and other interest bearing obligations	285	1,292
(Gain) loss on disposal/retirement of property and equipment	123	1
(Gain) loss on sale of investments	—	(299)
Changes in assets and liabilities:		
Receivables and related party receivables	10,268	(1,812)
Inventory	—	1,306
Prepaid expenses and other	(68)	(644)
Deposits and other	—	13
Accounts payable	(2,269)	(669)
Accrued liabilities	7,045	(576)
Deferred revenue	8,743	(1,894)
Net cash used in operating activities	(33,061)	(36,346)
Cash flows from investing activities:		
Purchase of short-term investments	—	(4,000)
Transfer from restricted cash	—	1,500
Purchase of property and equipment	(2,521)	(2,341)
Proceeds from sale of short-term investments	—	4,045
Net cash used in investing activities	(2,521)	(796)
Cash flows from financing activities:		
Proceeds from short-term loan	508	—
Principal payments of short-term loan	(13,400)	(763)
Payments under capital lease obligations	(439)	(513)
Proceeds from issuance of convertible notes	—	10,787
Principal payments of convertible notes	(5,000)	—
Proceeds from issuance of common shares	5,031	71,447
Net cash provided by (used in) financing activities	(13,300)	80,958
Net decrease in cash and cash equivalents	(48,882)	43,816
Cash and cash equivalents at the beginning of the period	84,812	36,262
Cash and cash equivalents at the end of the period	\$ 35,930	\$ 80,078

See accompanying notes to condensed consolidated financial statements.

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

1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business

XOMA Ltd. ("XOMA" or the "Company"), a Bermuda company, is a biopharmaceutical company that develops for commercialization antibodies and other genetically-engineered protein products to treat immunological and inflammatory disorders, cancer, and infectious diseases. The Company's products are presently in various stages of development and most are subject to regulatory approval before they can be introduced commercially. The Company has one approved product, RAPTIVA[®], which is marketed in the United States and Europe, for the treatment of moderate-to-severe plaque psoriasis under a collaboration agreement with Genentech, Inc. ("Genentech"). XOMA's pipeline includes both proprietary products and collaborative programs at various stages of preclinical and clinical development.

Basis of Presentation

The condensed consolidated financial statements include the accounts of XOMA and its subsidiaries. All significant intercompany accounts and transactions were eliminated during consolidation. The unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q. These financial statements and related disclosures have been prepared with the assumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these statements should be read in conjunction with the audited Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003, filed with the SEC on March 15, 2004.

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which are necessary to present fairly the Company's consolidated financial position as of September 30, 2004, the consolidated results of the Company's operations for the three and nine months ended September 30, 2004 and 2003, and the Company's cash flows for the nine months then ended. The condensed consolidated balance sheet amounts at December 31, 2003, have been derived from audited consolidated financial statements. The interim results of operations are not necessarily indicative of the results that may occur for the full fiscal year or future periods.

Critical Accounting Policies

The Company believes that there have been no significant changes in its critical accounting policies during the nine months ended September 30, 2004, as compared with those previously disclosed in its Annual Report on Form 10-K for the year ended December 31, 2003, filed with the SEC on March 15, 2004.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Concentration of Risk

Cash, cash equivalents, short-term investments and receivables are financial instruments, which potentially subject the Company to concentrations of credit risk. The Company maintains and invests excess cash in money market funds and short-term investments that bear minimal risk. The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the nine months ended September 30, 2004, one customer represented 77% of total revenues and, as of September 30, 2004, there were no billed or unbilled receivables outstanding from this customer. For the nine months ended September 30, 2003, two customers represented 64% and 19% of total revenues and, as of September 30, 2003, there were billed and unbilled receivables outstanding from one of these customers of \$10.0 million.

Reclassifications

Certain items previously reported in specific financial statement captions have been reclassified to conform to the fiscal 2004 presentation. Such reclassifications have not impacted previously reported revenues, operating loss or net loss.

XOMA Ltd.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Collaboration arrangement

Beginning in 2004, the Company is reporting its RAPTIVA® collaboration profit or loss as a single line item to reflect the terms of the agreement with Genentech, which includes XOMA's share of Genentech's operating profit or loss before research and development expenses from RAPTIVA® sales in the United States, royalty income on sales of RAPTIVA® outside of the United States and any research and development cost sharing adjustments between the companies. If quarterly collaboration activity results in a profit, XOMA's portion will be included in total revenues; if the quarterly collaboration activity results in a loss, XOMA's portion will be included in operating expenses. The Company currently anticipates its share of the collaboration activity to be losses through 2004 due to product selling and marketing costs, which are expected to exceed gross profit. Research and development costs incurred directly by the Company related to RAPTIVA® will continue to be included in research and development expense.

In connection with the revised presentation of RAPTIVA® collaboration profit or loss, the Company reclassified the following amounts (in thousands):

	Three months ended September 30, 2003			Nine months ended September 30, 2003		
	Revised	Original	Reclassified	Revised	Original	Reclassified
Research and development	\$ 16,622	\$ 15,933	\$ 689	\$ 44,108	\$ 41,417	\$ 2,691
General and administrative *	3,603	6,266	(2,663)	9,933	14,869	(4,936)
Collaboration arrangement	1,974	—	1,974	2,245	—	2,245
Total operating costs and expenses	\$ 22,199	\$ 22,199	\$ —	\$ 56,286	\$ 56,286	\$ —

* Shown as "Marketing, general and administrative" in prior year.

Share-Based Compensation

In accordance with the provisions of the Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), as amended by Financial Accounting Standards No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of SFAS No. 123," the Company has elected to continue to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and related interpretations and to adopt the "disclosure only" alternative described in SFAS 123. Under APB 25, if the exercise price of the Company's employee share options equals or exceeds the fair market value on the date of the grant or the fair value of the underlying shares on the date of the grant as determined by the Company's Board of Directors, no compensation expense is recognized. Accordingly, the financial statements reflect amortization of compensation resulting from options granted at exercise prices which were below market price at the grant date. Had compensation cost for the Company's share-based compensation plans been based on the fair value method at the grant dates for awards under these plans consistent with the provisions of SFAS 123, the Company's net loss and loss per share would have been increased to the pro forma amounts indicated below for the three and nine months ended September 30, 2004 and 2003 (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net loss – as reported	\$(20,143)	\$ (9,850)	\$(61,354)	\$(39,004)
Deduct:				
Total share-based employee compensation expense determined under fair value method	(759)	(838)	(2,640)	(2,441)
Pro forma net loss	\$(20,902)	\$(10,688)	\$(63,994)	\$(41,445)
Loss per share:				
Basic and diluted – as reported	\$ (0.24)	\$ (0.13)	\$ (0.73)	\$ (0.54)
Basic and diluted – pro forma	\$ (0.25)	\$ (0.15)	\$ (0.76)	\$ (0.57)

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XOMA Ltd.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The fair value of each option grant under these plans is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants during the periods indicated below:

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Dividend yield	0%	0%	0%	0%
Expected volatility	1.02%	.93%	.82%	98%
Risk-free interest rate	3.29%	1.20%	1.45%	1.23%
Expected life	4.5 years	5.8 years	6.3 years	5.0 years

On March 31, 2004, the FASB issued an Exposure Draft, "Share-Based Payment - An Amendment of FASB Statements No. 123 and 95" ("SFAS 123R"). The proposed SFAS 123R addresses the accounting for transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed SFAS 123R would eliminate the ability to account for share-based compensation transactions using APB 25, and generally would require instead that such transactions be accounted for using a fair-value based method. As proposed, companies would be required to recognize an expense for compensation cost related to share-based payment arrangements including stock options and employee stock purchase plans. The new rules would be applied on a modified prospective basis as defined in the proposed SFAS 123R, and would be effective for public companies for interim or annual periods beginning after June 15, 2005. The Company is currently evaluating option valuation methodologies and assumptions in light of the evolving accounting standards related to employee stock options. Current estimates of option values using the Black-Scholes model (as shown above) may not be indicative of results from valuation methodologies ultimately adopted in the final rules

Comprehensive Income (Loss)

Unrealized gains or losses on the Company's available-for-sale securities are included in other comprehensive income (loss). Comprehensive income (loss) and its components for the three and nine months ended September 30, 2004 and 2003, are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net loss	\$(20,143)	\$(9,850)	\$(61,354)	\$(39,004)
Unrealized gain (loss) on securities available-for-sale	14	(75)	31	32
Comprehensive loss	\$(20,129)	\$(9,925)	\$(61,323)	\$(38,972)

Net Loss Per Common Share

Basic and diluted net loss per common share is based on the weighted average number of common shares outstanding during the period in accordance with Statement of Financial Accounting Standards No. 128.

The following potentially dilutive outstanding securities were not considered in the computation of diluted net loss per share because they would be antidilutive for the nine months ended September 30, 2004 and 2003, (in thousands):

	Nine months ended September 30,	
	2004	2003
Options for common shares	5,959	5,601
Warrants for common shares	525	700
Convertible notes, debentures and related interest, as if converted	3,818	9,743

XOMA Ltd.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2004	December 31, 2003
Accrued collaboration arrangement	\$ 5,006	\$ —
Accrued payroll costs	3,957	4,290
Accrued co-development, net	2,495	—
Accrued legal fees	895	1,035
Accrued clinical trial costs	206	451
Other	649	387
Total	\$ 13,208	\$ 6,163

2. COLLABORATIVE AGREEMENTS

On February 27, 2004, the Company entered into an exclusive multi-product collaboration agreement with Chiron Corporation (“Chiron”) for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will share costs and profits on a 70-30 basis, with XOMA’s share being 30%. XOMA was entitled to initial payments totaling \$10 million, which were received in March and June of 2004. This initial payment of \$10 million is being recognized ratably over sixty months, the expected term of the agreement, as license and collaborative fees.

Additionally, a loan facility of up to \$50 million to fund up to 75% of XOMA’s share of development expenses to be incurred beginning in 2005 will be available to XOMA. Chiron’s profit share, if and when such profit is achieved, is subject to a limited upward adjustment, which, in turn, may be reduced if certain benchmarks are achieved including if Chiron elects to extend the program from three years to five years.

On February 24, 2004, the Company amended certain terms of the investment agreement with Millennium Pharmaceuticals, Inc. (“Millennium”). The key elements of the revised investment agreement included an extension of the maturity date of the \$5.0 million outstanding convertible debt to April 15, 2004 (or the third business day after effectiveness of the related registration statement, if later), and a rescheduling of the Company’s decision points regarding whether to sell the remaining \$14.7 million worth of common shares to four option dates through March of 2005, at each of which the Company may issue up to \$3,675,000 worth of common shares. On April 15, 2004, the \$5.0 million of convertible debt to Millennium was paid in full in cash. On July 27, 2004, the Company exercised its option to sell 0.9 million shares of common stock to Millennium for \$3.7 million. On October 12, 2004, the companies announced a further change in their agreements whereby Millennium assumed responsibility for all subsequent development work and expenses for MLN2222 at initiation of Phase II testing. The Company will continue to provide quantities of bulk drug substance requested by Millennium at the expense of Millennium for Phase II trials. The Company will be entitled to receive an undisclosed royalty on future net sales of MLN2222, as well as payments related to the achievement of clinical and regulatory milestones. The investment agreement between Millennium and XOMA is terminated and there will be no further issuance of the Company common shares to Millennium.

In the third quarter of 2004, the Company entered into a collaboration with Aphton Corporation (“Aphton”) for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. Under the terms of the agreement, the companies will share costs and profits on a 70-30 basis, with XOMA’s share being 30%. XOMA will have worldwide manufacturing rights for these products and the ability to share up to 30% in the commercialization efforts in the U.S. in accordance with the terms of the agreement. Aphton will share commercialization rights in the U.S. and will have exclusive rights to commercialize all products outside the U.S.

In November of 2004, XOMA and Alexion Pharmaceuticals, Inc. determined that the lead molecule in their TPO mimetic collaboration did not meet the criteria established in the program for continued development. The companies are evaluating next steps for the collaboration, including a potential alternative TPO mimetic compound for development.

3. LEGAL PROCEEDINGS

In July of 2003, a complaint was filed in the General Court of Justice, Superior Court Division, Orange County, North Carolina, in a lawsuit captioned Hamlet v. Genentech, Inc., et al., No. 03 CVS 1161, and was subsequently amended, by participants in one of the Phase III clinical trials of RAPTIVA[®]. The complaint asserts claims for alleged negligence, breach of fiduciary duty, fraud, misrepresentation and medial negligence against the plaintiff’s treating physician, the physician’s medical practice, Genentech, XOMA, the institutional review board responsible for the trial and the contract research organization retained to conduct the trial. The complaint seeks unspecified compensatory damages alleged to be in excess of \$10,000. As set forth in the complaint, the plaintiff was initially in the placebo group of this trial; he did not receive RAPTIVA[®] during this time, and his claims are based on his failure to receive his indicated treatment, not his receipt of RAPTIVA[®]. At a recent hearing, XOMA was successful in having all claims that allege or depend on XOMA being a health care provider dismissed, and the Court dismissed the fiduciary duty and constructive fraud claims as well. Four of the defendants, including XOMA, have reached agreement with the plaintiff on a settlement, but a formal settlement agreement and release have not yet been executed.

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

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements and the related disclosures, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts in our consolidated financial statements and accompanying notes. On an on-going basis, we evaluate our estimates, including those related to terms of research collaborations, investments, stock compensation, impairment issues, and the estimated useful life of assets and contingencies. 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.

Results of Operations

Revenues for the three months ended September 30, 2004, were \$0.6 million compared with \$12.6 million for the three months ended September 30, 2003, a 96% decrease. Revenues for the nine months ended September 30, 2004, were \$1.5 million compared with \$18.2 million for the nine months ended September 30, 2003, a 92% decrease. License and collaborative fees revenue was \$0.5 million and \$1.4 million for the three and nine months ended September 30, 2004, compared with \$12.1 million and \$14.1 million for the same periods of 2003. The prior year amounts reflected a \$10.0 million termination fee from Baxter Healthcare Corporation (“Baxter”) as a result of the termination of agreements between the companies related to the licensing and development of our NEUPREX[®] product, as well as license fees from several bacterial cell expression technology license arrangements. Contract and other revenue was \$29,000 and \$65,000 for the three and nine months ended September 30, 2004, compared with \$0.6 million and \$4.0 million for the same periods of 2003, reflecting the impact on contract revenues of the termination of agreements with Baxter and Onyx Pharmaceuticals, Inc. (“Onyx”). The Baxter agreement was terminated during the third quarter of 2003, and the Onyx agreement was effectively terminated in the fourth quarter of 2003. Baxter and Onyx represented 81% and 9%, respectively, of our total revenues for the three months ended September 30, 2003, and 64% and 19%, respectively, of our total revenues for the nine months ended September 30, 2003.

Research and development expenses for the three and nine months ended September 30, 2004, were \$12.6 million and \$38.4 million, respectively, compared with \$16.6 million and \$44.1 million for the same periods of 2003, or decreases of 24% and 13%, respectively. These decreases reflect reduced spending on RAPTIVA[®], MLN2201 (formerly known as MLN01), MLN2222, ING-1 and NEUPREX[®] partially offset by higher development costs associated with development of our XMP.629 compound that was being developed for acne, our collaboration with Chiron Corporation (“Chiron”), our collaboration with Alexion Pharmaceuticals, Inc. (“Alexion”) on a TPO mimetic antibody and new product research. On August 16, 2004, we announced the results of a Phase II trial with XMP.629 gel. The results were inconclusive in terms of clinical benefit of XMP.629 compared with vehicle gel, and pending a more complete analysis, we do not intend to initiate additional clinical trials with XMP.629. In October of 2004, we and Millennium Pharmaceuticals, Inc. (“Millennium”) amended our agreements whereby Millennium assumed responsibility for all subsequent development work and expenses for MLN2222 at the initiation of Phase II testing. We continue to explore new collaborative opportunities that may affect future research and development expense.

Our research and development activities can be divided into earlier stage programs, which include molecular biology, process development, pilot-scale production and preclinical testing, and later stage programs, which include clinical testing, regulatory affairs, and manufacturing clinical supplies. The cost associated with these programs approximate the following (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Earlier stage programs	\$ 8,306	\$ 11,996	\$ 23,307	\$ 29,753
Later stage programs	4,256	4,626	15,132	14,355
Total	\$ 12,562	\$ 16,622	\$ 38,439	\$ 44,108

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

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	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Internal projects	\$ 7,659	\$ 7,354	\$ 23,765	\$ 18,630
Collaborative arrangements	4,903	9,268	14,674	25,478
Total	\$ 12,562	\$ 16,622	\$ 38,439	\$ 44,108

For the three and nine months ended September 30, 2004, one (XMP.629) and two (MLN2222 and XMP.629) development programs, respectively, each individually accounted for more than 10% but less than 20% and no development program accounted for more than 20% of our total research and development expenses. For the three and nine months ended September 30, 2003, one development program (MLN2222) accounted for more than 10% but less than 20%, one development program (RAPTIVA®) accounted for more than 20% but less than 30% and no development program accounted for more than 30% of our total research and development expenses.

General and administrative expenses for the three and nine months ended September 30, 2004, were \$4.0 million and \$11.5 million, respectively, an increase of 11% and 16% from \$3.6 million and \$9.9 million for the three and nine months ended September 30, 2003, respectively. These increases reflected higher business development expenses and costs associated with implementing procedures and staffing necessary to meet the requirements of the Sarbanes-Oxley Act of 2002.

In October of 2003, the U.S. Food and Drug Administration ("FDA") approved RAPTIVA® (efalizumab) for marketing. Beginning in 2004, we are reporting our RAPTIVA® collaboration profit or loss as a single line item to reflect the terms of our agreement with Genentech, Inc. ("Genentech"), which will include our share of Genentech's operating profit or loss from RAPTIVA® sales in the United States, royalty income on sales of RAPTIVA® outside of the United States and any research and development cost sharing adjustments. If quarterly collaboration activity results in a profit, our portion will be included in total revenues; if the quarterly collaboration activity results in a loss, our portion will be included in operating expenses. We currently anticipate that because of product launch costs, collaboration activity with respect to RAPTIVA® will not be profitable in 2004. Research and development costs incurred directly by us related to RAPTIVA® will continue to be included in research and development expense.

Collaboration arrangement expense, which relates exclusively to RAPTIVA® (see Note 1), was \$3.9 million and \$12.3 million for the three and nine months ended September 30, 2004, respectively, compared with expenses of \$2.0 million and \$2.2 million for the three and nine months ended September 30, 2003. The current year amounts reflect our 25% share of commercialization costs for RAPTIVA® in excess of Genentech's revenues less cost of goods sold. The 2003 amounts reflect a research and development cost sharing adjustment in our favor in excess of our share of pre-launch marketing expenses.

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Net collaboration profit (loss) before R&D expense	\$(3,404)	\$(2,663)	\$(11,851)	\$(4,937)
R&D co-development benefit (charge)	(504)	689	(486)	2,692
Royalties from international sales	51	—	51	—
Total collaboration arrangement benefit (expense)	\$(3,857)	\$(1,974)	\$(12,286)	\$(2,245)

Investment and interest income for the three and nine months ended September 30, 2004, was \$0.2 million and \$0.5 million, respectively, compared with \$0.1 million and \$0.3 million for the same periods of 2003. The increase resulted principally from increased interest income due to increased average cash balances. Interest expense for the three and nine months ended September 30, 2004, was \$0.3 million and \$0.9 million, respectively, compared with \$0.4 million and \$1.4 million for the same period of 2003. These decreases reflected lower interest rates and partial repayment of notes due to Genentech and Millennium. Other income (expense) for both the three and nine months ended September 30, 2004, was \$(0.1) million compared with \$0.1 million and \$0.3 million for the same periods of 2003. The 2004 expense reflected a loss on the write-off of fixed assets. The 2003 income amounts resulted from gains on sales of investments.

Liquidity and Capital Resources

Cash, cash equivalents and short-term investments at September 30, 2004, was \$36.4 million compared with \$85.2 million at December 31, 2003. This decrease primarily reflects cash used in operations of \$33.1 million, a \$13.2 million payment on our short-term loan obligation to Genentech and a \$5.0 million payment of our convertible debt to Millennium.

Net cash used in operating activities was \$33.1 million for the nine months ended September 30, 2004, compared with \$36.3 million for the nine months ended September 30, 2003. When compared with 2003, the decrease in 2004 reflected a higher net loss that was offset by the \$10.0 million received in January of 2004 from Baxter related to the termination of agreements, and the \$8.8 million in deferred revenue remaining from the \$10.0 million received from Chiron, in 2004, related to the initiation of an exclusive collaboration agreement in oncology in February of 2004.

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Net cash used in investing activities was \$2.5 million for the nine months ended September 30, 2004, compared with \$0.8 million for the nine months ended September 30, 2003. The increase in the first nine months of 2004 when compared with the first nine months of 2003 was primarily due to an increase of \$0.2 million in purchases of fixed assets in 2004 compared with 2003 and restrictions on \$1.5 million of cash being released in 2003. Capital spending is expected to continue at a similar level for the remainder of 2004.

Net cash used in financing activities was \$13.3 million for the nine months ended September 30, 2004, compared with cash provided by financing activities of \$81.0 million for the nine months ended September 30, 2003. Financing activities in the first nine months of 2004 consisted principally of a \$13.2 million payment to retire our short-term loan obligation to Genentech, a \$5.0 million payment of our convertible debt to Millennium, \$0.4 million for principal payments on capital lease obligations and \$0.2 million for principal payments on a short-term loan partially offset by \$1.4 million in proceeds from the sale of common shares through share option exercises and the employee share purchase plan, \$0.5 million proceeds from a short-term note and \$3.7 million in proceeds from 0.9 million common shares sold under our investment agreement with Millennium. Financing activities in the first nine months of 2003 consisted principally of a \$10.8 million net funding from Genentech under our development agreement, \$67.2 million in net proceeds from common shares sold under a public offering, \$4.0 million in proceeds from common shares sold under our investment agreement with Millennium and \$0.2 million from proceeds of common shares primarily related to employee share purchase and option incentive programs. This was partially offset by principal payments of \$0.8 million to retire a short-term loan obligation and \$0.5 million for principal payments on capital lease obligations.

In the first quarter of 2004, we announced the amendment of certain terms of the investment agreement with Millennium. The key elements of the revised investment agreement included an extension of the maturity date of the \$5.0 million outstanding convertible debt to April 15, 2004 (or the third business day after effectiveness of the related registration statement, if later), and a rescheduling of our decision points regarding whether to sell the remaining \$14.7 million worth of common shares to four option dates through March of 2005, at each of which we may issue up to \$3,675,000 worth of common shares. On April 15, 2004, the \$5.0 million of convertible debt to Millennium was paid in full in cash. On July 27, 2004, we exercised our option and issued 920,284 common shares for proceeds of \$3,675,000. On October 12, 2004, we announced an amendment of the development agreement whereby Millennium assumed responsibility for all subsequent development work and expenses for MLN2222 at initiation of Phase II testing. We will continue to provide quantities of bulk drug substance requested by Millennium at the expense of Millennium for Phase II trials. We will be entitled to receive an undisclosed royalty on future net sales of MLN2222, as well as payments related to the achievement of clinical and regulatory milestones. The investment agreement between the companies is terminated and there will be no further issuance of our common shares to Millennium.

In the first quarter of 2004, we entered into an exclusive multi-product collaboration agreement with Chiron for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will share costs and profits on a 70-30 basis, with our share being 30%. We were entitled to initial payments totaling \$10 million, which we received in March and June of 2004. These payments will be recognized ratably over sixty months, the expected term of the agreement. Additionally, Chiron is obligated to provide a loan facility of up to \$50 million to fund up to 75% of our share of development expenses to be incurred beginning in 2005. Chiron's profit share, if and when such profit is achieved, is subject to a limited upward adjustment, which in turn, may be reduced if certain benchmarks are achieved or if Chiron elects to extend the program from three years to five years.

In the third quarter of 2004, we entered into a collaboration with Aphton Corporation ("Aphton") for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. Under the terms of the agreement, the companies will share costs and profits on a 70-30 basis, with our share being 30%. We will have worldwide manufacturing rights for these products and the ability to share up to 30% in the commercialization efforts in the U.S. in accordance with the terms of the agreement. Aphton will share commercialization rights in the U.S. and will have exclusive rights to commercialize all products outside the U.S.

Our cash, cash equivalents and short-term investments are expected to decrease through 2004 with the use of cash to fund ongoing operations.

The present outlook is for higher losses in 2004 than recorded in 2003, primarily due to decreased license and contract revenues and costs related to the launch of RAPTIVA[®]. Our strategy is to continue broadening our product pipeline utilizing our existing capacity, through internal development and additional collaborations such as our arrangements with Genentech, Millennium, Alexion, Chiron and Aphton.

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Based on current spending levels, anticipated revenues, partner funding and remaining net proceeds from our last underwritten public offering, we estimate that we have sufficient cash resources to meet our anticipated net cash consumption levels through approximately the end of 2005. We currently plan to access additional sources of funding that we believe to be available to us, including capital market financing, to meet our anticipated net cash consumption levels longer term. Any significant revenue shortfalls or increases in planned spending on development programs could shorten this period. Additional licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. For a further discussion of the risks related to our business and their effects on our cash flow and ability to raise new funding on acceptable terms, see "Forward Looking Information and Cautionary Factors That May Affect Future Results" included in this Item 2 below.

Although operations are influenced by general economic conditions, we do not believe that inflation had a material impact on financial results for the periods presented. We believe that we are not dependent on materials or other resources that would be significantly impacted by inflation or changing economic conditions in the foreseeable future.

Critical Accounting Policies

Critical accounting policies are those that require significant judgment and/or estimates by management at the time that the financial statements are prepared such that materially different results might have been reported if other assumptions had been made. We consider certain accounting policies related to revenue recognition and recognition of research and development expenses to be critical policies. We believe there have been no significant changes to our critical accounting policies since we filed our 2003 Annual Report on Form 10-K with the Securities and Exchange Commission on March 15, 2004. For a description of our critical accounting policies, please refer to our 2003 Annual Report on Form 10-K.

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

Certain statements contained herein related to the relative size of our loss for 2004, the relative levels of our expenses and revenues for the balance of 2004, the sufficiency of our cash resources, the marketing and sales effort in support of RAPTIVA[®], as well as other statements related to current plans for product development and existing and potential collaborative and licensing relationships, 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, the actual loss for 2004 could be higher depending on revenues from licensees and collaborators, the size and timing of expenditures, and whether there are unanticipated expenses; expenses could be higher and/or revenues could be lower depending on research and development costs, availability of licensing opportunities and other factors; the sufficiency of cash resources could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated or if funds are not available on acceptable terms; and the marketing and sales effort for RAPTIVA[®] may not be successful due to the strength of competition or if physicians do not adopt the product as treatment for their patients. These and other risks, including those related to the results of pre-clinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; competition; market demand for products; scale-up 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 the remainder of this section.

The Marketing And Sales Effort In Support Of Our Only Product To Receive Regulatory Approval Has Only Recently Begun And May Not Be Successful.

RAPTIVA[®], our only product to receive regulatory approval, was approved by the FDA on October 27, 2003, for the treatment of chronic moderate-to-severe plaque psoriasis in adults who are candidates for systemic therapy or phototherapy. Genentech is responsible for the marketing and sales effort in support of this product and has only commenced the full intended scope of this effort within the past nine months. In September of 2004, Serono, S.A. ("Serono"), Genentech's international marketing partner for RAPTIVA[®], announced that RAPTIVA[®] had received approval for use in the European Union ("EU") and that the product is being launched in several EU countries in the fourth quarter of 2004. We currently have no active role in this marketing and sales effort. We currently anticipate that because of product launch costs, collaboration activity with respect to RAPTIVA[®] will not be profitable in 2004, and we expect no material revenues for the fourth quarter of 2004 from our 25% share of U.S. operating profits or other royalties related to RAPTIVA[®]. Successful commercialization of this product is subject to a number of risks, including Genentech's and Serono's ability to implement its marketing and sales effort and achieve sales; the strength of competition from other products being marketed or developed to treat psoriasis; physicians' and patients' acceptance of RAPTIVA[®] as a treatment for psoriasis; Genentech's ability to provide manufacturing capacity to meet demand for the product; and pricing and reimbursement issues. Many of these risks are discussed in more detail below.

Because All Of Our Products Are Still Being Developed, We Will Require Substantial Funds To Continue; We Cannot Be Certain That Funds Will Be Available And, If Not Available, We May Have To Take Actions Which Could Adversely Affect Your Investment.

If adequate funds are not available, we may have to 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 products and production technologies,
- expansion of our production capabilities,
- various human clinical trials,
- protection of our intellectual property, and
- sales and marketing costs for RAPTIVA[®].

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Based on current spending levels, anticipated revenues, partner funding and remaining net proceeds received from our last underwritten public offering, we estimate that we have sufficient cash resources to meet our anticipated net cash consumption levels through approximately the end of 2005. We currently plan to access additional sources of funding that we believe to be available to us, including capital market financing, to meet our anticipated net cash consumption levels longer term. Any significant revenue shortfalls or increases in planned spending on development programs could shorten this period. Additional licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. 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 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, if at all.

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

Specifically, although the October of 2003 FDA approval of RAPTIVA® would generally be expected to improve operating cash flow to the extent of our share of operating profits from Genentech's sales of RAPTIVA® in the U.S., such approval also requires repayment in cash, shares or deferred repayment of up to \$40.0 million of amounts owed to Genentech. In November of 2003, we announced our election to defer \$40.0 million of such repayment and to repay the remainder of the development loan using shares. The commercialization loan was payable only in cash and approximately \$3.0 million was paid in January of 2004 and the remaining balance of \$10.2 million was paid in May of 2004. In addition, the receipt of regulatory approval terminated Genentech's obligation to continue to loan us our portion of development and commercialization expenses for RAPTIVA®.

Most Of Our Therapeutic Products Have Not Received Regulatory Approval. If These Products Do Not Receive Regulatory Approval, Neither Our Third Party Collaborators Nor We Will Be Able To Manufacture And Market Them.

Our products cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. Only one of our therapeutic products has received regulatory approval. The United States government and governments of other countries extensively regulate many aspects of our products, 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 products will be regulated by the FDA as biologics. The review of therapeutic biologic products has been transferred within the FDA from the Center for Biologics Evaluation and Research to the Center for Drug Evaluation and Research, the body that reviews drug products. Because implementation of this plan may not be complete, we do not know when or how this change will affect us. 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, which may have a material impact on the FDA product approval process.

Our potential products 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,

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- 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,
- our future results will justify further development, or
- we will ultimately achieve regulatory approval for any of these products.

For example,

- in 1996, we and Genentech began testing RAPTIVA[®] in patients with moderate-to-severe plaque psoriasis. In April of 2002, we and Genentech announced that a pharmacokinetic study conducted on RAPTIVA[®] comparing XOMA-produced material and Genentech-produced material did not achieve the pre-defined statistical definition of comparability, and the FDA requested that another Phase III study be completed before the filing of a Biologics License Application for RAPTIVA[®], delaying the filing of a Biologics Licensing Application with the FDA for RAPTIVA[®] beyond the previously-planned time frame of the summer of 2002. In March of 2003, we announced completion of enrollment in a Phase II study of RAPTIVA[®] in patients suffering from rheumatoid arthritis. In May of 2003, we and Genentech announced our decision to terminate Phase II testing of RAPTIVA[®] in patients suffering from rheumatoid arthritis based on an evaluation by an independent Data Safety Monitoring Board that suggested no overall net clinical benefit in patients receiving the study drug. We also completed enrollment in a Phase II study of RAPTIVA[®] as a possible treatment for patients with psoriatic arthritis. In March of 2004, we announced that the study did not reach statistical significance.
- in December of 1992, we began human testing of our NEUPREX[®] product, a genetically engineered fragment of a particular human protein, and licensed certain worldwide rights to Baxter in January of 2000. In April of 2000, members of the FDA and representatives of XOMA and Baxter discussed results from the Phase III trial that tested NEUPREX[®] in pediatric patients with a potentially deadly bacterial infection called meningococemia, and senior representatives of the FDA indicated that the data presented were not sufficient to support the filing of an application for marketing approval at that time.
- in 2003, we completed two Phase I trials of XMP.629, a BPI-derived topical peptide compound targeting acne, evaluating the safety, skin irritation and pharmacokinetics. In January of 2004, we announced the initiation of Phase II clinical testing in patients with mild-to-moderate acne. In August of 2004, we announced the results of a Phase II trial with XMP.629 gel. The results were inconclusive in terms of clinical benefit of XMP.629 compared with vehicle gel.
- in November of 2004, in conjunction with Alexion, we determined that the lead molecule in our TPO mimetic collaboration did not meet the criteria established in the program for continued development. The companies are evaluating next steps for the collaboration, including a potential alternative TPO mimetic compound for development.

Given that regulatory review is an interactive and continuous process, we maintain 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.

Because All Of Our Products 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, 2004, we had an accumulated deficit of \$660.9 million.

For the nine months ended September 30, 2004, we had a net loss of approximately \$61.4 million, or \$0.73 per common share (basic and diluted). For the year ended December 31, 2003, we had a net loss of approximately \$58.7 million, or \$0.78 per share (basic and diluted). We expect to incur additional losses in the future, primarily due to increased sales and marketing expenses related to RAPTIVA[®], the Millennium collaboration, the Aphton collaboration and new product research including our oncology product collaboration with Chiron.

Our ability to achieve profitability is dependent in large part on obtaining regulatory approval for our products and entering into agreements for product development and commercialization, both 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 all of our products are still being developed, we do not know whether we will ever achieve profitability or whether cash flow from future operations will be sufficient to meet our needs.

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If Third Party Collaborators Do Not Successfully Develop And Market Our Products, We May Not Be Able To Do So On Our Own.

Our financial resources and our marketing experience and expertise are limited. Consequently, we depend, to a large extent, upon securing the financial resources and marketing capabilities of third parties with whom we collaborate.

- In April of 1996, we and Genentech entered into an agreement whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA[®]. In April of 1999, the companies amended the agreement. In March of 2003, the companies further 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.
- In November of 2001, we entered into a collaboration with Millennium to develop two of Millennium's products for certain vascular inflammation indications. In October of 2003, we announced that we had discontinued one of these products, MLN2201. In December of 2003, we announced the initiation of Phase I testing on the other product, MLN2222.
- In December of 2003, we and Alexion agreed to collaborate for the development and commercialization of an antibody to treat chemotherapy-induced thrombocytopenia. The TPO mimetic antibody was designed to mimic the activity of human thrombopoietin, a naturally occurring protein responsible for platelet production.
- In March of 2004, we and Chiron announced we had agreed to collaborate for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will jointly research, develop, and commercialize multiple antibody product candidates. In July of 2004, we announced the first product candidate out of the collaboration, anti-CD40.
- In September of 2004, we entered into a collaboration with Apton Corporation for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies.

Because our collaborators are independent third parties, they may be subject to different risks than we are and have significant discretion in determining the efforts and resources they will apply. We do not know whether Genentech, Millennium, Alexion, Chiron or Apton will successfully develop and market any of the products that are or may become the subject of one of our collaborations. In particular, each of these collaborations provides for sharing of collaboration expenses, which means that not only we but our collaborators must have sufficient available funds for the collaborations to continue. In addition, our collaboration with Chiron provides for funding by it in the form of periodic loans, and we cannot be certain that Chiron will have the necessary funds available when these loans are to be made.

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

- In January of 2000, we licensed the worldwide rights to all pharmaceutical compositions containing a particular human protein for treatment of meningococemia and additional potential future human clinical indications to Baxter. In July of 2003, this arrangement was terminated, and the rights returned to XOMA. Although we are evaluating future options for developing this product, we do not know whether any options we may pursue will succeed.
- In January of 2001, we entered into a strategic process development and manufacturing alliance with Onyx to scale-up production to commercial volume of one of Onyx's cancer products. In June of 2003, Onyx notified XOMA that it was discontinuing development of the product and terminating the agreement so that it could focus on another of its anticancer compounds.

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.

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.

Primarily as a result of our bacterial cell expression licensing program, we have access to numerous phage display technologies licensed to us by other parties. However, we have had access to these technologies for only a short time and, to varying degrees, are still dependent on the licensing parties for training and other aspects of 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. We cannot be certain that these restrictions or the rights of others will not impede our ability to utilize these technologies.

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Because We Have No History Of Profitability And Because The Biotechnology Sector Has Been Characterized By Highly Volatile Stock Prices, Announcements We Make And General Market Conditions For Biotechnology Stocks Could Result In A Sudden Change In The Value Of Our Common Shares.

As a biopharmaceutical company, we have experienced significant volatility in our common shares. 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. From November 5, 2003 through November 5, 2004, our share price has ranged from a high of \$7.71 to a low of \$1.94. On November 5, 2004, the last reported sale price of the common shares as reported on the Nasdaq National Market was \$1.99 per share. Factors contributing to such volatility include, but are not limited to:

- sales and estimated or forecasted sales of products,
- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of our products,
- 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,
- announcements of technological innovations or new indications for our therapeutic products,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares 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.

We Or Our Third Party Collaborators May Not Be Able To Increase Existing Or Acquire New Manufacturing Capacity Sufficient To Meet Market Demand.

Genentech is responsible for manufacturing or arranging for the manufacturing of commercial quantities of RAPTIVA[®]. Should Genentech have difficulty in providing manufacturing capacity to produce RAPTIVA[®] in sufficient quantities, we do not know whether we will be able to meet market demand. If any of our other products 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 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.

Although We Have Received Approval For Our Only Approved Product, We Do Not And Cannot Currently Market Any Of Our Other Products For Commercial Sale And We Do Not Know Whether There Will Be A Viable Market For Our Products.

Even though we and Genentech received FDA approval in October of 2003 to market RAPTIVA[®] and even if we receive regulatory approval for our other products, our products may not be accepted in the marketplace. 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 RAPTIVA[®] if they believe other products to be more effective or are more comfortable prescribing other products. Consequently, we do not know if physicians or patients will adopt or use our products for their approved indications.

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Other Companies May Render Some Or All Of Our Products Noncompetitive Or Obsolete.

Developments by others may render our products 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, 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.

Without limiting the foregoing, we are aware that:

- In April of 2004, Amgen Inc. ("Amgen") announced that its rheumatoid arthritis and psoriatic arthritis drug, Enbrel[®], has been approved by the FDA for the same psoriasis indication as RAPTIVA[®] and in September of 2004 it was announced that the product received approval in the European Union in this same indication.
- Biogen Idec Inc. has been marketing in the U.S. since 2003 their product Amevive[®] to treat the same psoriasis indication as RAPTIVA[®] and has recently received approval in Canada;
- Centocor, Inc., a unit of Johnson & Johnson, has announced that it has tested its rheumatoid arthritis and Crohn's disease drug, Remicade[®], in psoriasis showing clinical benefits and that the European Commission has granted approval of Remicade[®], in combination with methotrexate, to treat psoriatic arthritis, in the European Union;
- Abbott Laboratories has presented data from a Phase II psoriasis trial showing clinical benefits of its rheumatoid arthritis drug Humira[™];
- other companies are developing monoclonal antibody or other products for treatment of inflammatory skin disorders.

It is possible that one or more other companies may be developing one or more products based on the same human protein as our NEUPREX[®] product, and these product(s) may prove to be more effective than NEUPREX[®].

Amgen is developing AMG 531, a recombinant protein, for the treatment of immune thrombocytopenic purpura. This condition is related to thrombocytopenia, the indication that is the subject of our collaboration with Alexion. AMG 531 has completed Phase I and II studies.

There are at least two competitors developing a complement inhibitor which may compete with MLN2222. Alexion and its partner Proctor & Gamble have initiated enrollment in a second Phase III trial of pexelizumab, a monoclonal antibody. This study is expected to enroll approximately 4,000 patients undergoing coronary artery bypass graft surgery. TP10 is a complement inhibitor developed by AVANT Immunotherapeutics, Inc. ("Avant") for applications including the limitation of complement-mediated damage following surgery on cardiopulmonary by-pass. Avant anticipates completing enrollment in the Phase IIb study in 200-300 women undergoing cardiac bypass surgery by the end of 2004. Avant is also working closely with partner, Lonza Biologics plc, to complete process development and scale-up efforts in 2004 in preparation for the production of Phase III clinical materials and the start of that trial by year-end 2005.

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Currently, there are at least two companies developing topical peptide treatments for acne which may compete with XMP.629. Micrologix Biotech, Inc. is developing MBI 594AN, a topical peptide that has completed a Phase IIB trial for the treatment of acne, and Helix Biomedix, Inc. is developing several peptide compounds.

In collaboration with Chiron, we are co-developing the monoclonal Ab target CD40, and, at the current time, there are several CD40 related programs under development, mostly focused on the development of CD40 ligand products. For example, SGN-40 is a humanized monoclonal antibody under development by Seattle Genetics, Inc. which is targeting CD40 antigen. Phase I clinical trials of SGN-40 were initiated in March of 2004 in patients with multiple myeloma. Another example is 5d12, an antiCD40 antibody under development by Tanox, Inc. for Crohn's disease. Chiron licensed the antibody to Tanox, Inc. in 1995 and retains some commercialization and technology rights.

Even If We Or Our Third Party Collaborators 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 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 health care 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.

If Our And Our Partners' Patent Protection For Our Principal Products And Processes Is Not Enforceable, We May Not Realize Our Profit Potential.

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our partners hold and are in the process of applying for a number of patents in the United States and abroad to protect our products 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 patent position of biotechnology companies generally is highly uncertain and involves complex legal and factual questions, and no consistent policy regarding the breadth of allowed claims has emerged from the actions of the U.S. Patent and Trademark Office with respect to biotechnology patents. Legal considerations surrounding the validity of biotechnology patents continue to be in transition, and historical legal standards surrounding questions of validity may not continue to be applied, and current defenses as to issued biotechnology patents may not in fact be considered substantial in the future. These factors have contributed to uncertainty as to:

- the degree and range of protection any patents will afford against competitors with similar technologies,
- if and when patents will issue,
- whether or not others will obtain patents claiming aspects similar to those covered by our patent applications, or
- the extent to which we will be successful in avoiding infringement of any patents granted to others.

The Patent Office has issued approximately 74 patents to us related to our products based on human bactericidal permeability-increasing protein, which we call BPI, including novel compositions, their manufacture, formulation, assay and use. In addition, we are the exclusive licensee of BPI-related patents and applications owned by New York University and Incyte Pharmaceuticals, Inc. The Patent Office has also issued nine patents to us related to our bacterial expression technology.

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

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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 not be honored 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.

Protecting Our 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, if the litigation included a claim of infringement by us of another party's patent that was 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.

The Financial Terms Of Some Of Our Existing Or Future Collaborative Arrangements Could Result In Dilution Of Our Share Value.

In November of 2003, we announced that we exercised our option to defer payment of \$40.0 million of our convertible loan from Genentech related to the development of RAPTIVA® and pay the remaining balance of approximately \$29.6 million under the development loan with preference shares before year-end 2003. These preference shares were issued in December of 2003 and are convertible into an aggregate of 3,818,395 common shares at a conversion price of approximately \$7.75 per share, the price determined under the loan agreements at the time we notified Genentech of our election. This arrangement, as well as future arrangements we may enter into with similar effect, could result in dilution in the value of our shares.

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.

The same factors that affect us directly because we are a biotechnology company 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 or 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 expression technology, we have in the past and may in the future agree to accept equity securities of the licensee in payment of license fees. The future value of these or any other shares we receive is subject both to market risks affecting our ability to realize the value of these shares and more generally to the business and other risks to which the issuer of these shares may be subject.

As We Do More Business Internationally, We Will Be Subject To Additional Political, Economic And Regulatory Uncertainties.

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

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Because We Are A Relatively Small Biopharmaceutical Company With Limited Resources, We May Not Be Able To Attract And Retain Qualified Personnel, And The Loss Of Key Personnel Could Delay Or Prevent Achieving Our Objectives.

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. There is intense competition for such personnel. Our research, product development and business efforts could be adversely affected by the loss of one or more of key members of our scientific or management staff, particularly our executive officers: John L. Castello, our Chairman of the Board, President and Chief Executive Officer; Patrick J. Scannon, M.D., Ph.D., our Senior Vice President and Chief Scientific and Medical Officer; Peter B. Davis, our Vice President, Finance and Chief Financial Officer; and Christopher J. Margolin, our Vice President, General Counsel and Secretary. We have employment agreements with Mr. Castello, Dr. Scannon and Mr. Davis. We currently have no key person insurance on any of our employees. Clarence L. Dellio, XOMA's Senior Vice President and Chief Operating Officer, has announced his retirement, to be effective as of December 31, 2004. It is anticipated that Mr. Dellio will begin functioning on a reduced schedule starting in mid-November.

We Are Exposed To An Increased Risk Of Product Liability Claims.

The sale, testing and marketing of medical products entails an inherent risk of allegations of product liability. We believe that we currently have adequate levels of insurance for our clinical trials, however, in the event of one or more large, unforeseen awards, such levels may not provide adequate coverage. We will seek to obtain additional insurance, if needed, as commercialization of RAPTIVA[®] continues; however, because we have not yet determined whether additional insurance is needed, we do not know whether adequate insurance coverage will be available or be available at acceptable costs. 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.

We May Be Subject To Increased Risks Because We Are A Bermuda Company.

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

- “blacklisting” of our common shares by certain pension funds;
- legislation restricting certain types of transactions; and
- punitive tax legislation.

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

If You Were To Obtain A Judgment Against Us, It May Be Difficult To Enforce Against Us Because We Are A Foreign Entity.

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

Our Shareholder Rights Agreement Or Bye-laws 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 XOMA in a transaction that our board of directors opposes.

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Our bye-laws:

- 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;
- 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; and
- contain provisions, similar to those contained in the Delaware General Corporation Law that may make business combinations with interested shareholders more difficult.

These provisions of our shareholders rights agreement and our bye-laws, 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, could limit the ability of shareholders to approve transactions that they may deem to be in their best interests, and could make it considerably more difficult for a potential acquirer to replace management.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio. We do not invest in derivative financial instruments. By policy, we make our investments in high quality debt securities, limit the amount of credit exposure to any one issuer, limit duration by restricting the term of the instrument, and hold investments to maturity except under rare circumstances

We also have a long-term interest bearing obligation to Genentech. Interest on this obligation of six-month LIBOR plus 1% is reset at the end of June and December each year and, therefore, is variable.

The table below presents the amounts and related weighted interest rates of our cash equivalents at September 30, 2004:

	<u>Maturity</u>	<u>Fair Value (in thousands)</u>	<u>Average Interest Rate</u>
Overnight Funds	Daily	\$ 35,930	1.86%

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chairman of the Board, President and Chief Executive Officer and our Vice President, Finance and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-14(c) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on this evaluation, our Chairman of the Board, President and Chief Executive Officer and our Vice President, Finance and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to XOMA and its consolidated subsidiaries required to be included in our periodic SEC filings.

In April of 2003, we implemented a new financial reporting system which represents a significant change in our internal controls. During our evaluation of internal controls conducted for the second quarter of 2003, special procedures were performed regarding the system conversion and implementation. We concluded that the system conversion and implementation was properly controlled to ensure accurate financial reporting. We are further enhancing internal financial controls and staffing consistent with the requirements of the Sarbanes-Oxley Act of 2002. Apart from this, there were no changes in our internal controls over financial reporting during the first nine months of 2004 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial accounting.

In the period ended September 30, 2004, we completed a fixed asset inventory in which we identified and wrote-off old, obsolete and missing fixed assets with an original cost of \$9.0 million and a net book value of \$0.1 million.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In July of 2003, a complaint was filed in the General Court of Justice, Superior Court Division, Orange County, North Carolina, in a lawsuit captioned Hamlet v. Genentech, Inc., et al., No. 03 CVS 1161, and was subsequently amended, by a participant in one of the Phase III clinical trials of RAPTIVA[®]. The complaint asserts claims for alleged negligence, breach of fiduciary duty, fraud, misrepresentation and medical negligence against the plaintiff's treating physician, the physician's medical practice, Genentech, XOMA, the institutional review board responsible for the trial and the contract research organization retained to conduct the trial. The complaint seeks unspecified compensatory damages alleged to be in excess of \$10,000. As set forth in the complaint, the plaintiff was initially in the placebo group of this trial; he did not receive RAPTIVA[®] during this time, and his claims are based on his failure to receive his indicated treatment, not his receipt of RAPTIVA[®]. At a recent hearing, XOMA was successful in having all claims that allege or depend on XOMA being a health care provider dismissed, and the Court dismissed the fiduciary duty and constructive fraud claims as well. Four of the defendants, including XOMA, have reached agreement with the plaintiff on a settlement, but a formal settlement agreement and release have not yet been executed.

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

On September 24, 2003, the Company completed a registered offering of 9,000,000 common shares. On October 21, 2003, the underwriters exercised their over-allotment option and purchased an additional 1,350,000 common shares. The common shares sold in the offering were registered under the Securities Act of 1933, as amended, on a Registration Statement on Form S-3 (Reg. No. 333-107929) that was declared effective by the SEC on September 8, 2003.

The Company is using the net proceeds from its September 2003 registered offering of common shares for general corporate purposes, including current research and development projects, the development of new products or technologies, general working capital and operating expenses, leasehold improvements and equipment acquisitions. Pending application of the net proceeds as described above, the Company has invested the remaining net proceeds of the offering in short-term, investment-grade, interest-bearing securities.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

(a) Exhibits:

- 31.1 Certification of John L. Castello, Principal Executive Officer, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Peter D. Davis, Principal Financial Officer, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of John L. Castello, Chief Executive Officer, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Peter D. Davis, Chief Financial Officer, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.1 Press Release dated November 9, 2004, furnished herewith.

XOMA Ltd.
SIGNATURES

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

XOMA Ltd.

Date: November 9, 2004

By: /s/ JOHN L. CASTELLO

John L. Castello
Chairman of the Board, President and
Chief Executive Officer

Date: November 9, 2004

By: /s/ PETER D. DAVIS

Peter D. Davis
Vice President, Finance and
Chief Financial Officer

Certification
Pursuant to Section 302 Of The Sarbanes-Oxley Act Of 2002
(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))

I, John L. Castello, certify that:

1. I have reviewed this quarterly report on Form 10-Q of XOMA Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/ John L. Castello

John L. Castello
Chairman of the Board, President and Chief Executive Officer

Certification
Pursuant to Section 302 Of The Sarbanes-Oxley Act Of 2002
(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))

I, Peter B. Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of XOMA Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/ Peter B. Davis

Peter B. Davis
Vice President, Finance and Chief Financial Officer

Certification
Pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002
(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2004, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company at the end of and for the periods covered by such Report.

Date: November 9, 2004

/s/ John L. Castello

John L. Castello
Chairman of the Board, President and Chief Executive Officer

This certification will not be deemed filed for purposes of Section 18 of the Exchange Act (15 U.S.C. 78), or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

Certification
Pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002
(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2004, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company at the end of and for the periods covered by such Report.

Date: November 9, 2004

/s/ Peter B. Davis

Peter B. Davis
Vice President, Finance and Chief Financial Officer

This certification will not be deemed filed for purposes of Section 18 of the Exchange Act (15 U.S.C. 78), or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

News Release



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Investor Relations
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Media Relations
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XOMA Reports Third Quarter 2004 Financial Results

RAPTIVA® approved in more than 30 countries, including European Union

Berkeley, CA – November 9, 2004 – XOMA Ltd. (NASDAQ: XOMA), a biopharmaceutical development company, announced results for the quarter ended September 30, 2004.

For the third quarter of 2004, the Company recorded a net loss of \$20.1 million or \$0.24 per share, compared with \$9.9 million or \$0.13 per share for the third quarter of 2003. As of September 30, 2004, XOMA held \$36.4 million in cash, cash equivalents, and short-term investments, compared with \$85.2 million at December 31, 2003. Short-term notes payable were \$0.3 million at September 30, 2004, compared with \$18.6 million at December 31, 2003.

Recent accomplishments include:

- Serono, AG (virt-x: SEO and NYSE: SRA) received European Commission Marketing Authorisation for RAPTIVA®, bringing the total number of countries in which RAPTIVA® is approved to more than 30.
- Serono has launched RAPTIVA® in Germany, UK, Denmark, Sweden, Switzerland, Australia, Argentina, Brazil and Mexico. Year-to-date RAPTIVA® sales in the United States by Genentech were \$36.0 million through the third quarter.
- Triton Biosystems, Inc. has licensed XOMA's ING-1 antibody for cancer to use as a targeting molecule with its Targeted Nano-Therapeutic[®] (TNT™) System.
- XOMA re-structured its arrangement with Millennium Pharmaceuticals, Inc. (NASDAQ: MLNM) on MLN2222 to limit XOMA's participation in development through Phase I clinical testing, with Millennium assuming responsibility and development costs from then on. XOMA will continue to manufacture product at Millennium's request and cost and XOMA will be entitled to potential milestones based on the clinical and regulatory progress of the product and a royalty on sales.
- Apton Corporation (NASDAQ: APHT) has signed a collaboration agreement with XOMA to develop treatments for gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies.

"The recent EU marketing approval for RAPTIVA® brings a global presence in over 30 countries with sales growing in the United States and launches being implemented in different regions," said John L. Castello, president, chairman and chief executive officer of XOMA. "Our oncology strategy is bearing fruit in the form of our active partnership with Chiron and our new antibody collaboration with Apton, as well as licensing our ING-1 product to Triton. These agreements provide promising new sources of product candidates to add to our development pipeline."

"Serono's RAPTIVA® marketing approvals in the European Union can be an important step in putting RAPTIVA® on a profitable footing for us," said Peter B. Davis, XOMA's vice president of finance and chief financial officer. "We're also putting a heavy emphasis on our business development efforts, not only to strengthen our pipeline, but to improve our profitability by utilizing our existing capabilities."

- More -

Revenues

Total revenues for the third quarter of 2004 were \$0.6 million compared with \$12.6 million in the third quarter of 2003. Year-to-date revenues of \$1.5 million decreased from \$18.2 million for the prior year period. The 2003 revenues included license fees from several bacterial cell expression technology license arrangements, as well as revenue derived from agreements with Baxter Healthcare Corporation and Onyx Pharmaceuticals, Inc. that have subsequently been terminated. The Baxter termination fee of \$10 million dollars was also included in 2003 third quarter revenues.

In relation to the collaboration agreement between XOMA and Chiron for oncology antibody therapeutics, the Company is recognizing the \$10 million upfront payment that it received as revenue over 60 months beginning with March of 2004.

Expenses

Research and development expenses for the quarter ended September 30, 2004, decreased to \$12.6 million from \$16.6 million for the same period in 2003. Spending increases on XOMA's XMP.629 topical acne compound, the Chiron collaboration, new product research and the TPO mimetic antibody program were more than offset by reduced spending on the MLN2222 complement inhibitor product, RAPTIVA®, NEUPREX® and ING-1, as well as on the MLN2201 program, which was discontinued in 2003.

General and administrative expenses for the three months ended September 30, 2004, increased to \$4.0 million from \$3.6 million for the three months ended September 30, 2003. The increase was due to a number of factors, notably increasing business development activities and strengthening of internal financial systems and controls.

Collaboration arrangement expenses of \$3.9 million in the quarter ended September 30, 2004, represent profit and cost sharing amounts from Genentech related to RAPTIV®. This compared with \$2.0 million in the three months ended September 30, 2003. The 2004 figure reflects sales and marketing costs for RAPTIVA® in excess of gross profit. The 2003 amount reflects an R&D cost sharing adjustment in XOMA's favor which was more than offset by XOMA's share of pre-launch marketing expenses for RAPTIVA®.

Liquidity and Capital Resources

Net cash used in operating activities was \$33.1 million for the first nine months of 2004 compared with \$36.3 million for the nine months ended September 30, 2003. The lower cash usage in 2004 compared with 2003 reflected a higher net loss, which was more than offset by \$10 million received from Baxter related to NEUPREX® and \$10 million received from Chiron related to the initiation of an exclusive collaboration for the development of antibody products in oncology.

Based on current spending levels, anticipated revenues and partner funding, XOMA estimates that it has sufficient cash resources to meet its anticipated net cash consumption levels through approximately the end of 2005. The company currently plans to access additional sources of funding that it believes to be available, including capital market financing, to meet its anticipated net cash consumption levels longer term. Any significant revenue shortfalls or increases in planned spending on development programs could shorten this period. Additional licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. Progress or setbacks by potentially competing products may also affect XOMA's ability to secure new funding on acceptable terms.

-More-

News Release

2004 Financial Outlook

XOMA expects to record higher losses in 2004 than in 2003, primarily due to costs related to the RAPTIVA® sales launch and the termination of two revenue-generating agreements in the second half of 2003. The Company's strategy is to continue broadening its pipeline through both internal development programs and additional collaborations beyond its existing partnerships with Alexion Pharmaceuticals, Inc., Aphton, Chiron, Genentech, and Millennium.

Product Highlights

Commercial Product: RAPTIVA® (Efalizumab)

RAPTIVA® is the first FDA-approved biologic therapy designed to provide continuous control of chronic moderate-to-severe plaque psoriasis in adults age 18 or older who are candidates for systemic therapy or phototherapy. Patients can self-administer the drug as a single, once-weekly subcutaneous injection after training by a healthcare professional.

RAPTIVA® was developed in the U.S. through a partnership between Genentech and XOMA and received FDA approval in October of 2003. U.S. sales of RAPTIVA® through the third quarter of 2004 were \$36.0 million.

RAPTIVA® is licensed outside of the United States and Japan through an agreement made with Serono in August of 2002. Serono announced in September that it has received European Commission Marketing Authorisation for RAPTIVA® to treat people with moderate-to-severe chronic plaque psoriasis for whom other systemic treatments or phototherapy have been inadequate or inappropriate. RAPTIVA® is also approved in Switzerland and Australia, as well as Argentina, Mexico and Brazil. Serono has launched RAPTIVA® in Germany, UK, Denmark, Sweden, Switzerland, Australia, Argentina, Brazil and Mexico.

XOMA and Genentech are continuing long-term clinical testing of RAPTIVA® in psoriasis patients, and additional indications are in pilot clinical studies.

XMP.629 for acne

Results from a Phase II randomized, double-blind, placebo-controlled dose-ranging efficacy and safety study in 240 mild-to-moderate acne patients undergoing 12 weeks of daily topical administration of XMP.629 were inconclusive for efficacy with an unexpectedly high response rate in the placebo group. The drug appeared safe and well-tolerated in this study. Previous data from several Phase I studies in healthy volunteers and acne patients, suggested that the topical application of XMP.629 is safe, non-irritating, and well tolerated.

The XMP.629 peptide, derived from human bactericidal/permeability-increasing protein (BPI), targets bacteria associated with inflammatory lesions in acne patients, including those resistant to current antibiotic treatments. Several preclinical studies showed the XMP.629 peptide to be a potent agent against *Propionibacterium acnes* and related skin microorganisms associated with acne, as well as demonstrating favorable topical properties.

XOMA has announced that pending a more complete analysis it does not plan to initiate additional clinical trials with XMP.629.

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Oncology Therapeutic Antibodies Program

In March of 2004, Chiron and XOMA announced an exclusive, worldwide, multi-product collaboration to develop and commercialize antibody products for the treatment of cancer. Under this agreement, the companies will jointly research, develop, and commercialize multiple antibody product candidates. The companies share expenses and revenues, generally on a 70-30 basis, with XOMA's share being 30 percent. Financial terms include initial payments to XOMA totaling \$10 million and a loan facility of up to \$50 million to fund up to 75 percent of XOMA's share of expenses beginning in 2005.

In July, Chiron acquired Sagres Discovery, a privately held discovery-stage company based in Davis, California, that specializes in the discovery and validation of oncology targets. Chiron has access to all of Sagres' proprietary oncology technology. Further review of these targets could identify additional antibody target candidates for the XOMA collaboration.

Also in July, XOMA announced that the first product candidate under this collaboration is an anti-CD40 antibody targeting B-cell malignancies. The companies intend to file an IND before year-end 2004 and to begin clinical testing in early 2005.

ING-1 Licensed to Triton

In October, 2004, Triton BioSystems and XOMA announced that Triton has in-licensed the exclusive worldwide rights to commercially use XOMA's proprietary anti-tumor ING-1 monoclonal antibody with Triton's Targeted Nano-Therapeutics™ (TNT™) System. The TNT™ System ablates tumors by using tiny magnetic spheres delivered systemically with antibodies. The tiny spheres within the tumors are induced to heat by a localized externally applied magnetic field. ING-1, a Human Engineered™ monoclonal antibody with high affinity to the Ep-CAM antigen, is expressed in high concentrations on many adenocarcinoma tumor cells. The combination of the ING-1 antibody with the TNT™ System is intended to create a novel, highly selective, safe, and effective treatment for adenocarcinomas, such as breast, colorectal, lung, ovary and prostate.

TPO Mimetic Collaboration with Alexion

In November 2004, XOMA and Alexion determined that the lead molecule in their TPO mimetic collaboration did not meet the criteria established in the program for continued development. The companies are evaluating next steps for the collaboration, including a potential alternative TPO mimetic compound for development.

Anti-Gastrin Antibody Collaboration with Aphton

In September 2004, Aphton Corporation and XOMA announced a worldwide collaboration to develop treatments for gastrointestinal (GI) and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. Under the terms of the agreement, Aphton and XOMA will share all development expenses and all commercialization profits and losses for all product candidates on a 70/30 basis, respectively. XOMA will have worldwide manufacturing rights for these products and the ability to share up to 30% in the commercialization efforts in the United States. Aphton will share U.S. commercialization rights and will have exclusive rights to commercialize all products outside the United States. Antibodies to be developed under the collaboration will bind and neutralize the hormones gastrin 17 and gly-gastrin 17 (a gastrin precursor) that are known to be involved in tumor progression in GI cancers. Gastrin expression and the appearance of gastrin receptors have been associated with increasing malignant characteristics of GI tumors and with poorer prognostic outcomes. Specifically, gastrin is known to be involved in the progression of colorectal, stomach, liver and pancreatic cancers and inhibiting gastrin may inhibit such growth.

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News Release

Investor Conference Call

XOMA has scheduled an investor conference call regarding this announcement to be held tomorrow, November 10, 2004, beginning at 4:00 PM EST (1:00 P.M. PST). Investors are invited to listen to the conference call by phone or via XOMA's website, <http://www.xoma.com/>. The U.S./Canada dial-in number for the live call is 1-877-869-7222 and the conference ID number is 9090048. The international dial-in number is 1-706-679-5933 and uses the same conference I.D. number. To listen to the call via the Internet, go to XOMA's website a few minutes before the start of the call to register, download, and install any necessary audio software.

An audio replay of the call will be available beginning two hours after the conclusion of the webcast through 6:00 p.m. EST (3:00 p.m. PST) on November 24, 2004. Replay access numbers are 1-800-642-1687 (U.S./Canada) or 1-706-645-9291 (International); Conference I.D. 9090048.

About XOMA

XOMA is focused on the development and commercialization of antibody and other protein-based biopharmaceuticals for disease targets that include cancer, immunological and inflammatory disorders, and infectious diseases. XOMA's proprietary and collaborative product development programs include: RAPTIVA® for moderate to severe plaque psoriasis (marketed) and other indications in collaboration with Genentech, Inc.; MLN 2222, a recombinant protein for reducing the incidence of post-operative events in coronary artery bypass graft surgery patients with Millennium Pharmaceuticals, Inc. (Phase I); CHIR-12.12, an anti-CD40 antibody for treating B-cell tumors and additional product candidates in connection with an antibody oncology collaboration with Chiron Corporation (preclinical); a TPO mimetic antibody to treat chemotherapy-induced thrombocytopenia in collaboration with Alexion Pharmaceuticals, Inc. (preclinical); and anti-gastrin antibody product candidates in conjunction with the antibody collaboration for the treatment of gastrointestinal cancers with Aption Corporation (preclinical). XOMA's proprietary bactericidal/permeability-increasing protein (BPI)-derived programs include NEUPREX®, in a Phase I/II study to limit complications following pediatric cardiopulmonary bypass surgery. For more information about XOMA's product pipeline and antibody product development capabilities and technologies, please visit XOMA's website at <http://www.xoma.com/>.

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News Release

Certain statements contained herein related to the relative size of the Company's loss for 2004, the sufficiency of its cash resources and the marketing and sales efforts for RAPTIVA[®], as well as other statements related to the progress and timing of product development, present or future licensing, collaborative or financing arrangements 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, the actual loss for 2004 could be higher depending on revenues from licensees and collaborators, the size and timing of expenditures and whether there are unanticipated expenditures; the sufficiency of cash resources will be shortened if capital market financing is not available on acceptable terms during this period and could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated or if other funds are not available on acceptable terms; and the marketing and sales efforts for RAPTIVA[®] may not be successful if Genentech fails to meet its commercialization goals, due to the strength of the competition, if physicians do not adopt the product as treatment for their patients or if European Union or other important regulatory approvals are not obtained. These and other risks, including those related to the results of pre-clinical testing, the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data), changes in the status of the existing collaborative relationships, availability of additional licensing or collaboration opportunities, the ability of collaborators and other partners to meet their obligations, market demand for products, scale up and marketing capabilities, competition, international operations, share price volatility, XOMA's financing needs and opportunities, uncertainties regarding the status of biotechnology patents, uncertainties as to the cost of protecting intellectual property and risks associated with XOMA's status as a Bermuda company, are described in more detail in the Company's most recent annual report on Form 10-K and in other SEC filings.

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Condensed Consolidated Financial Statements Follow

XOMA Ltd.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2004	December 31, 2003
	(unaudited)	(note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 35,930	\$ 84,812
Short-term investments	468	436
Receivables	370	10,625
Related party receivables	125	94
Prepaid expenses and other	1,335	1,267
	<u>38,228</u>	<u>97,234</u>
Property and equipment, net	20,475	21,337
Related party receivables – long-term	76	120
Deposits and other	159	159
	<u>58,938</u>	<u>118,850</u>
Total assets	\$ 58,938	\$ 118,850
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,789	\$ 5,058
Accrued liabilities	13,208	6,163
Notes payable	286	13,343
Capital lease obligations	279	520
Deferred revenue	2,000	90
Convertible note	—	5,284
	<u>18,562</u>	<u>30,458</u>
Capital lease obligations – long-term	74	272
Deferred revenue – long-term	6,833	—
Interest bearing obligation – long-term	40,641	39,906
	<u>66,110</u>	<u>70,636</u>
Total liabilities	66,110	70,636
Shareholders' equity:		
Preference shares, \$.05 par value, 1,000,000 shares authorized Series A, 135,000 designated, no shares issued and outstanding	—	—
Series B, 8,000 designated, 2,959 and 2,959 shares issued and outstanding, respectively. Aggregate liquidation preference of \$29.6 million.	1	1
Common shares, \$.0005 par value, 135,000,000 shares authorized, 85,565,765 and 83,998,697 shares outstanding, respectively	43	42
Additional paid-in capital	653,470	647,534
Accumulated comprehensive income	197	166
Accumulated deficit	(660,883)	(599,529)
	<u>(7,172)</u>	<u>48,214</u>
Total shareholders' equity	(7,172)	48,214
Total liabilities and shareholders' equity	\$ 58,938	\$ 118,850

note 1: Amounts derived from the Company's audited financial statements appearing in the Annual Report on Form 10-K for the year ended December 31, 2003, as filed with the Securities and Exchange Commission.

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

	Three months ended September 30,		Nine months ended September 30,	
	2004	2003	2004	2003
Revenues:				
License and collaborative fees	\$ 530	\$12,050	\$ 1,442	\$ 14,125
Contract and other revenue	29	582	65	4,032
Total revenues	559	12,632	1,507	18,157
Operating costs and expenses:				
Research and development	12,562	16,622	38,439	44,108
General and administrative	4,015	3,603	11,538	9,933
Collaboration arrangement	3,857	1,974	12,286	2,245
Total operating costs and expenses	20,434	22,199	62,263	56,286
Loss from operations	(19,875)	(9,567)	(60,756)	(38,129)
Other income (expense):				
Investment and interest income	158	75	452	260
Interest expense	(307)	(449)	(925)	(1,424)
Other income (expense)	(119)	91	(125)	289
Net loss	\$(20,143)	\$(9,850)	\$(61,354)	\$(39,004)
Basic and diluted net loss per common share	\$ (0.24)	\$ (0.13)	\$ (0.73)	\$ (0.54)
Shares used in computing basic and diluted net loss per common share	85,284	73,224	84,619	72,371