

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-14710

**XOMA Ltd.**

(Exact name of registrant as specified in its charter)

**Bermuda**  
(State or other jurisdiction  
of incorporation or organization)

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

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

**(510) 204-7200**  
(Telephone Number)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Shares, U.S. \$.0005 par value  
Preference Share Purchase Rights

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act of 1934). Yes  No

The aggregate market value of voting shares held by non-affiliates of the registrant is \$398,802,388 as of June 29, 2007.

Number of Common Shares outstanding as of March 7, 2008: 132,253,954

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Company's Proxy Statement for the Company's 2008 Annual General Meeting of Shareholders are incorporated by reference into Part III of this Report.

[Table of Contents](#)

XOMA Ltd.  
2007 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS

**[PART I](#)**

|          |   |    |
|----------|---|----|
| Item 1.  | <a href="#">Business</a>  | 1  |
| Item 1A. | <a href="#">Risk Factors</a>  | 18 |
| Item 1B. | <a href="#">Unresolved Staff Comments</a>                           | 36 |
| Item 2.  | <a href="#">Properties</a>  | 36 |
| Item 3.  | <a href="#">Legal Proceedings</a>                                   | 36 |
| Item 4.  | <a href="#">Submission of Matters to a Vote of Security Holders</a> | 37 |

**[PART II](#)**

|          |  |    |
|----------|--|----|
| Item 5.  | <a href="#">Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities</a> | 38 |
| Item 6.  | <a href="#">Selected Financial Data</a>  | 40 |
| Item 7.  | <a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>                        | 42 |
| Item 7A. | <a href="#">Quantitative and Qualitative Disclosures about Market Risk</a>   | 56 |
| Item 8.  | <a href="#">Financial Statements and Supplementary Data</a>  | 57 |
| Item 9.  | <a href="#">Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</a>                         | 57 |
| Item 9A. | <a href="#">Controls and Procedures</a>  | 57 |
| Item 9B. | <a href="#">Other Information</a>  | 59 |

**[PART III](#)**

|          |  |    |
|----------|--|----|
| Item 10. | <a href="#">Directors, Executive Officers, and Corporate Governance</a>  | 60 |
| Item 11. | <a href="#">Executive Compensation</a>   | 60 |
| Item 12. | <a href="#">Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters</a> | 60 |
| Item 13. | <a href="#">Certain Relationships and Related Transactions, and Director Independence</a>                      | 60 |
| Item 14. | <a href="#">Principal Accounting Fees and Services</a>   | 60 |

**[PART IV](#)**

|          |   |    |
|----------|---|----|
| Item 15. | <a href="#">Exhibits, Financial Statement Schedules</a> | 61 |
|----------|---|----|

|                            |    |
|----------------------------|----|
| <a href="#">SIGNATURES</a> | 62 |
|----------------------------|----|

|   |     |
|---|-----|
| <a href="#">INDEX TO FINANCIAL STATEMENTS</a> | F-1 |
|---|-----|

|                                   |   |
|-----------------------------------|---|
| <a href="#">INDEX TO EXHIBITS</a> | i |
|-----------------------------------|---|

**PART I**

**Item 1. Business**

**Overview**

XOMA Ltd. (“XOMA” or the “Company”), a Bermuda company, is a leading biopharmaceutical company focused on the discovery, development and manufacture of therapeutic antibodies. XOMA uses its expertise, technologies and capabilities to build a product pipeline that includes multiple proprietary and collaborative development programs. The Company’s lead product candidate is XOMA 052, a high affinity anti-IL-1 beta antibody with the potential to treat multiple inflammatory diseases of large unmet need. XOMA 052 is currently in Phase 1 clinical studies of Type 2 diabetes patients.

XOMA has multiple revenue streams and generates revenues from product royalties, technology licenses, development collaborations and biodefense contracts. The Company receives royalties on two approved products, RAPTIVA<sup>®</sup>, which is marketed globally for the treatment of moderate-to-severe plaque psoriasis, and LUCENTIS<sup>®</sup>, which is marketed globally for the treatment of neovascular (wet) age-related macular degeneration. XOMA has established on-going technology licensing programs for certain of its proprietary technologies, which have attracted numerous significant licensees including Pfizer, Inc. (“Pfizer”). The Company’s development collaborations include arrangements with Novartis AG (“Novartis”), Schering Plough Research Institute (“SPRI”) and Takeda Pharmaceutical Company Limited (“Takeda”). XOMA’s biodefense initiatives currently include a contract with the National Institute of Allergy and Infectious Diseases (“NIAID”) to develop three anti-botulinum neurotoxin monoclonal antibodies.

The Company has a premier antibody discovery and development platform that incorporates leading antibody phage display libraries and XOMA’s proprietary bacterial cell expression (“BCE”), Human Engineering<sup>™</sup>, and mammalian cell expression (“MCE”) technologies. BCE is an enabling technology for the discovery and manufacture of antibodies and other proteins. As a result, more than 50 pharmaceutical and biotechnology companies have signed BCE licenses.

***Strategy***

We are advancing a pipeline of biotherapeutic products using our proven expertise, technologies and capabilities from antibody discovery through product development. We expand our pipeline by developing proprietary products and technologies, collaborating with pharmaceutical and biotechnology companies and providing contract services to government agencies responsible for biodefense. We fund a portion of our development activities through multiple revenue streams, including product royalties, technology licenses, collaborations and biodefense contracts. We believe the global demand for therapeutic antibodies and related products will continue to grow and that as it does, the revenues we receive through royalties, licenses and product sales will increase. The principal elements of our strategy are to:

- *Focus on advancing our near-term proprietary pipeline.* Using our internal capabilities and technology platform, we discovered XOMA 052, a highly potent antibody that targets the pro-inflammatory cytokine, IL-1 beta. In 2007 we began Phase 1 clinical studies of XOMA 052 in patients with Type 2 diabetes and, contingent on the outcome of these investigations we plan to initiate clinical studies of XOMA 052 in other indications in 2008, including gout, systemic juvenile idiopathic arthritis (“sJIA”), and rheumatoid arthritis. We believe XOMA 052 has the potential to treat multiple diseases of unmet medical need and that this potential increases the product’s likelihood of successful development. We plan to advance XOMA 629, a synthetic peptide compound derived from bactericidal/permeability-increasing protein (“BPI”), a human host-defense protein that is one of the body’s early lines of defense against invading microorganisms.
- *Focus on mid-term and longer-term opportunities to enhance our portfolio of proprietary products through internal discovery programs, licensing, acquisition, and in-kind product trades.* We intend to continue internal drug discovery efforts and advance multiple preclinical programs to generate new

---

## Table of Contents

product candidates that can expand our proprietary pipeline. We plan to continue to identify, evaluate and pursue the acquisition of complementary and strategically valuable products and technologies. We will also pursue non-cash, in-kind product trades as part of future antibody development collaborations and agreements for access to our antibody technologies.

- *Continue to pursue opportunities to discover, develop and manufacture therapeutic antibodies for biodefense* We have a successful history of providing contract services to the U.S. government for the development of anti-botulinum neurotoxin antibodies. We intend to pursue additional contracts with the U.S. government for the development of anti-botulinum neurotoxin antibody products, the development of antibodies against other biodefense threats, and the manufacture and stock-piling of antibodies for biodefense. In addition, we intend to leverage our experience and expertise in biodefense and pursue business opportunities with allied governments in Europe and Asia that have similar biodefense needs.
- *Expand our collaboration agreements for antibody discovery and development.* We believe we possess a comprehensive and highly advanced suite of technologies and capabilities in the discovery, optimization, development and production of antibody products. Major pharmaceutical and biotechnology companies collaborate with us for access to our technologies and capabilities. These collaborations provide us with rights in strategically valuable products and revenues including upfront payments, annual license fees, research and development manufacturing revenue, milestones and royalties on sales. We intend to expand our collaboration activity through existing and/or new collaboration agreements.
- *Increase licensing revenues from existing and future proprietary technologies.* We have a history of generating significant revenue from our proprietary technologies, including our BCE technology, which we have licensed to more than 50 companies in exchange for complementary technologies, licensing fees, royalties and other revenues. Our technology licensing activities generated \$36.5 million in revenue for the year ended December 31, 2007, including \$30.0 million in BCE license fees from our August 2007 contract with Pfizer. We also license our Human Engineering (“HE™”) technology, which allows modification of non-human monoclonal antibodies to reduce or eliminate detectable immunogenicity and make them suitable for medical purposes in humans. We believe that we can continue to generate significant revenues from BCE, HE™ and other proprietary technologies in the future.

## **Proprietary Products**

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

- **XOMA 052 (formerly XMA005.2)** is a Human Engineered™ monoclonal antibody with a high-affinity and high-potency inhibitory activity against its inflammatory target. This high potency means that it may allow us to evaluate less frequent dosing than most current therapeutics. We are currently conducting two Phase 1 clinical trials in type II diabetes patients, one in the U.S. and one in Europe. Based on positive results in the Phase 1 type II diabetes studies, we also plan to pursue the evaluation of XOMA 052 in the treatment of gout, rheumatoid arthritis, and sJIA.
- **XOMA 629 (a reformulation of XMP.629)** is a topical anti-bacterial formulation of a peptide derived from bactericidal/permeability-increasing protein (“BPI”), an integral part of the protective human immune system. XOMA is developing XOMA 629 as a possible treatment for superficial skin infections. The emergence of infections resistant to current antibiotics has encouraged our researchers to review the properties of the compound for its dermatological applications. Based on an internal evaluation of this program in 2007 the Company has chosen to focus its development efforts on the use of this product in superficial skin infections, including impetigo and the eradication of staphylococcus aureus, including methicillin-resistant staphylococcus aureus (“MRSA”).

---

## [Table of Contents](#)

- **Other Products:** We are pursuing additional opportunities to further broaden our pre-clinical product pipeline. These include product development collaborations with other pharmaceutical and biotechnology companies and evaluations of product in-licensing, in-kind product trades and acquisition opportunities. No assurance can be given regarding the timing or likelihood of future collaborative arrangements or product licensure.

### Partnership Products

XOMA partners with world-class organizations in research of new products. Below is a list of current products in research through collaborations.

- **HCD122 (formerly CHIR-12.12) with Novartis (formerly Chiron Corporation):** We have a 30% interest in HCD122, which is a fully human anti-CD40 antagonist antibody intended as a treatment for B-cell mediated diseases, including malignancies and autoimmune diseases. This antibody has a dual mechanism of action blocking a tumor cell growth and survival signal as well as recruiting immune effector cells to kill tumor cells. HCD122 is the first product candidate selected under the multi-product antibody development and commercialization agreement for the treatment of cancer announced by Chiron and us, initiated in March of 2004. The first Investigational New Drug (“IND”) application was submitted in December of 2004. In April of 2005, we announced the initiation of a Phase 1 study for patients with advanced chronic lymphocytic leukemia (“CLL”) and in October of 2005, we initiated a second Phase 1 study for patients with multiple myeloma (“MM”). Phase 1 trials of HCD122 in patients with relapsed and refractory MM and CLL are ongoing. We expect to expand clinical development with one or more additional indications in 2008. In addition, there are multiple undisclosed preclinical stage programs that we are investigating as a result of our collaboration with Novartis.
- **Therapeutic Antibodies with SPRI:** SPRI is part of the Schering Plough Corporation, a global pharmaceutical company which reported net sales of \$12.7 billion in 2007. During 2006, we signed a contract with SPRI for therapeutic monoclonal antibody discovery and development against multiple targets selected by them, and we are currently conducting multiple discovery programs through this partnership.
- **Therapeutic Antibodies with Takeda:** Takeda is a major Japanese pharmaceutical company which reported net sales of \$11.1 billion in 2007. During 2006, we signed a contract with Takeda for therapeutic monoclonal antibody discovery and development against multiple targets selected by them, and we are currently conducting multiple discovery programs through this partnership.
- **Metabolic Disease Target with Lexicon Pharmaceuticals, Inc. (“Lexicon”):** In June of 2005, we began a collaboration to jointly develop and commercialize multiple antibody drugs for metabolic disease targets discovered by Lexicon using their proprietary gene knock-out technology. The initial targets are secreted proteins involved in various metabolic functions. When knocked out, the target genes result in mouse strains that display unique and desirable physiological functions, suggesting an important role of the target in disease. Antibodies to these targets may be developed to treat a variety of metabolic diseases.

### Royalties and Technology Licenses

#### *Royalties*

XOMA earns royalties in the mid- and low-single digits on two marketed antibody products and may earn future royalties on a third product that has been accepted for regulatory approval. These products are listed below in order of their development status, beginning with the most advanced:

- **RAPTIVA® (Efalizumab) with Genentech:** Genentech is a major biotechnology company which reported revenues of \$11.7 billion for 2007. RAPTIVA® is a humanized therapeutic monoclonal

## Table of Contents

antibody developed to treat immune system disorders. RAPTIVA® is the first biologic therapy designed to provide long-term control of chronic moderate-to-severe plaque psoriasis and can be self-administered by patients as a single, once-weekly subcutaneous injection. On October 27, 2003, the Food and Drug Administration (“FDA”) approved RAPTIVA® for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy. Genentech has been marketing RAPTIVA® in the United States since November of 2003. In September of 2004, Merck Serono S.A. (“Merck Serono”, formerly Serono S.A.), Genentech’s international marketing partner for RAPTIVA®, announced that RAPTIVA® had received approval for use in the European Union. By the end of 2006, Merck Serono had launched RAPTIVA® in over fifty countries worldwide.

In 2006, Merck Serono announced the results of the 24-week Clinical Experience Acquired with RAPTIVA® (“CLEAR”) study to evaluate RAPTIVA® in moderate-to-severe psoriasis patients and refractory patients. The CLEAR study confirmed the efficacy and safety of RAPTIVA® during the initial 12-week treatment period and demonstrated a continued improvement in clinical response for patients following an extended treatment. RAPTIVA® was also found to be equally effective in the subgroup of patients refractory to at least two systemic therapies. In 2006, Merck Serono also initiated CLEAREST™ in Europe with a seven year trial, the first large-scale pharmaco-epidemiological study of RAPTIVA® in psoriasis in Europe. The primary objective of this prospective, seven year cohort study is to gather additional long-term safety data of RAPTIVA® in 7,000 adult patients with moderate-to-severe plaque psoriasis over approximately 18,000 patient years of clinical treatment. In February of 2007, Genentech announced results from a 12-week Phase 4 study of RAPTIVA® that showed statistically significant improvement in patients with chronic moderate-to-severe plaque psoriasis involving the hands and feet. The study was the first randomized, double blind, placebo-controlled trial to evaluate a biologic agent in the treatment of this uniquely challenged subpopulation of psoriasis patients.

In 2007, we earned royalties of \$10.6 million from sales of RAPTIVA®.

- **LUCENTIS® (ranibizumab injection) by Genentech:** LUCENTIS® is an antibody fragment against Vascular Endothelial Growth Factor for the treatment of neovascular (wet) age-related macular degeneration, which causes central vision loss in the elderly, brought on by deterioration of the macula. LUCENTIS® was approved by the FDA in June of 2006 and in the European Union, where it is distributed by Novartis in January of 2007. It is the first marketed therapeutic product manufactured under a license using our BCE technology.

In 2007, we earned royalties of \$6.1 million from sales of LUCENTIS®.

- **CIMZIA® (certolizumab pegol) by UCB:** CIMZIA® is an anti-TNF (Tumor Necrosis Factor) alpha antibody fragment and is marketed in Switzerland for Crohn’s disease. The FDA accepted the regulatory application of CIMZIA® for rheumatoid arthritis in the U.S. in February of 2008. UCB has stated that regulatory filing in Europe for rheumatoid arthritis is planned for the first half of 2008. CIMZIA® was also submitted for regulatory approval for Crohn’s disease in the U.S. and Europe. In September of 2007, UCB announced it received a negative opinion on the market authorization in the European Union in the treatment of Crohn’s disease. In December of 2007, UCB announced it submitted an appeal requesting a Committee for Medicinal Products for Human Use (“CHMP”) re-examination of the opinion and that a decision is expected during the first half of 2008. In addition, CIMZIA® is also in clinical trials for the treatment of psoriasis.

### **Technology Licenses**

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

- **Bacterial Cell Expression.** Bacterial cell expression is an enabling technology for the discovery and selection, as well as the development and manufacture, of recombinant protein pharmaceuticals,

## Table of Contents

including diagnostic and therapeutic antibodies for commercial purposes. Genetically engineered bacteria are used in the recombinant expression of target proteins for biopharmaceutical research and development. Reasons include the relative simplicity of gene expression in bacteria as well as many years of experience culturing such species as *E. coli* in laboratories and manufacturing facilities. In support of our own biopharmaceutical development efforts, XOMA scientists have developed efficient and cost-effective bacterial expression technologies for producing antibodies and other recombinant protein products.

We have granted over 50 licenses to biotechnology and pharmaceutical companies, including our August 2007 \$30.0 million license agreement with Pfizer, to use our patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. Bacterial antibody expression is also a key technology used in multiple systems for high-throughput screening of antibody domains. Expression of antibodies by phage display technology, for example, depends upon the expression and secretion of antibody domains from bacteria as properly folded, functional proteins.

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

|  |                                    |                                    |
|--|------------------------------------|------------------------------------|
| Affimed Therapeutics AG                                | Crucell Holland B.V.               | Novartis AG                        |
| Affitech AS  | Dompe, s.p.a.                      | Pfizer, Inc.                       |
| Alexion Pharmaceuticals, Inc.                          | Dyax Corp.                         | Schering-Plough Corporation        |
| Applied Molecular Evolution, Inc. (AME)                | E.I. duPont de Nemours and Company | Takeda Pharmaceutical Company Ltd. |
| Avecia Limited   | Eli Lilly and Company              | The Medical Research Council       |
| Aventis Pharma Deutschland GmbH (Hoechst)              | Genentech, Inc.                    | UCB S.A.                           |
| BioInvent International AB                             | Genzyme Corporation                | Unilever plc                       |
| Biosite Incorporated                                   | Invitrogen Corporation             | Verenium Corporation               |
| Cambridge Antibody Technology Limited<br>(AstraZeneca) | Merck & Co., Inc.                  | Wyeth Pharmaceuticals Division     |
| Centocor, Inc.   | MorphoSys AG                       | ZymoGenetics, Inc.                 |

These licenses are sometimes associated with broader agreements. For example, in October of 2006, we entered into a licensing and product development agreement with Affimed Therapeutics AG (“Affimed”). Under the terms of the agreement, Affimed received a license to use our BCE technology for research related to recombinant antibody products, with an option to acquire a BCE license for production and commercialization of antibodies, in particular their proprietary TandAb and Flexibody products. In addition, we will provide Affimed with cell line development and process development services specific to a TandAb therapeutic product candidate that they are currently developing. The agreement further provided for XOMA to receive a license under Affimed’s antibody library patents for antibody discovery purposes, as well as for the development and commercialization of antibodies. In addition, Affimed will build two customized patient-derived human antibody phage display libraries according to our specifications.

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

---

## Table of Contents

HE™ technology was used in development of our XOMA 052, which is currently in Phase 1 studies in humans, and certain other antibody products. In 2006, we entered into HE™ technology service agreements and humanized antibodies for AVEO Pharmaceuticals, Inc. (“AVEO”) and Attenuon, LLC (“Attenuon”). In January of 2008, we entered into an HE™ agreement with Functional Genetics, Inc. (“FGI”).

- **Antibody discovery libraries.** XOMA has installed six commercial human antibody phage display libraries for the discovery of therapeutic candidates. In addition, we are building proprietary custom human antibody phage display libraries for therapeutic antibody discovery that can be used in parallel with or as an alternative for the commercial libraries. We believe that access to multiple libraries offers a number of benefits to XOMA and its partners, because it enables screening several libraries simultaneously to increase the probability of technical and business success in finding rare and unique, functional antibodies directed to targets of interest.

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

### **Biodefense and Contract Manufacturing**

Our fully integrated infrastructure also allows us to offer technical development, product development and manufacturing services. In March of 2005, we were awarded an 18-month competitive bid contract worth approximately \$15.0 million from NIAID to develop three anti-botulinum neurotoxin monoclonal antibodies. In July of 2006, NIAID awarded XOMA an additional three year contract worth approximately \$16.3 million to further develop and produce these antibodies to support initial clinical development with an overall goal to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. We are pursuing additional biodefense opportunities in the U.S. and key international markets including the development of additional anti-botulinum neurotoxin monoclonal antibodies, other monoclonal antibody-based biodefense products, and the manufacture of antibodies to supply strategic national stockpiles.

In November of 2006, we were named as a subcontractor under a prime contract between SRI International and NIAID. Once the final terms are negotiated, we can manufacture a variety of monoclonal antibody therapeutic agents of importance to NIAID in the areas of biodefense and infectious diseases. We expect the final contract to run five years and total \$28.1 million. Successful negotiation of the subcontract would, if the full amount is funded, bring the total of our governmental contract awards to approximately \$60.0 million since March of 2005. We are continuing to seek other opportunities for government and biodefense contracts.

### **Products Available for Out-Licensing**

In an effort to focus our resources on our XOMA 052 program, we have identified the following products as available for out-licensing:

- **NEUPREX® (opebacan/rBPI<sub>21</sub>)** is an injectable formulation of opebacan, a modified recombinant fragment of human BPI. BPI is a human host-defense protein made by a type of white blood cell that is important in the body’s defenses against microbial infection. Opebacan shares BPI’s anti-infective properties and it is a potent neutralizer of endotoxin. More than 1,100 patients have been treated with NEUPREX® in clinical studies without any apparent safety concerns.

In January of 2007, in conjunction with Harvard Medical School, we initiated an open label, dose escalating Phase 1/2 clinical trial of NEUPREX® in adults and children undergoing allogeneic hematopoietic stem cell transplantation (“HSCT”) to evaluate safety, pharmacokinetics and markers of



---

## Table of Contents

biological activity. Earlier research indicates that endotoxemia can induce or worsen acute graft vs. host disease in these patients who are also susceptible to infectious complications due to the large doses of radiation or chemotherapy they receive prior to transplantation. During 2008, we plan to review the results from this ongoing trial including review of the potential use in acute radiation syndrome as part of the United States Government's biodefense efforts.

During 2007, we completed support for two investigator-initiated trials at University of Texas Southwestern in Dallas in pediatric patients with congenital heart abnormalities requiring open heart surgery at Children's Hospital and in patients with burn injuries at Parkland Burn Center. These Phase 1 trials evaluated opebacan's safety and its role in improving endotoxin-induced complications in these patient populations. We expect to review the results from these two small trials in 2008 and discuss them with potential licensees.

In September of 2006, the European Medicines Agency ("EMA") granted an orphan medicinal product designation to NEUPREX® in meningococcal sepsis, a potentially life-threatening bacterial infection predominantly affecting young children. We are completing the regulatory assessment for NEUPREX® under the EMA exceptional circumstances mechanism based on the currently available clinical data in meningococcal sepsis and will discuss this assessment with potential licensees.

- **ING-1** is a HE™ monoclonal antibody developed by us to specifically target tumor cells in adenocarcinoma patients. ING-1 antibodies bind with high affinity to the Ep-CAM antigen and recruit host immune cells to kill the cancer cell. We have completed three Phase 1 clinical studies of ING-1, testing both intravenous and subcutaneous formulations in patients with advanced or refractory adenocarcinomas.

In October of 2004, we entered into an agreement with Triton BioSystems, Inc. ("Triton") under which Triton has in-licensed the exclusive worldwide right to use the ING-1 monoclonal antibody with Triton's Targeted Nano-Therapeutics™ ("TNT™") System. The TNT™ System is an innovative product that ablates tumors by using tiny magnetic spheres delivered, to the tumor, systemically with antibodies and heated by means of a magnetic field directed to the tumor. 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. ING-1 remains available for licensing outside the field covered by the Triton license.

- **Anti-gastrin Monoclonal Antibody:** In September of 2004, we began a collaboration to develop antibody treatments for gastrointestinal and other gastrin-sensitive cancers where neutralizing gastrin may inhibit tumor growth. We have selected a lead therapeutic candidate with demonstrated high affinity and in vivo neutralization activity. Our collaboration partner filed for bankruptcy in May of 2006 and the collaboration was terminated.

## Table of Contents

The following table describes important information related to certain products on which we may earn royalties or that we are currently developing:

| <u>Program</u>                              | <u>Description</u>   | <u>Indication</u>   | <u>Status</u>  | <u>Collaborator/ Developer</u>                    |
|---|--|---|--|---|
| <b>XOMA 052</b>                             | HE™ antibody to IL-1β  | Type 2 diabetes, gout, rheumatoid arthritis, and systemic juvenile idiopathic arthritis | Phase 1 for T2D  | Proprietary                                       |
| <b>XOMA 629</b>                             | Topical formulation of BPI derived anti-microbial peptide                                | Impetigo and methicillin-resistant staphylococcus aureus                                | Preclinical  | Proprietary                                       |
| <b>HCD122</b>                               | Fully human antibody to CD40 with dual mechanism of action                               | B-cell cancers  | Phase 1 for CLL & MM   | Novartis, XOMA has 30% interest                   |
| <b>Anti-botulinum neurotoxin antibodies</b> | Therapeutic antibodies to botulinum neurotoxin Type A                                    | Botulism poisoning  | Preclinical  | Proprietary                                       |
| <b>Multiple Therapeutic Antibodies</b>      | Fully human monoclonal antibodies to undisclosed disease targets                         | Undisclosed   | Preclinical  | Novartis  |
| <b>Multiple Therapeutic Antibodies</b>      | Fully human monoclonal antibodies to undisclosed disease targets                         | Undisclosed   | Preclinical  | Schering Plough Research Institute (fully funded) |
| <b>Multiple Therapeutic Antibodies</b>      | Fully human monoclonal antibodies to undisclosed disease targets                         | Undisclosed   | Preclinical  | Takeda (fully funded)                             |
| <b>Multiple Therapeutic Antibodies</b>      | Fully human and HE™ monoclonal antibodies to novel undisclosed metabolic disease targets | Various metabolic diseases  | Preclinical  | Lexicon   |
| <b>RAPTIVA® (Efalizumab)</b>                | Humanized anti-CD11a monoclonal antibody   | Moderate-to-severe plaque psoriasis   | Marketed in U.S., Europe and elsewhere, XOMA earns royalties | Genentech   |
| <b>LUCENTIS®</b>                            | Humanized antibody fragment against Vascular Endothelial Growth Factor                   | Neovascular (wet) age-related macular degeneration                                      | Marketed in U.S. and Europe, XOMA earns royalties            | Genentech   |
| <b>CIMZIA®</b>                              | Anti-TNF alpha antibody fragment   | Crohn's disease and rheumatoid arthritis  | Various clinical phases                                      | UCB   |

## Table of Contents

The following table describes important information related to certain products that are available for licensing:

| <u>Program</u>                 | <u>Description</u>   | <u>Indication</u>                                      | <u>Status</u>           | <u>Collaborator/ Developer</u>  |
|--------------------------------|--|--|-------------------------|---|
| <b>NEUPREX®<br/>(Opebacan)</b> | IV formulation of rBPI <sub>21</sub> , a modified recombinant fragment of bactericidal/permeability-increasing protein | Multiple anti-infective and anti-endotoxin indications | Various clinical phases | Proprietary, available for outlicensing   |
| <b>ING-1</b>                   | HE™ antibody to Ep-CAM   | Adenocarcinomas  | Phase 1                 | Licensed to Triton for use with TNT® technology; otherwise available for outlicensing |
| <b>Gastrin</b>                 | Anti-Gastrin antibody  | Gastric cancers  | Preclinical             | Proprietary, available for outlicensing   |

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

### *Current Agreements*

#### *Genentech*

In April of 1996, we entered into a collaboration agreement with Genentech for the development of RAPTIVA®. In March of 2003, we entered into amended and expanded agreements related to all aspects of the collaboration, to reflect the then current understanding between the companies. The agreements called for us to share in the development costs and to receive a 25% share of future United States operating profits and losses and a royalty on sales outside the United States. The agreements also called for Genentech to finance our share of development costs up until first FDA marketing approval via a convertible subordinated loan, and our share of pre-launch marketing and sales costs via an additional commercial loan facility. Under the loan agreement, upon FDA approval of the product, which occurred on October 27, 2003, we elected to pay \$29.6 million of the development loan in convertible preference shares and to defer repayment of the remaining \$40.0 million as an offset against future proceeds from our 25% share of United States operating profits on the product. On December 22, 2003, we issued the preference shares to Genentech which are convertible into approximately 3.8 million common shares at a price of \$7.75 per common share. The \$13.4 million of outstanding principal and interest on the commercial loan was payable only in cash and was paid in January and May of 2004.

In January of 2005, we announced a restructuring of our arrangement with Genentech on RAPTIVA®. Under the restructured arrangement, effective January 1, 2005, we are entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA® in all indications. The previous cost and profit sharing arrangement for RAPTIVA® in the United States was discontinued, and Genentech will be responsible for all operating and development costs associated with the product. In addition, our obligation to pay the outstanding balance to Genentech of \$40.9 million under the development loan, including accrued interest, was extinguished.

In December of 1998, we licensed our BCE technology to Genentech, which utilized it in the development of LUCENTIS® for the treatment of neovascular (wet) age-related macular degeneration. LUCENTIS® was approved by the FDA in June of 2006 and in the European Union in January of 2007. We are entitled to receive an undisclosed royalty on worldwide sales of LUCENTIS®.

---

## **Table of Contents**

### ***Novartis***

In February of 2004, we entered into an exclusive, worldwide, multi-product collaboration with Novartis to develop and commercialize antibody products for the treatment of cancer. Under the terms of the agreement, the companies agreed to jointly research, develop, and commercialize multiple antibody product candidates. The companies share expenses and revenues, generally on a 70-30 basis, with our share being 30%. Novartis' profit share is subject to a limited upward adjustment, which, in turn, may be reduced if we achieve certain milestones. Financial terms include initial payments to us in 2004 totaling \$10.0 million and a loan facility, secured by our interest in the collaboration, of up to \$50.0 million to fund up to 75% of our share of expenses beginning in 2005. In the first quarter of 2007, Novartis' and our mutual obligations to conduct antibody discovery, development and commercialization work together on an exclusive basis in oncology expired, except with respect to existing collaboration projects which have reached the development stage.

### ***Schering Plough***

In May of 2006, we entered into a fully funded collaboration agreement with the SPRI division of Schering-Plough Corporation for therapeutic monoclonal antibody discovery and development. Under the agreement, SPRI will make upfront, annual maintenance and milestone payments to us, fund our research and development and manufacturing activities related to the agreement and pay royalties on sales of products resulting from the collaboration. During the collaboration, we will discover therapeutic antibodies against multiple targets selected by SPRI using multiple human antibody phage display libraries, may optimize antibodies through affinity maturation or other protein engineering, may use our proprietary HE<sup>TM</sup> technology to humanize antibody candidates generated by hybridoma techniques, perform pre-clinical studies to support regulatory filings, develop cell lines and production processes and produce antibodies for initial clinical trials. SPRI selected the first target at the inception of the agreement and, in December of 2006, exercised its right to initiate the additional discovery and development programs.

### ***Schering Plough/AVEO***

In April of 2006, we entered into an agreement with AVEO to utilize our HE<sup>TM</sup> technology to humanize AV-299 under which AVEO paid us an up-front license fee and development milestones. Under this agreement we created four HE<sup>TM</sup> versions of the original AV-299, all of which met design goals and from which AVEO selected one as its lead development candidate. In the future, AVEO will pay annual maintenance fees, additional development milestones and royalties.

In September of 2006, as a result of the successful humanization of AV-299, we entered into a second agreement with AVEO to manufacture and supply AV-299, AVEO's novel anti-HGF antibody, in support of early clinical trials. Under the agreement, we created AV-299 production cell lines and conducted process and assay development. We will also perform cGMP manufacturing activities in support of AVEO's IND filing and early clinical trials. AVEO retains all development and commercialization rights to AV-299.

In April of 2007, Schering Corporation, acting through its Schering-Plough Research Institute division, entered into a research, development and license agreement with AVEO concerning AV-299 and other anti-HGF molecules. In connection with the aforementioned license agreement, AVEO has assigned its entire right, title and interest in, to and under its manufacturing agreement with XOMA to SPRI.

### ***Takeda***

In November of 2006, we entered into a fully funded collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development. During the collaboration, we will discover and optimize therapeutic antibodies against multiple targets selected by Takeda. Under the agreement, Takeda will make upfront, annual maintenance and milestone payments to us, fund our research and development and

---

## **Table of Contents**

manufacturing activities for preclinical and early clinical studies and pay royalties on sales of products resulting from the collaboration. Takeda will be responsible for clinical trials and commercialization of drugs after an IND submission and is granted the right to manufacture once the product enters into Phase 2 clinical trials.

### ***Lexicon***

In June of 2005, we entered into a collaboration agreement with Lexicon to jointly develop and commercialize antibody drugs for certain targets discovered by Lexicon. The collaboration is designed to combine Lexicon's target discovery and biotherapeutics capabilities with our antibody generation, process development and manufacturing expertise to accelerate the development and commercialization of novel therapeutic antibodies.

During the three-year initial term, Lexicon will select for submission to the collaboration targets from among those discovered and analyzed in its Genome5000 program. In this program, Lexicon is using its gene knockout technology to discover the physiological functions of 5,000 potential drug targets. Our role is to generate or engineer antibodies that modulate the collaboration's targets using phage display libraries and our proprietary HE™ technology. The companies are sharing the responsibility and costs for research, preclinical, clinical and commercialization activities. Costs and profits are allocated 65% to Lexicon and 35% to us. We will have principal responsibility for manufacturing antibodies for use in clinical trials and commercial sales.

### ***Pfizer***

In August of 2007, XOMA entered into a license agreement with Pfizer, Inc. ("Pfizer") for non-exclusive, worldwide rights for XOMA's patented bacterial cell expression (BCE) technology for research (including phage display), development and manufacturing of antibody products. Under the terms of the agreement, XOMA received an initial license fee payment of \$30 million and will receive milestone (licensee achievement based), royalty and other fees on future sales of all products subject to this license, including products currently in late-stage clinical development.

### ***NIAID***

In March of 2005, we were awarded a \$15.0 million competitive bid contract from NIAID, a division of the National Institutes of Health, to develop three anti-botulinum neurotoxin monoclonal antibodies. Under this contract, we created production cell lines using our proprietary antibody expression systems, built Master and Manufacturer's Working Cell Banks, developed production processes and produced initial quantities of the three antibodies. The contract was performed over an eighteen month period and was 100% funded with Federal funds from NIAID under Contract No. HHSN266200500004C. Final acceptance of the project was received in October of 2006.

In July of 2006, we were awarded a \$16.3 million contract funded with Federal funds from NIAID under Contract No. HHSN266200600008C/N01-A1-60008 to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. Under this contract, we will create and produce an innovative injectable product comprised of three anti-type A botulinum neurotoxin monoclonal antibodies to support entry into Phase 1 safety human clinical trials. The work is being performed on a cost plus fixed fee basis, per the terms of the contract, over a three year period.

### ***Attenuon***

In September of 2006, we entered into an agreement with Attenuon to utilize our HE™ technology to humanize a monoclonal antibody targeting the urokinase plasminogen activator system for the treatment of cancer. Under the terms of the agreement, XOMA received up-front and annual maintenance fees and will

---

## **Table of Contents**

receive future annual maintenance fees, development milestones and royalties. Attenuon will retain all development and commercialization rights to the antibody.

### ***Triton***

In October of 2004, we entered into an agreement with Triton under which Triton licensed the exclusive worldwide rights from us to use our ING-1 monoclonal antibody with Triton's TNT™ System. The TNT™ System ablates tumors by using tiny magnetic spheres delivered, to the tumor, systemically with antibodies and heated by means of a magnetic field directed to the tumor. 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. The license to Triton includes United States and foreign patent rights related to our ING-1 and HET™ technologies along with several pending applications. ING-1 remains available for licensing outside the field covered by the Triton license. Under the terms of the contract, we received an upfront license fee and will receive milestones and royalties.

### ***Recently Terminated Agreements***

#### ***Taligen***

In September of 2006, we entered into an agreement with Taligen Therapeutics, Inc. ("Taligen") which formalized an earlier letter agreement, which was signed in May of 2006, for the development and Good Manufacturing Practices ("cGMP") manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement (the "letter agreement") which provides that we will not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provides that we will conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate ("Avecia"). The letter agreement also provides that, subject to payment by Taligen of approximately \$1.7 million, we will grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license under our-owned project innovations. We have received \$0.6 million as the first installment under the payment terms of the letter agreement and are entitled to receive two additional payments totaling approximately \$1.1 million upon fulfillment of certain obligations. We have not received any further payments from Taligen and do not know whether we will receive the remaining \$1.1 million.

### **Competition**

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

## Table of Contents

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

| <u>Product/Candidate</u> | <u>Competitors</u>   |
|--------------------------|--|
| <b>Raptiva</b>           | Amgen, Inc. with Wyeth Pharmaceuticals<br>Abbott Laboratories<br>Johnson & Johnson<br>Biogen Idec Inc. |
| <b>Lucentis</b>          | Pfizer, Inc.<br>OSI Pharmaceuticals, Inc.<br>QLT Inc.  |
| <b>XOMA 052</b>          | Amgen, Inc.<br>Regeneron Pharmaceuticals, Inc.<br>Novartis AG  |
| <b>XOMA 629</b>          | Migenix, Inc.<br>Cutanea Life Sciences, Inc.<br>Helix Biomedix, Inc.<br>GlaxoSmithKline                |
| <b>HCD122</b>            | Seattle Genetics, Inc.<br>Kirin Brewery Company, Limited with Astellas Pharma Inc.                     |
| <b>Biodefense</b>        | Cangene<br>Emergent BioSolutions   |

### **Regulatory**

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

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

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

Following completion of clinical trials, a Biologics License Application is submitted to the FDA to request marketing approval. Internal FDA committees are formed that evaluate the application, including scientific background information, animal and laboratory efficacy studies, toxicology, manufacturing facility and clinical

---

## Table of Contents

data. During the review process, a dialogue between the FDA and the applicant is established in which FDA questions are raised and additional information is submitted. During the final stages of the approval process, the FDA generally requests presentation of clinical or other data before an FDA advisory committee, at which point, some or all of such data may become available. Also, during the later stages of review, the FDA conducts an inspection of the manufacturing facility to establish that the product is made in conformity with good manufacturing practice. If all outstanding issues are satisfactorily resolved and labeling established, the FDA issues a license for the product and for the manufacturing facility, thereby authorizing commercial distribution.

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

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

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

Under Community law, the applicant may request grant of a MA under exceptional circumstances if comprehensive data on the efficacy and safety of the drug, under normal conditions of use cannot be provided because its intended indications are encountered so rarely (such as in the case of a medicinal product intended for treating an orphan disease) that comprehensive evidence cannot reasonably be collected, the present state of scientific knowledge will not allow comprehensive information to be collected, or it would be against generally accepted medical ethics to collect comprehensive information. The Rapporteur, Co-Rapporteur and the other CHMP members will assess the justification/data submitted for exceptional circumstances as part of the overall assessment of the benefit/risk of the application. It is up to the CHMP, during the review, to ultimately decide on whether grant of a MA under exceptional circumstances is justified on the evidence before them. Approval under exceptional circumstances is subject to a requirement for specific procedures related to safety and results of its use and is reviewed annually to reassess the risk-benefit balance of the product. Once approval is granted, the product can be marketed under the single European MA in all member states of the European Union and the European Economic Area. Consistent with the single MA, the labeling for Europe is identical throughout all member states except that all labeling must be translated into the local language of the country of intended importation and in relation to the content of the so called “blue box” on the outer packaging in which locally required information may be inserted.



---

## **Table of Contents**

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

### **Patents and Trade Secrets**

As a result of our ongoing activities, we hold and are in the process of applying for a number of patents in the United States and internationally to protect our products and important processes. We also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the patent position of biotechnology companies generally is highly uncertain and no consistent policy regarding the breadth of allowed claims has emerged from the actions of the U.S. Patent and Trademark Office (“Patent Office”) with respect to biotechnology patents. Accordingly, no assurance can be given that our patents will afford protection against competitors with similar technologies, or others will not obtain patents claiming aspects similar to those covered by our patent applications.

We have established an extensive portfolio of patents and applications related to our BPI-related products, including novel compositions, their manufacture, formulation, assay and use. We are also the exclusive licensee of BPI-related patents and applications owned by New York University (“NYU”), including those directed to novel BPI-related protein and DNA compositions, as well as their production and uses. Finally, we are the exclusive licensee of BPI-related patents and applications owned by Incyte Corporation (“Incyte”), including those related to endotoxin-associated uses of BPI.

We have established a portfolio of patents related to our bacterial expression technology, including claims to novel promoter sequences, secretion signal sequences, compositions, methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products, and improved methods and cells for expression of recombinant protein products. U.S. Patent No. 5,028,530 is directed to expression vehicles containing an araB promoter, host cells and processes for regulated expression of recombinant proteins. U.S. Patent Nos. 5,576,195 and 5,846,818 are related to DNA encoding a pectate lyase signal sequence, recombinant vectors, host cells and methods for production and externalization of recombinant proteins. U.S. Patent Nos. 5,595,898, 5,698,435 and 5,618,920 address secretable immunoglobulin chains, DNA encoding the chains and methods for their recombinant production. U.S. Patent Nos. 5,693,493, 5,698,417 and 6,204,023 relate to methods for recombinant production/secretion of functional immunoglobulin molecules. U.S. Patent No. 7,094,579 relates to eukaryotic signal sequences and their use in methods for prokaryotic expression of recombinant proteins. U.S. Patent No. 6,803,210 relates to improved bacterial host cells that are deficient in one or more of the active transport systems for an inducer of an inducible promoter, such as arabinose for an araB promoter, and methods for the use of such cells for the production of recombinant proteins. Most of the more important European patents in this portfolio will expire in July of 2008.

---

## Table of Contents

We have also established a portfolio of patent applications related to our mammalian expression technology, including U.S. Patent Application Publication No. 2003/0203447 for which we have received a Notice of Allowance, related to methods and materials for increasing the expression of recombinant polypeptides using expression vectors containing multiple copies of a transcription unit encoding a polypeptide of interest.

We have established a portfolio of patents and applications related to our HE<sup>TM</sup> technology, including U.S. Patent No. 5,766,886, directed to methods of modifying antibody variable domains to reduce immunogenicity. Related patents and applications are directed to antibodies engineered according to our patented methods. We believe that our patented HE<sup>TM</sup> technology provides an attractive alternative to other humanization technologies.

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

### **Research and License Agreements**

We have contracted with a number of academic and institutional collaborators to conduct research and development activities. Under these agreements, we generally fund either the research and development or evaluation of products, technologies or both, will own or obtain exclusive licenses to products or technologies developed and may pay royalties on sales of products covered by certain licenses. The rates and durations of such royalty payments vary by product and institution and range, generally, for periods from five years to indefinite duration. Aggregate expenses incurred by us under all of our research agreements were \$161,000 in 2007 and negligible in 2006 and 2005. We have entered into certain license agreements with respect to the following products:

- In December of 2007, we entered into an agreement with The Regents of the University of California (“Regents”) to license the rights to antibodies directed against anti-botulinum neurotoxin Types A, B and E. Under the agreement, XOMA will make milestone payments and the Regents will receive royalties on commercial sales of the antibody products. With this license, we have the exclusive right under pending patent applications to develop for commercial applications these antibodies intended to treat botulism poisoning. The antibodies covered by the license agreement are currently being developed by XOMA under a \$16.3 million contract award from the National Institute of Allergy and Infectious Diseases (NIAID), a division of the National Institutes of Health, (Contract No. HHSN266200600008C/N01-A1-60008) to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of biological agents used in bioterrorism.
- In August of 1990, we entered into a research collaboration and license agreement with NYU whereby we obtained an exclusive license to patent rights for DNA materials and genetic engineering methods for the production of BPI and fragments thereof. BPI is part of the body’s natural defense system against infection and we are investigating the use of products based on BPI for various indications. We have obtained an exclusive, worldwide license for the development, manufacture, sale and use of BPI products for all therapeutic and diagnostic uses, have paid a license fee, will make milestone payments and pay royalties to NYU on the sale of such products. The license becomes fully paid upon the later of the expiration of the relevant patents or fifteen years after the first commercial sale, subject to NYU’s right to terminate for certain events of default.  
Each party has the right to terminate the agreement upon a material breach by the other party of the performance of its obligations under the agreement, subject to customary cure periods. Upon termination of the agreement prior to the expiration of the relevant patents, all rights in and to NYU’s intellectual property revert to NYU.
- In July of 1998, we entered into a license agreement with Incyte whereby we obtained an exclusive (even as to Incyte), freely sublicenseable, worldwide license to all of Incyte’s patent rights relating to

---

## **Table of Contents**

BPI. We will pay Incyte a royalty on sales of BPI products covered by the license, up to a maximum of \$11.5 million and made a \$1.5 million advance royalty payment, one-half in cash and one-half in our common shares. We also issued warrants to Incyte to purchase 250,000 of our common shares at \$6.00 per share. As of December 31, 2007, 125,000 of these warrants remain outstanding. Due to offsets against other royalties, we may not ultimately incur increased total BPI royalty payments as a result of this license.

The agreement expires in July of 2008 unless, on or prior to such date, the license granted therein becomes fully paid up in accordance with its terms. Incyte has the right to terminate the agreement (subject to a customary cure period) upon a breach by us of any of our material obligations under the agreement.

### **International Operations**

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

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

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

### **Employees**

As of December 31, 2007, we employed 311 non-unionized full-time employees at our California facilities, principally in Berkeley, California. Our employees are engaged in clinical, process development and manufacturing, quality assurance and control, research and product development, and in executive, finance and administrative positions. We consider our employee relations to be excellent.

### **Available Information**

For information on XOMA's investment prospects and risks, please contact Mr. Greg Mann, Senior Director, Investor Relations and Corporate Communications at (800) 246-9662 or by sending an e-mail message to [investorrelations@xoma.com](mailto:investorrelations@xoma.com). Our principal executive offices are located at 2910 Seventh Street, Berkeley, California 94710 U.S.A. Our telephone number is (510) 204-7200.

The following information can be found on our website at <http://www.xoma.com> or can be obtained free of charge by contacting our Investor Relations Department:

- Our annual report on Form 10-K, quarterly reports on Form 10-K, current reports on Form 8-K and all amendments to those reports will be available as soon as reasonably practicable after such material is

---

## Table of Contents

electronically filed with the United States Securities and Exchange Commission (“SEC”). All reports we file with the SEC can also be obtained free of charge via EDGAR through the SEC’s website at <http://www.sec.gov>.

- Our policies related to corporate governance, including our Code of Ethics applying to our directors, officers and employees (including our principal executive officer and principal financial and accounting officer) that we have adopted to meet the requirements set forth in the rules and regulations of the SEC and its corporate governance principles are available.
- The charters of the Audit, Compensation and Nominating & Governance Committees of our Board of Directors are available.

We intend to satisfy the applicable disclosure requirements regarding amendments to, or waivers from, provisions of our Code of Ethics by posting such information on our website.

### **Item 1A. Risk Factors**

The following risk factors and other information included in this annual report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

#### **Our present and future revenues rely significantly on sales of products marketed and sold by others.**

Currently, our revenues rely significantly upon sales of RAPTIVA® and LUCENTIS®, in which we have only royalty interests. RAPTIVA® 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 and Merck Serono, Genentech’s international marketing partner for RAPTIVA®, are responsible for the marketing and sales effort in support of this product. In September of 2004, Merck Serono announced that RAPTIVA® had received approval for use in the European Union and the product was launched in several European Union countries in the fourth quarter of 2004. LUCENTIS® was approved by the FDA on June 30, 2006, for the treatment of age-related macular degeneration. Genentech and Novartis, Genentech’s international marketing partner for LUCENTIS®, are responsible for the marketing and sales effort in support of this product. We have no role in marketing and sales efforts, and Genentech, Merck Serono and Novartis do not have an express contractual obligation to us regarding the marketing or sales of RAPTIVA® or LUCENTIS®.

Under our current arrangements with Genentech, we are entitled to receive royalties on worldwide sales of RAPTIVA® and LUCENTIS®. Successful commercialization of these products is subject to a number of risks, including, but not limited to:

- Genentech’s and Merck Serono’s willingness and ability to implement their marketing and sales effort and achieve sales;
- the strength of competition from other products being marketed or developed to treat psoriasis;
- the occurrence of adverse events which may give rise to safety concerns;
- physicians’ and patients’ acceptance of RAPTIVA® as a treatment for psoriasis and LUCENTIS® as a treatment for age-related macular degeneration;
- Genentech’s ability to provide manufacturing capacity to meet demand for the products; and
- pricing and reimbursement issues.

According to Genentech, United States sales of RAPTIVA® during 2007 were \$107 million, compared with \$90 million and \$79 million during 2006 and 2005, respectively. According to Merck Serono, sales of

---

## Table of Contents

RAPTIVA® outside of the United States during 2007 were \$106 million, compared with \$70 million and \$33 million during 2006 and 2005, respectively. According to Genentech, United States sales of LUCENTIS® were \$815 million during 2007 compared with \$380 million in 2006 and sales outside the United States were \$393 million in 2007 compared with \$27 million during 2006. LUCENTIS® sales began on June 30, 2006, upon its approval by regulatory agencies. Given our current reliance on RAPTIVA® and LUCENTIS® as principal sources of our revenues, any material adverse developments with respect to the commercialization of RAPTIVA® or LUCENTIS® may cause our revenues to decrease and may cause us to incur losses in the future.

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

If adequate funds are not available, we may have to raise additional funds in a manner that may dilute or otherwise adversely affect the rights of existing shareholders, curtail or cease operations, or file for bankruptcy protection in extreme circumstances. We have spent, and we expect to continue to spend, substantial funds in connection with:

- research and development relating to our products and production technologies,
- expansion of our production capabilities,
- various human clinical trials, and
- protection of our intellectual property.

Based on current spending levels, anticipated revenues, collaborator funding, and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. As a result, we do not know when or whether:

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

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

**Our level of leverage and debt service obligations could adversely affect our financial condition.**

As of December 31, 2007, we (including our subsidiaries) had approximately \$50.9 million of indebtedness outstanding. We may not be able to generate cash sufficient to pay the principal of, interest on and other amounts due in respect of our indebtedness when due. We and our subsidiaries may also incur additional debt that may be secured. In connection with our collaboration with Novartis, Novartis has extended a line of credit to us (through our U.S subsidiary) for \$50.0 million to fund up to 75% of our expenses thereunder, of which \$20.6 million was drawn as of December 31, 2007. This line of credit is secured by a pledge of our interest in the collaboration. On November 9, 2006, XOMA (US) LLC entered into a five-year, \$35.0 million term loan facility with Goldman Sachs Specialty Lending Holdings, Inc. (“Goldman Sachs”) and borrowed the full amount thereunder. The outstanding balance as of December 31, 2007 was \$30.3 million. The loan is guaranteed by XOMA and is

---

## Table of Contents

secured by the payment rights relating to RAPTIVA<sup>®</sup>, LUCENTIS<sup>®</sup> and CIMZIA<sup>™</sup>. So long as this loan is outstanding, these assets will not be available to XOMA or any other lender to secure future indebtedness.

Our level of debt and debt service obligations could have important effects on us and our investors. These effects may include:

- making it more difficult for us to satisfy our obligations with respect to our convertible notes and our obligations to other persons with respect to our other debt;
- limiting our ability to obtain additional financing or renew existing financing at maturity on satisfactory terms to fund our working capital requirements, capital expenditures, acquisitions, investments, debt service requirements and other general corporate requirements;
- increasing our vulnerability to general economic downturns, competition and industry conditions, which could place us at a competitive disadvantage compared with our competitors that are less leveraged;
- increasing our exposure to rising interest rates to the extent any of our borrowings are at variable interest rates;
- reducing the availability of our cash flow to fund our working capital requirements, capital expenditures, acquisitions, investments and other general corporate requirements because we will be required to use a substantial portion of our cash flow to service debt obligations; and
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate.

Our ability to satisfy our debt obligations will depend upon our future operating performance and the availability of refinancing debt. If we are unable to service our debt and fund our business, we may be forced to reduce or delay capital expenditures, seek additional debt financing or equity capital, restructure or refinance our debt or sell assets. We cannot assure you that we would be able to obtain additional financing, refinance existing debt or sell assets on satisfactory terms or at all.

**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. 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. Initiation of clinical trials requires approval by health authorities. Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients under the supervision of a qualified principal investigator. Clinical trials must be conducted in accordance with FDA and International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use ("ICH") Good Clinical Practices and the European Clinical Trials Directive under protocols that detail the objectives of the study, the parameters to be

---

## Table of Contents

used to monitor safety and the efficacy criteria to be evaluated. Other national, foreign and local regulations may also apply. The developer of the drug must provide information relating to the characterization and controls of the product before administration to the patients participating in the clinical trials. This requires developing approved assays of the product to test before administration to the patient and during the conduct of the trial. In addition, developers of pharmaceutical products must provide periodic data regarding clinical trials to the FDA and other health authorities, and these health authorities may issue a clinical hold upon a trial if they do not believe, or cannot confirm, that the trial can be conducted without unreasonable risk to the trial participants. We cannot assure you that U.S. and foreign health authorities will not issue a clinical hold with respect to any of our clinical trials in the future.

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

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. Even if the FDA or other regulatory agency approves a product candidate, the approval may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, marketing and/or production of such product. Even for approved products such as RAPTIVA® and LUCENTIS®, the FDA may impose ongoing requirements for post-approval studies, including additional research and development and clinical trials, and may subsequently withdraw approval based on these additional trials. The FDA and other agencies also may impose various civil or criminal sanctions for failure to comply with regulatory requirements, including withdrawal of product approval. 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.

### **We face uncertain results of clinical trials of our potential products.**

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,
- our preclinical and clinical studies will be successful,
- we will be successful in generating viable product candidates to targets,

---

## Table of Contents

- we will be able to provide necessary additional data,
- results of future clinical trials will justify further development, or
- we will ultimately achieve regulatory approval for any of these products.

For example, In 2003, we completed two Phase 1 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 2 clinical testing in patients with mild-to-moderate acne. In August of 2004, we announced the results of a Phase 2 trial with XMP.629 gel. The results were inconclusive in terms of clinical benefit of XMP.629 compared with vehicle gel. In 2007, after completing an internal evaluation of this program, we chose to focus development efforts on the use of this product in superficial skin infections, including impetigo and the eradication of staphylococcus aureus, including MRSA.

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

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

Administering any of our products or potential products may produce undesirable side effects, also known as adverse effects. Toxicities and adverse effects that we have observed in pre-clinical studies for some compounds in a particular research and development program may occur in preclinical studies or clinical trials of other compounds from the same program. Such toxicities or adverse effects could delay or prevent the filing of an IND (or a foreign equivalent) with respect to such products or potential products or cause us to cease clinical trials with respect to any drug candidate. In clinical trials, administering any of our products to humans may produce adverse effects. These adverse effects could interrupt, delay or halt clinical trials of our products and could result in the FDA or other regulatory authorities denying approval of our products for any or all targeted indications. The FDA, other regulatory authorities, our partners or we may suspend or terminate clinical trials at any time. Even if one or more of our products were approved for sale, the occurrence of even a limited number of toxicities or adverse effects when used in large populations may cause the FDA to impose restrictions on, or stop, the further marketing of such drugs. Indications of potential adverse effects or toxicities which may occur in



---

## Table of Contents

clinical trials and which we believe are not significant during the course of such clinical trials may later turn out to actually constitute serious adverse effects or toxicities when a drug has been used in large populations or for extended periods of time. Any failure or significant delay in completing preclinical studies or clinical trials for our products, or in receiving and maintaining regulatory approval for the sale of any drugs resulting from our products, may severely harm our reputation and business.

Given that regulatory review is an interactive and continuous process, we maintain a policy of limiting announcements and comments upon the specific details of regulatory review of our 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 December 31, 2007, we had an accumulated deficit of \$739.9 million.

For the year ended December 31, 2007, we had a net loss of approximately \$12.3 million or \$0.10 per common share (basic and diluted). For the year ended December 31, 2006, we had a net loss of approximately \$51.8 million or \$0.54 per common share (basic and diluted).

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

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

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

- In April of 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA®. In April of 1999, March of 2003, and January of 2005, the companies amended the agreement. In October of 2003, RAPTIVA® was approved by the FDA for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy and, in September of 2004, Merck Serono announced the product's approval in the European Union. In January of 2005, we entered into a restructuring of our collaboration agreement with Genentech which ended our existing cost and profit sharing arrangement related to RAPTIVA® in the United States and entitles us to a royalty interest on worldwide net sales.
- 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. As of May of 2006, we completed the transfer of the data from the Phase I study to Millennium as per our amended agreement.
- In March of 2004, we announced we had agreed to collaborate with Chiron Corporation (now Novartis) for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will jointly research, develop, and commercialize multiple

---

## Table of Contents

antibody product candidates. In April of 2005, we announced the initiation of clinical testing of the first product candidate out of the collaboration, HCD122, an anti-CD40 antibody, in patients with advanced CLL. In October of 2005, we announced the initiation of the second clinical trial of HCD122 in patients with multiple myeloma.

- In October of 2004, we announced the licensing of our ING-1 product to Triton for use with their TNT™ System.
- In March of 2005, we entered into a contract with NIAID to produce three monoclonal antibodies designed to protect United States citizens against the harmful effects botulinum neurotoxin of used in bioterrorism. In July of 2006, we entered into an additional contract with NIAID for the development of an appropriate formulation for human administration of these three antibodies in a single injection.
- In June of 2005, we announced the formation of a collaboration to jointly develop and commercialize antibody drugs for certain targets discovered by Lexicon.
- We have licensed our BCE technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to over 50 companies. As of December 31, 2007, we were aware of one antibody product manufactured using this technology that has received FDA approval, Genentech's LUCENTIS® (ranibizumab injection) for treatment of neovascular (wet) age-related macular degeneration, and one antibody manufactured using this technology that is in late-stage clinical testing, UCB's CIMZIA™ (certolizumab pegol, CDP870) an anti-TNF alpha antibody fragment for rheumatoid arthritis and Crohn's disease.

Because our collaborators and licensees 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 related to their agreements with us. If these collaborators and licensees do not successfully develop and market these products, we may not have the capabilities, resources or rights to do so on our own. We do not know whether our collaborators or licensees will successfully develop and market any of the products that are or may become the subject of one of our collaboration or licensing arrangements. In particular, each of these arrangements provides for either sharing of collaboration expenses, which means that not only we but our collaborators must have sufficient available funds for the collaborations to continue, or funding solely by our collaborators or licensees. In addition, our collaboration with Novartis provides for funding by it in the form of a line of credit to us, and we cannot be certain that Novartis will provide the necessary funds available when we attempt to draw on the line of credit. Furthermore, our contracts with NIAID contain numerous standard terms and conditions provided for in the applicable federal acquisition regulations and customary in many government contracts. Uncertainty exists as to whether we will be able to comply with these terms and conditions in a timely manner, if at all. In addition, given our relative lack of experience in programs under contract with government agencies, we are uncertain as to the extent of NIAID's demands and the flexibility that will be granted to us in meeting those demands. Lastly, CIMZIA® has not received marketing approval from the FDA or the EMEA, and therefore we cannot assure you that it will be approved for marketing in the US or the EU or that it will be successfully commercialized.

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

- In December of 2003, we agreed to collaborate with Alexion Pharmaceuticals, Inc. ("Alexion") 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 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. In the first quarter of 2005, the companies determined not to continue with this development program and in the second quarter of 2005, the collaboration was terminated.

---

## Table of Contents

- In November of 2004, we announced the licensing of our BPI product platform, including our NEUPREX® product, to Zephyr Sciences, Inc. In July of 2005, we announced our decision to terminate the license agreement with Zephyr due to Zephyr not meeting the financing requirements of the license agreement.
- In September of 2004, we entered into a collaboration with Apton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In January of 2006, Apton announced that its common stock had been delisted from Nasdaq. In May of 2006, Apton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code.
- In September of 2005, we signed a letter agreement with Cubist to develop production processes and to manufacture a novel two-antibody biologic in quantities sufficient to conduct Phase 3 clinical trials. In July of 2006, Cubist announced that it had decided to cease investment in this product because of stringent FDA requirements for regulatory approval, and as a result we have terminated our letter agreement with Cubist.
- In September of 2006, we entered into an agreement with Taligen which formalized an earlier letter agreement, which was signed in May of 2006, for the development and Good Manufacturing Practices (“cGMP”) manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement (the “letter agreement”) which provides that we will not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provides that we will conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate (“Avecia”). The letter agreement also provides that, subject to payment by Taligen of approximately \$1.7 million, we will grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license under our-owned project innovations. We have received \$0.6 million as the first installment under the payment terms of the letter agreement and are entitled to receive two additional payments totaling approximately \$1.1 million upon fulfillment of certain obligations. We have not received any further payments from Taligen and do not know whether we will receive the remaining \$1.1 million. This amount has not been recognized as revenue and is not included as an accounts receivable asset as of December 31, 2007.

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.**

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

---

## [Table of Contents](#)

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

There can be no assurance that the market price of our common shares will not decline below its present market price or that there will be an active trading market for our common shares. The market prices of biotechnology companies have been and are likely to continue to be highly volatile. Fluctuations in our operating results and general market conditions for biotechnology stocks could have a significant impact on the volatility of our common share price. We have experienced significant volatility in the price of our common shares. From January 1, 2007 through March 7, 2008, our share price has ranged from a high of \$4.39 to a low of \$1.96. On March 7, 2008, the closing price of the common shares as reported on the Nasdaq Global Market was \$2.56 per share. Factors contributing to such volatility include, but are not limited to:

- sales and estimated or forecasted sales of products for which we receive royalties,
- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of 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,
- technological innovations or new indications for our therapeutic products,
- introduction of new products or technologies by us or our competitors,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares issued and outstanding,
- the number of shares trading on an average trading day,
- announcements regarding other participants in the biotechnology and pharmaceutical industries, and
- market speculation regarding any of the foregoing.

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

Genentech is responsible for manufacturing or arranging for the manufacturing of commercial quantities of RAPTIVA® and LUCENTIS®. Should Genentech have difficulty in providing manufacturing capacity to produce these products in sufficient quantities, we do not know whether they will be able to meet market demand. If not, we will not realize revenues from the sales of these products. 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 or licensees need additional manufacturing facilities to meet market demand, we cannot predict that we will successfully obtain those facilities because we do not know whether they will be available on acceptable terms. In addition, any manufacturing facilities acquired or used to meet market demand must meet the FDA's quality assurance guidelines.

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

Although RAPTIVA® was approved in the United States in October of 2003 and in the European Union in 2004 and LUCENTIS® was approved in June of 2006 and in the European Union in January of 2007, their

---

## **Table of Contents**

acceptance in the marketplace may not continue. Furthermore, even if other products in which we have an interest receive approval in the future, they may not be accepted in the marketplace. In addition, we or our collaborators or licensees may experience difficulties in launching new products, many of which are novel and based on technologies that are unfamiliar to the healthcare community. We have no assurance that healthcare providers and patients will accept such products, if developed. For example, physicians and/or patients may not accept a product for a particular indication because it has been biologically derived (and not discovered and developed by more traditional means) or if no biologically derived products are currently in widespread use in that indication. Similarly, physicians may not accept a product, such as RAPTIVA® or LUCENTIS®, if they believe other products to be more effective or are more comfortable prescribing other products. Safety concerns may also arise in the course of on-going clinical trials or patient treatment as a result of adverse events or reactions.

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

### **Products and technologies of 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, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later; as a result, we may not be able to track development of competitive products, particularly at the early stages. Positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product's failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

## Table of Contents

The examples below pertain to competitive events in the market which we review quarterly and are not intended to be representative of all existing competitive events. Without limiting the foregoing, we are aware that:

### *RAPTIVA®*

- In April of 2004, Amgen Inc. and its partner Wyeth Pharmaceuticals, a division of Wyeth, announced that their rheumatoid arthritis and psoriatic arthritis drug, Enbrel®, had been approved by the FDA for the same psoriasis indication as RAPTIVA® and, in September of 2004, they announced that the product received approval in the European Union in this same indication;
- Abbott Laboratories has recently announced that it has successfully completed two Phase 3 psoriasis trials showing clinical benefits of its rheumatoid arthritis and psoriatic arthritis drug Humira™ for the treatment of psoriasis. They indicated that they will submit regulatory applications in the United States and Europe in the first half of 2007;
- In September of 2006, Centocor, Inc. (“Centocor”), a unit of Johnson & Johnson, announced that its rheumatoid arthritis and Crohn’s disease drug, Remicad® (infliximab) had been approved by the FDA for the treatment of adult patients with chronic severe (i.e. extensive and/or disabling) plaque psoriasis who are candidates for systemic therapy and when other systemic therapies are medically less appropriate. This drug had already been approved to treat plaque psoriasis in the European Union, psoriatic arthritis in the United States and, in combination with methotrexate, in the European Union;
- Biogen Idec Inc. (“Biogen”) sold its worldwide rights to Amevive®, which has been approved in the United States and Canada to treat the same psoriasis indication as RAPTIVA®, to Astellas Pharma US, Inc., in March of 2006;
- In October of 2007, Johnson & Johnson announced positive results from a Phase 3 clinical trial in moderate to severe plaque psoriasis of ustekinumab (CNTO 1275), a fully human monoclonal antibody that targets the cytokines interleukin-12 (IL-12) and interleukin-23 (IL-23). The BLA and MAA regulatory submissions for chronic moderate-to-severe plaque psoriasis were filed with the US FDA and EMEA in the EU in December of 2007; the BLA was accepted for review by the US FDA in February of 2008; and
- other companies are developing monoclonal antibody or other products for treatment of inflammatory skin disorders.

### *LUCENTIS®*

In addition to LUCENTIS®, there are two other FDA-approved therapies to treat macular degeneration: Pfizer, Inc.’s and OSI Pharmaceuticals, Inc.’s Macugen® and Novartis’ and QLT Inc.’s Visudyne®. LUCENTIS® also competes with Genentech’s cancer drug Avastin®.

### *XOMA 052*

In April of 2007, XOMA announced plans to initiate clinical testing of XOMA 052, a potent anti-inflammatory monoclonal antibody targeting Interleukin 1-beta (IL-1beta), in Type 2 diabetes patients. It is possible that other companies may be developing other products based on the same therapeutic target as XOMA 052 and that these products may prove more effective than XOMA 052. We are aware that:

- Amgen has been developing AMG 108, a fully human monoclonal antibody that targets inhibition of the action of IL-1, and they announced the initiation of a Phase 2 safety trial in rheumatoid arthritis patients in September of 2006;
- In February of 2008, Regeneron Pharmaceuticals, Inc. (“Regeneron”) announced it had received marketing approval from the FDA for ARCALYST(TM) (rilonacept) Injection for Subcutaneous Use, an interleukin-1 blocker or IL-1 Trap, for the treatment of Cryopyrin-Associated Periodic Syndromes

---

## Table of Contents

including Familial Cold Auto-inflammatory Syndrome and Muckle-Wells Syndrome in adults and children 12 and older. In September of 2007, Regeneron also announced that treatment with rilonacept demonstrated a statistically significant reduction in patient pain scores in a single-blind, placebo run-in-controlled study of 10 patients with chronic active gout. In November of 2007, Regeneron announced it had initiated a Phase 2 safety and efficacy trial of rilonacept in the prevention of gout flares induced by the initiation of uric acid-lowering drug therapy used to control the disease.

- Novartis has been developing ACZ885, a fully human anti-IL-1beta monoclonal antibody, and that they reported positive results in Phase 1 proof of concept clinical trials in rheumatoid arthritis and in Muckle-Wells Syndrome in June 2006. In July of 2007, they reported advancing ACZ885 into Phase 3 clinical trial for Muckle-Wells Syndrome and in December of 2007, they entered Phase 2 testing of ACZ885 in patients with Type 2 Diabetes Mellitus.

### *XOMA 629*

There are several companies developing topical peptide treatments which may compete with XOMA 629. Migenix Inc. and its partner Cutanea Life Sciences, Inc. are developing CLS001 (formerly MBI 594AN) for roseacea, a topical peptide that has completed two Phase 2 trials for the treatment of acne. Helix Biomedix, Inc. is developing several peptide compounds. GlaxoSmithKline has two products approved for impetigo, mupirocin and retapamulin. In addition, mupirocin is approved for use in eradication of MRSA nasal colonization and for secondary traumatic skin lesions. Retapamulin is being investigated for eradication of *S. aureus* nasal colonization.

### *HCD122*

In collaboration with Novartis, we are co-developing a humanized antibody to the 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. ("Seattle Genetics") which is targeting CD40 antigen. Seattle Genetics is currently conducting a Phase 2 clinical trial for patients with diffuse large B-cell lymphoma, the most common type of aggressive non-Hodgkin's lymphoma, and Phase 1 trials for patients with multiple myeloma or chronic lymphocytic leukemia. In January of 2007, Seattle Genetics entered into an exclusive worldwide license agreement with Genentech to develop and commercialize SGN-40. Under the agreement, Genentech will fund future research, development, manufacturing and commercialization costs. In January of 2007, Kirin Brewery Company, Limited and Astellas Pharma Inc. announced that they have entered into a license and collaborative research and development agreement under which they will exclusively collaborate in developing and marketing a fully human anti-CD40 antagonistic monoclonal antibody worldwide with a first target indication of prophylaxis of organ rejection associated with organ transplantation.

### *Biodefense*

- In May of 2006, the US Department of Health & Human Services (DHHS) awarded Cangene Corporation a five-year, \$362 million contract under Project Bioshield. The contract requires Cangene to manufacture and supply 200,000 doses of an equine heptavalent botulism anti-toxin to treat individuals who have been exposed to the toxins that cause botulism.
- Emergent BioSolutions, Inc. is currently in development of a botulism immunoglobulin candidate that may compete with our anti-botulinum neurotoxin monoclonal antibodies
- We are aware of additional companies that are pursuing biodefense-related antibody products. PharmAthene, Elusys Therapeutics, Inc. and Human Genome Sciences, Inc. are developing anti-anthrax antibodies. Cangene and Emergent BioSolutions, Inc. are developing anti-anthrax immune globulin products. These products may compete with our efforts in the areas of other monoclonal antibody-based biodefense products, and the manufacture of antibodies to supply strategic national stockpiles.

---

## [Table of Contents](#)

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

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

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

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

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

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

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

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

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our 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



---

## Table of Contents

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

- whether any pending or future patent applications held by us will result in an issued patent, or that if patents are issued to us, that such patents will provide meaningful protection against competitors or competitive technologies,
- whether competitors will be able to design around our patents or develop and obtain patent protection for technologies, designs or methods that are more effective than those covered by our patents and patent applications, or
- the extent to which our products could infringe on the intellectual property rights of others, which may lead to costly litigation, result in the payment of substantial damages or royalties, and/or prevent us from using technology that is essential to our products.

We have established an extensive portfolio of patents and applications, both United States and foreign, related to our BPI-related products, including novel compositions, their manufacture, formulation, assay and use. We have also established a portfolio of patents, both United States and foreign, related to our BCE technology, including claims to novel promoter sequences, secretion signal sequences, compositions and methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products.

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

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

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

We may be required to engage in litigation or other proceedings to protect our intellectual property. The cost to us of this litigation, even if resolved in our favor, could be substantial. Such litigation could also divert management's attention and resources. In addition, if this litigation is resolved against us, our patents may be declared invalid, and we could be held liable for significant damages. In addition, we may be subject to a claim

---

## **Table of Contents**

that we are infringing another party's patent. If such claim is resolved against us, we or our collaborators may be enjoined from developing, manufacturing, selling or importing products, processes or services unless we obtain a license from the other party. Such license may not be available on reasonable terms, thus preventing us from using these products, processes or services and adversely affecting our revenue.

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

We are subject to manufacturing risks which may hinder our ability to provide manufacturing services for our own benefit or to third parties. Additionally, unanticipated fluctuations in customer requirements may lead to manufacturing inefficiencies. We must provide our manufacturing services in compliance with regulatory requirements, in sufficient quantities and on a timely basis, while maintaining acceptable product quality and manufacturing costs. Additional resources and changes in our manufacturing processes may be required for each new product or customer or to meet increasing customer requirements once a contract has been initiated, and this work may not be successfully or efficiently completed.

In addition, the development work and products addressed in new contracts may not share production attributes with our existing projects to the extent we anticipate, and consequently these new contracts may require the development of new manufacturing technologies and expertise. If we are unable to develop manufacturing capabilities as needed, on acceptable terms, our ability to complete these contracts or enter into additional contracts may be adversely affected.

Manufacturing and quality problems may arise in the future as we continue to perform these services for our own benefit and under additional manufacturing contracts. Consequently, our internal development goals or milestones under our contracts may not be achieved in a timely manner or at a commercially reasonable cost, or at all. In addition, we continue to make investments to improve our manufacturing processes and to design, develop and purchase manufacturing equipment that may not yield the improvements that we expect. Inefficiencies or constraints related to our manufacturing may adversely affect our overall financial results. Such inefficiencies or constraints may also result in delays or loss of current or potential customers due to their dissatisfaction.

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

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

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

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

For example, in connection with our licensing transactions relating to our BCE 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.

---

## Table of Contents

### **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 and sales may be limited or disrupted by:

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

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

Our research, product development and business efforts could be adversely affected by the loss of one or more key members of our scientific or management staff, particularly our executive officers: Steven B. Engle, our Chairman, Chief Executive Officer and President; J. David Boyle II, our Vice President, Finance and Chief Financial Officer; Patrick J. Scannon, M.D., Ph.D., our Executive Vice President and Chief Biotechnology Officer; and Christopher J. Margolin, our Vice President, General Counsel and Secretary. We currently have no key person insurance on any of our employees.

In August of 2007, Mr. Engle succeeded John L. Castello as President and Chief Executive Officer. Mr. Engle has not previously been affiliated with our company, and our business could be adversely affected if he is not integrated effectively, or in a timely manner, into our company.

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

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. We had approximately 311 employees as of December 31, 2007, and we anticipate that we will require additional experienced executive, accounting, research and development, legal, administrative and other personnel in the future. There is intense competition for the services of these personnel, especially in California. Moreover, we expect that the high cost of living in the San Francisco Bay Area, where our headquarters and manufacturing facilities are located, may impair our ability to attract and retain employees in the future. If we do not succeed in attracting new personnel and retaining and motivating existing personnel, our operations may suffer and we may be unable to implement our current initiatives or grow effectively.

---

## **Table of Contents**

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

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

### **We are exposed to an increased risk of product liability claims.**

The testing, marketing and sales of medical products entails an inherent risk of allegations of product liability. In the event of one or more large, unforeseen awards of damages against us, our product liability insurance may not provide adequate coverage. A significant product liability claim for which we were not covered by insurance would have to be paid from cash or other assets. To the extent we have sufficient insurance coverage, such a claim would result in higher subsequent insurance rates. In addition, product liability claims can have various other ramifications including loss of future sales opportunities, increased costs associated with replacing products, and a negative impact on our goodwill and reputation, which could also adversely affect our business and operating results.

### **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 United States 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, including substantially all of our intellectual property, 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. Uncertainty exists as to whether Bermuda courts would enforce judgments of United States courts obtained in actions against us or our directors and officers that are predicated upon the civil liability provisions of the United States securities laws or entertain original actions brought in Bermuda against us or such persons predicated upon the United States 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.

---

## **Table of Contents**

### **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 us in a transaction that our Board of Directors opposes.

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.

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

We are authorized to issue, without shareholder approval, 1,000,000 preference shares, of which 2,959 were issued and outstanding as of December 31, 2007, which may give other shareholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common shares. In addition, we are authorized to issue, without shareholder approval, up to 210,000,000 common shares, of which 131,957,774 were issued and outstanding as of December 31, 2007. If we issue additional equity securities, the price of our common shares and, in turn, the price of our convertible notes may be materially and adversely affected.

### **If the trading price of our common shares fails to comply with the continued listing requirements of The Nasdaq Global Market, we would face possible delisting, which would result in a limited public market for our common shares and make obtaining future debt or equity financing more difficult for us.**

If we do not continue to comply with the continued listing requirements for The Nasdaq Global Market, then Nasdaq may provide written notification regarding the delisting of our securities. At that time, we would have the right to request a hearing to appeal The Nasdaq determination and would also have the option to apply to transfer our securities to The Nasdaq Capital Market.

We cannot be sure that our price will comply with the requirements for continued listing of our common shares on The Nasdaq Global Market, or that any appeal of a decision to delist our common shares will be successful. If our common shares lose their status on The Nasdaq Global Market and we are not successful in obtaining a listing on The Nasdaq Capital Market, our common shares would likely trade in the over-the-counter market.

If our common shares are neither listed for trading on a United States national or regional securities exchange nor approved for trading on The Nasdaq Global Market, Nasdaq Capital Market or any other

---

## **Table of Contents**

established United States system of automated dissemination or quotations of securities prices, it would be deemed a “fundamental change” under the indenture governing our convertible notes, giving the holders thereof the right to require us to repurchase such notes. Our failure to repurchase our convertible notes would constitute an event of default under the notes indenture, which might constitute an event of default under the terms of our other debt.

If our shares were to trade on the over-the-counter market, selling our common shares could be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and security analysts’ coverage of us may be reduced. In addition, in the event our common shares are delisted, broker-dealers have certain regulatory burdens imposed upon them, which may discourage broker-dealers from effecting transactions in our common shares, further limiting the liquidity thereof. These factors could result in lower prices and larger spreads in the bid and ask prices for common shares.

Such delisting from The Nasdaq Global Market or future declines in our share price could also greatly impair our ability to raise additional necessary capital through equity or debt financing, and could significantly increase the ownership dilution to shareholders caused by our issuing equity in financing or other transactions. Consent under the Exchange Control Act 1972 (and its related regulations) has been obtained from the Bermuda Monetary Authority for the issue and transfer of our shares, notes and other securities to and between non-residents of Bermuda for exchange control purposes, but this consent is conditional on our shares remaining listed on an appointed stock exchange. We cannot assure you that the Bermuda Monetary Authority will give the same or a similar consent in the event our common shares are no longer listed on The Nasdaq Global Market or another appointed stock exchange. In the absence of such a general consent, specific consents of the Bermuda Monetary Authority would be required for certain issues and transfers of our shares, notes and other securities.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

Our development and manufacturing facilities are located in Berkeley and Emeryville, California. We lease approximately 135,000 square feet of space including approximately 35,000 square feet of research and development laboratories, 48,000 square feet of production and production support facilities and 52,000 square feet of office space. A separate 17,000 square foot technology development and pilot facility is owned by us.

We produced multiple anti-botulinum neurotoxin antibodies and XOMA 052 in addition to performing numerous small-scale development runs in 2007. We have previously produced MLN2222, TPO mimetic antibody, NEUPREX<sup>®</sup>, RAPTIVA<sup>®</sup>, MLN2201 and ING-1 for clinical trials and other testing needs at our Berkeley manufacturing facilities, pursuant to a drug manufacturing license obtained from the State of California. We recently received Investigational Medicinal Products (IMP) Certification from the Medicines and Healthcare Products Regulatory Agency of the United Kingdom to allow production of clinical trial materials for use in the European Union. We base our manufacturing capability on recombinant DNA technology, which can produce therapeutic products from either mammalian or microbial cells. Our primary manufacturing facility houses three fermentation trains each with a tank size of 2,750 liters. Our Pilot Plant houses two fermentation trains each with a tank size of 500 liters. Each facility has associated isolation and purification equipment within production suites. We perform our own formulation and contract with third parties for final sterile filling and finishing.

### **Item 3. Legal Proceedings**

In September of 2004, XOMA (US) LLC entered into a collaboration with Aphton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code in the

---

## Table of Contents

United States Bankruptcy Court for the District of Delaware, No. 06-10510 (CSS). XOMA (US) LLC filed a proof of claim in the proceeding, as an unsecured creditor of Apton, for approximately \$594,000. Apton and the Official Committee of Unsecured Creditors filed a Proposed Plan of Reorganization that would result in a liquidation of Apton. The creditors have voted in favor of the plan, and the bankruptcy court has confirmed it. It is not presently known what, if any, distributions will be made to holders of unsecured claims.

### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were brought to a vote of our shareholders in the quarter ended December 31, 2007.

### **Executive Officers**

Our executive officers and their respective ages, as of December 31, 2007, and positions are as follows:

| <u>Name</u>                     | <u>Age</u> | <u>Title</u>   |
|---------------------------------|------------|--|
| Steven B. Engle                 | 53         | Chairman of the Board, Chief Executive Officer and President |
| Patrick J. Scannon, M.D., Ph.D. | 60         | Executive Vice President and Chief Biotechnology Officer     |
| J. David Boyle II               | 54         | Vice President, Finance and Chief Financial Officer          |
| Christopher J. Margolin, Esq.   | 61         | Vice President, General Counsel and Secretary                |

The Board of Directors elects all officers annually. There is no family relationship between or among any of the officers or directors.

### **Business Experience**

**Mr. Engle** is XOMA's Chairman of the Board, Chief Executive Officer and President. He has more than 25 years of executive leadership and biotechnology and pharmaceutical industry experience. Prior to joining XOMA in 2007, he served as chairman of the board and chief executive officer of La Jolla Pharmaceutical Company, a publicly-held biopharmaceutical company focused on the research and development of therapeutic products for autoimmune and antibody-mediated diseases. He joined La Jolla Pharmaceutical Company in 1993, became president and a director in 1994, chief executive officer in 1995, and chairman of the board in 1997. Prior to joining La Jolla, he held executive-level positions at Cygnus Therapeutic Systems, a developer of drug delivery systems, and Micro Power Systems, Inc., a manufacturer of high technology products, including medical devices. He began his professional career with the Strategic Decisions Group and the Stanford Research Institute. Mr. Engle is a graduate of the University of Texas with BS and MS degrees in Biomedical Engineering.

**Dr. Scannon** is one of our founders and has served as a director since our formation. Dr. Scannon became Executive Vice President and Chief Biotechnology Officer in May of 2006. Previously he was our Chief Scientific and Medical Officer beginning in March of 1993, served as our Vice Chairman, Scientific and Medical Affairs from April of 1992 to March of 1993 and our President from our formation until April of 1992. In 2007, Dr. Scannon was invited to join the newly formed National Biodefense Science Board, reporting to the Secretary for the Department of Health and Human Services; he also became a member of the Board of Directors for Pain Therapeutics, Inc, a biopharmaceutical company. He serves on the Defense Sciences Research Council for the Defense Advanced Research Projects Agency (DARPA) and on the Threat Reduction Advisory Committee for the Department of Defense. From 1979 until 1981, Dr. Scannon was a clinical research scientist at the Letterman Army Institute of Research in San Francisco. A Board-certified internist, Dr. Scannon holds a Ph.D. in organic chemistry from the University of California, Berkeley and an M.D. from the Medical College of Georgia.

**Mr. Boyle** is our Vice President, Finance and Chief Financial Officer. Before joining us in January 2005, he was Vice President, Finance for Polycom, Inc. From 1996 to 1999, he served as Executive Vice President and

## Table of Contents

Chief Financial Officer of Salix Pharmaceuticals Ltd. Before joining Salix, Mr. Boyle spent five years with Serono, S.A. in Switzerland and the United States, most recently as Vice President, Finance and Administration for North America.

**Mr. Margolin** is our Vice President, General Counsel and Secretary. During his time with the Company, Mr. Margolin has been responsible for the legal and intellectual property function and, at various times, the business development, human resources and licensing functions. Prior to joining us in 1991, Mr. Margolin was a corporate attorney holding several different executive legal positions for Raychem Corporation, an international high technology company, for 11 years. From 1975 to 1980, he was a division counsel for TRW Inc. and from 1972 to 1975, he was an associate at the law firm of McCutchen, Black, Verleger and Shea in Los Angeles.

## **PART II**

### **Item 5. Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

#### *Market for Registrant's Common Equity*

Our common shares trade on the Nasdaq Global Market under the symbol "XOMA." The following table sets forth the quarterly range of high and low reported sale prices of our common shares on the Nasdaq Global Market for the periods indicated.

|                | Price Range |         |
|----------------|-------------|---------|
|                | High        | Low     |
| <b>2007</b>    |             |         |
| First Quarter  | \$ 3.50     | \$ 2.14 |
| Second Quarter | 3.80        | 2.88    |
| Third Quarter  | 3.77        | 1.96    |
| Fourth Quarter | 4.39        | 2.95    |
| <b>2006</b>    |             |         |
| First Quarter  | \$ 2.46     | \$ 1.57 |
| Second Quarter | 2.32        | 1.59    |
| Third Quarter  | 1.90        | 1.60    |
| Fourth Quarter | 2.50        | 1.86    |

On March 7, 2008, there were 2,683 shareholders of record of our common shares, one of which is Cede & Co., a nominee for Depository Trust Company ("DTC"). All of the common shares held by brokerage firms, banks and other financial institutions as nominees for beneficial owners are deposited into participant accounts at DTC and are therefore considered to be held of record by Cede & Co. as one shareholder.

#### *Dividend Policy*

We have not paid dividends on our common shares. We currently intend to retain any earnings for use in the development and expansion of our business. We, therefore, do not anticipate paying cash dividends on our common shares in the foreseeable future See Note 5, "Share Capital," to the Consolidated Financial Statements.

#### *Plan-Based Awards*

The section labeled "Plan-Based Awards" appearing in our proxy statement for the 2008 Annual General Meeting of Shareholders is incorporated herein by reference.

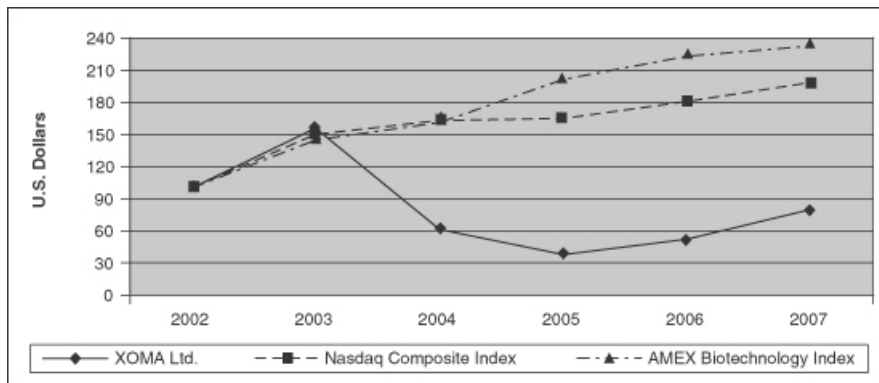


[Table of Contents](#)

*Performance Graph*

The following graph compares the five-year cumulative total returns for XOMA common stock with the comparable cumulative return of certain indices. The graph assumes \$100 invested on the same date in each of the indices. Returns of the company are not indicative of future performance.

**FIVE-YEAR PERFORMANCE GRAPH**



| As of December 31, | XOMA Ltd. | Nasdaq Composite Index | AMEX Biotechnology Index |
|--------------------|-----------|------------------------|--------------------------|
| 2002               | \$100.00  | \$100.00               | \$100.00                 |
| 2003               | 156.03    | 150.01                 | 144.91                   |
| 2004               | 61.23     | 162.89                 | 160.92                   |
| 2005               | 37.83     | 165.13                 | 201.32                   |
| 2006               | 52.01     | 180.85                 | 223.01                   |
| 2007               | 80.14     | 198.60                 | 232.54                   |

*Debt and Equity Issuances*

During 2007 we eliminated all of our remaining convertible debt. For the year ended December 31, 2006, \$27.5 million of New Notes were converted into 18,262,264 common shares including 3,602,879 shares related to the additional interest payment feature of the notes. During the first quarter of 2007, \$42.0 million of New Notes were voluntarily converted by holders through March 7, 2007, at which time we announced that we had elected to automatically convert 100% of the remaining \$2.5 million of New Notes outstanding. As a result, 25,640,187 shares were issued to effect the conversion of the principal balances. Additionally, we issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted New Notes.

In February of 2006, we completed an exchange offer with holders of our 6.5% convertible senior notes due 2012 in which we exchanged \$60.0 million aggregate principal amount of our new 6.5% Convertible SNAPs<sup>SM</sup> due 2012 (the "New Notes") for all \$60.0 million aggregate principal amount of our then outstanding convertible senior notes due 2012. We also issued an additional \$12.0 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million. The New Notes were initially convertible into approximately 38.4 million common shares at a conversion rate of 533.4756 of common shares per \$1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately \$1.87 per common share.

## Table of Contents

In February of 2005, we issued \$60.0 million of 6.5% convertible senior notes due in 2012, the proceeds of which were being used for general corporate purposes, including current research and development projects, the development of new products or technologies, equipment acquisitions, general working capital purposes and operating expenses. The notes were initially convertible into approximately 32 million common shares at a conversion rate of 533.4756 of our common shares per \$1,000 principal amount of notes, which is equivalent to a conversion price of approximately \$1.87 per common share. The convertible senior notes were issued, to the initial purchasers, for net proceeds of \$56.6 million.

### Item 6. Selected Financial Data

The following table contains our selected financial information including consolidated statement of operations and consolidated balance sheet data for the years 2003 through 2007. The selected financial information has been derived from our audited consolidated financial statements. The selected financial information should be read in conjunction with the consolidated financial statements and notes thereto included in Item 8 of this report and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 below. The data set forth below is not necessarily indicative of the results of future operations.

|   | Year Ended December 31,                  |                    |                 |                    |                    |
|---|--|--------------------|-----------------|--------------------|--------------------|
|   | 2007                                     | 2006               | 2005            | 2004               | 2003               |
|   | (In thousands, except per share amounts) |                    |                 |                    |                    |
| <b>Consolidated Statement of Operations Data</b>            |  |                    |                 |                    |                    |
| Total revenues (1)  | \$ 84,252                                | \$ 29,498          | \$ 18,669       | \$ 3,665           | \$ 24,412          |
| Total operating costs and expenses (2)                      | 86,796                                   | 70,182             | 54,694          | 81,761             | 81,950             |
| Loss from operations  | (2,544)                                  | (40,684)           | (36,025)        | (78,096)           | (57,538)           |
| Other income (expense), net (3)                             | (9,782)                                  | (11,157)           | 38,807          | (846)              | (1,115)            |
| Net income (loss) before taxes                              | (12,326)                                 | (51,841)           | 2,782           | (78,942)           | (58,653)           |
| Income tax expense  | —  | —                  | 3               | —                  | —                  |
| Net income (loss)   | <u>\$ (12,326)</u>                       | <u>\$ (51,841)</u> | <u>\$ 2,779</u> | <u>\$ (78,942)</u> | <u>\$ (58,653)</u> |
| Basic net income (loss) per common share                    | <u>\$ (0.10)</u>                         | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  | <u>\$ (0.93)</u>   | <u>\$ (0.78)</u>   |
| Diluted net income (loss) per common share                  | <u>\$ (0.10)</u>                         | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  | <u>\$ (0.93)</u>   | <u>\$ (0.78)</u>   |
|   | December 31,                             |                    |                 |                    |                    |
|   | 2007                                     | 2006               | 2005            | 2004               | 2003               |
|   | (In thousands)                           |                    |                 |                    |                    |
| <b>Balance Sheet Data</b>                                   |  |                    |                 |                    |                    |
| Cash and cash equivalents                                   | \$ 22,500                                | \$ 28,002          | \$ 20,804       | \$ 23,808          | \$ 84,812          |
| Short-term investments                                      | 16,067                                   | 18,381             | 22,732          | 511                | 436                |
| Restricted cash   | 6,019                                    | 4,330              | —               | —                  | —                  |
| Current assets  | 58,088                                   | 65,888             | 50,288          | 26,607             | 97,234             |
| Working capital   | 34,488                                   | 43,221             | 33,744          | 3,004              | 66,776             |
| Total assets  | 84,815                                   | 91,478             | 72,577          | 46,260             | 118,850            |
| Current liabilities   | 23,600                                   | 22,667             | 16,544          | 23,603             | 30,458             |
| Long-term liabilities (4)                                   | 60,897                                   | 106,984            | 76,706          | 47,267             | 40,178             |
| Redeemable convertible preferences shares, at par value (5) | 1  | 1                  | 1               | 1                  | 1                  |
| Accumulated deficit   | (739,859)                                | (727,533)          | (675,692)       | (678,471)          | (599,529)          |
| Total shareholders' equity (net capital deficiency)         | 318                                      | (38,173)           | (20,673)        | (24,610)           | 48,214             |

We have paid no dividends

(1) 2007 includes a non-recurring license fee from Pfizer, Inc. of \$30.0 million.

## Table of Contents

- (2) Increases in 2007 and 2006 reflect increased spending on our development of XOMA 052 and our contracts with NIAID, SPRI, AVEO and Takeda. 2004 and 2003 include approximately \$16.4 million and \$7.5 million, respectively, of collaboration arrangement expenses related to our collaboration with Genentech on RAPTIVA®. This agreement was amended and, effective January 1, 2005, we no longer incurred these expenses.
- (3) 2007 and 2006 include interest expense of \$6.1 and \$6.9 million, respectively, related to the revaluation of the embedded derivative to fair market value and the payment in common shares, of the additional interest feature, on our convertible debt. 2005 includes a one-time gain of \$40.9 million as a result the restructuring of the Genentech agreement in January 2005.
- (4) In 2007, we eliminated the remaining \$44.5 million in convertible debt issued in 2006. The balance as of December 31, 2007 includes \$30.3 million from our Goldman Sachs term loan, \$20.6 million for our Novartis note, and \$10.0 million in long-term deferred revenue. In 2006, we exchanged convertible senior notes (issued in 2005) for \$60.0 million of 6.5% Convertible SNAPs<sup>SM</sup> due 2012 and issued an additional \$12.0 million of 6.5% SNAPs<sup>SM</sup> to the public for cash. The balance as of December 31, 2006 also includes our \$35.0 million term loan from Goldman Sachs completed in November of 2006. 2005 includes liabilities incurred in connection with our \$60.0 million aggregate principal amount of convertible senior notes due 2012 issued in February of 2005.
- (5) Aggregate liquidation preference of \$29.6 million.

### Quarterly Results of Operations (Unaudited)

The following is a summary of the quarterly results of operations for the years ended December 31, 2007 and 2006.

|   | Consolidated Statements of Operations    |                   |                    |                    |
|---|--|-------------------|--------------------|--------------------|
|   | Quarter Ended                            |                   |                    |                    |
|   | March 31                                 | June 30           | September 30       | December 31        |
|   | (In thousands, except per share amounts) |                   |                    |                    |
| <b>2007</b>                                 |  |                   |                    |                    |
| Total revenues (6)                          | \$ 12,252                                | \$ 14,136         | \$ 43,140          | \$ 14,724          |
| Total operating costs and expenses (7)      | 20,838                                   | 21,667            | 20,423             | 23,868             |
| Other expense, net                          | (7,342)                                  | (807)             | (900)              | (733)              |
| Net income (loss)                           | <u>\$ (15,928)</u>                       | <u>\$ (8,338)</u> | <u>\$ 21,817</u>   | <u>\$ (9,877)</u>  |
| Basic net income (loss) per common share    | <u>\$ (0.14)</u>                         | <u>\$ (0.06)</u>  | <u>\$ 0.17</u>     | <u>\$ (0.07)</u>   |
| Diluted net income (loss) per common share  | <u>\$ (0.14)</u>                         | <u>\$ (0.06)</u>  | <u>\$ 0.16</u>     | <u>\$ (0.07)</u>   |
| <b>2006</b>                                 |  |                   |                    |                    |
| Total revenues                              | \$ 5,604                                 | \$ 7,512          | \$ 7,355           | \$ 9,027           |
| Total operating costs and expenses          | 17,234                                   | 16,490            | 16,860             | 19,598             |
| Other income (expense), net                 | (8,973)                                  | 3,063             | (1,331)            | (3,916)            |
| Net loss                                    | <u>\$ (20,603)</u>                       | <u>\$ (5,915)</u> | <u>\$ (10,836)</u> | <u>\$ (14,487)</u> |
| Basic and diluted net loss per common share | <u>\$ (0.23)</u>                         | <u>\$ (0.06)</u>  | <u>\$ (0.11)</u>   | <u>\$ (0.14)</u>   |

- (6) Revenues in the quarter ended September 30, 2007 include a \$30.0 million non-recurring license fee from Pfizer.
- (7) Operating expenses for the quarter ended September 30, 2007 include a non-recurring credit of \$2.8 million related to an agreement reached with a major collaborator regarding material costs previously recorded under the collaboration agreement.

---

## [Table of Contents](#)

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Overview**

We are a biopharmaceutical company that discovers, develops and manufactures antibodies and other genetically-engineered protein products to treat immunological and inflammatory disorders, cancer and infectious diseases.

In the near term, our ability to achieve profitability will be highly dependent on sales levels of RAPTIVA<sup>®</sup>, which we developed under a collaboration agreement with Genentech, and LUCENTIS<sup>®</sup> for which Genentech licensed our BCE technology. Genentech is responsible for the manufacturing, marketing and sales effort in support of these products and we are entitled to receive royalties on worldwide sales. RAPTIVA<sup>®</sup> has been approved in the United States and the European Union for treating patients suffering from moderate-to-severe plaque psoriasis. LUCENTIS<sup>®</sup> is approved in the United States and Europe and is a treatment for neovascular (wet) age-related macular degeneration. Our near-term profits will also be influenced by our ability to generate revenues or benefit from cost-sharing arrangements, funded research and development, contract manufacturing or other development activities. We are developing a number of products, both proprietary and under collaboration agreements with other companies and may enter into additional arrangements. Our objective in development collaborations is to leverage our existing development infrastructure to broaden and strengthen our new product pipeline beyond what we can accomplish with proprietary products, thereby diversifying our development risk and gaining financial support from our collaboration partners.

We incurred a net loss in two of the past three years and expect to continue to operate at a loss until sufficient profits are generated from RAPTIVA<sup>®</sup>, LUCENTIS<sup>®</sup> and various manufacturing and development arrangements, or until we achieve additional regulatory approvals and commence commercial sales of additional products. The timing and likelihood of additional approvals is uncertain and there can be no assurance that approvals will be granted or that revenues from product sales will be sufficient to attain profitability.

#### **Critical Accounting Policies and the Use of Estimates**

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

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

#### ***Revenue Recognition***

Revenue is generally recognized when the four basic criteria of revenue recognition are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) is based on management's judgments regarding the nature of the fee charged for products or services delivered and the collectibility of those fees. Allowances are established for estimated uncollectible amounts, if any.

---

## **Table of Contents**

We recognize revenue from license and collaboration arrangements, contract services, product sales and royalties. Our revenue arrangements with multiple elements are divided into separate units of accounting, if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

### ***License and Collaborative Fees***

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

Up-front fees should be recognized ratably over the expected benefit period under the arrangement. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement. We have \$14.6 million of deferred up-front fees related to three research and collaboration agreements that are being amortized over a range of two to five years.

Milestone payments under collaborative arrangements are recognized as revenue upon completion of the milestone events, which represent the culmination of the earnings process because we have no future performance obligations related to the payment. Milestone payments that require a continuing performance obligation on our part are recognized over the expected period of the continuing performance obligation. Amounts received in advance are recorded as deferred revenue until the related milestone is completed.

### ***Contract Revenue***

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

### ***Royalty Revenue***

Royalty revenue and royalty receivables are generally recorded in the periods these royalties are earned, in advance of collection. The royalty revenue and receivables in these instances are based upon communication with collaborative partners, historical information and forecasted sales trends. Under some of our agreements with licensees that include receipt of royalty revenue, we do not have sufficient historical information to estimate royalty revenues or receivables in the period that these royalties are earned. For these contracts, we record royalty revenue upon cash receipt.

### ***Research and Development Expenses***

We expense research and development expenses as incurred. Research and development expenses consist of direct and research-related allocated overhead costs such as facilities costs, salaries and related personnel costs, patent costs and material and supply costs. In addition, research and development expenses include costs related to clinical trials to validate our testing processes and procedures and related overhead expenses. Under cost sharing

---

## **Table of Contents**

arrangements with collaborative partners, differences between our actual research and development spending and our share of such spending under the collaboration agreement will also be included as a cost sharing adjustment in our research and development expense. Expenses resulting from clinical trials are recorded when incurred based in part on estimates as to the status of the various trials. From time to time, research and development expenses may include upfront fees and milestones paid to collaborative partners for the purchase of rights to in-process research and development. Such amounts are expensed as incurred. The timing of upfront fees and milestone payments in the future may cause variability in our future research and development expenses.

### ***Long-Lived Assets***

In accordance with Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” we record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

### ***Share Based Compensation***

In December 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-Based Payment” (SFAS 123R), which requires that all share-based payments to employees and directors, including grants of stock options, be recognized in the statement of operations based on their fair values. SFAS 123R supersedes Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25) and amends SFAS No. 95, “Statement of Cash Flows”. On January 1, 2006, we adopted SFAS 123R, which requires the measurement and recognition of compensation expense for all share-based payment awards made to our employees and directors, including employee share options and employee share purchases related to the Employee Share Purchase Plan, on estimated fair values.

Prior to the adoption of SFAS 123R, in accordance with the provisions of SFAS 123, we elected to follow APB 25, and FASB Interpretation No. 44, “Accounting for Certain Transactions Involving Stock Compensation—an Interpretation of APB Opinion No. 25”, in accounting for our employee stock-based plans. Under APB 25, if the exercise price of our employee and director stock options was equal to or greater than the fair value of the underlying stock on the date of grant, no compensation expense was recognized. However, as required by SFAS 123, the pro forma impact of expensing the fair value of our stock options and employee stock purchase plan was disclosed in the notes to our Consolidated Financial Statements.

In connection with our adoption of SFAS 123R, we use the modified prospective transition method. Under this method, we are required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. To estimate the value of an award, we use the Black-Scholes option pricing model. This model requires inputs such as expected life, expected volatility and risk-free interest rate. Further, the forfeiture rate also impacts the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. While estimates of expected life, volatility and forfeiture rate are derived primarily from our historical data, the risk-free rate is based on the yield available on United States Treasury zero-coupon issues. We review our valuation assumptions quarterly and, as a result, it is likely we will change our valuation assumptions used to value share based awards granted in future periods.

At December 31, 2007, there was \$6.9 million of unrecognized share-based compensation expense related to unvested share options with a weighted-average remaining recognition period of 3.2 years.

### ***Income Taxes***

We account for uncertain tax positions in accordance with FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”), an interpretation of FASB Statement No. 109, “Accounting for

## Table of Contents

Income Taxes” (“SFAS 109”). The application of income tax law and regulations are inherently complex. Interpretations of and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income.

## Results of Operations

### Revenues

Total revenues in 2007 were \$84.3 million, compared with \$29.5 million in 2006 and \$18.7 million in 2005 as shown in the table below (in thousands):

|                                | Year ended December 31, |                  |                  |
|--------------------------------|-------------------------|------------------|------------------|
|                                | 2007                    | 2006             | 2005             |
| License and collaborative fees | \$ 36,460               | \$ 2,846         | \$ 5,061         |
| Contract and other revenue     | 31,057                  | 16,329           | 7,392            |
| Royalties                      | 16,735                  | 10,323           | 6,216            |
| Total revenues                 | <u>\$ 84,252</u>        | <u>\$ 29,498</u> | <u>\$ 18,669</u> |

License and collaborative fees revenues in 2007 were \$36.5 million, compared with \$2.8 million in 2006 and \$5.1 million in 2005. These revenues include upfront and milestone payments related to the out-licensing of our products and technologies and other collaborative arrangements. The increase of \$33.7 million for 2007 compared with 2006 primarily resulted from one-time payments from Pfizer, Inc. (“Pfizer”) and an existing technology partner in 2007 totaling \$31.3 million. These payments represent initial license fees for which no remaining obligation of the Company exists. We recognized \$4.3 million in revenue during the first quarter of 2007 which was the unamortized revenue from the \$10.0 million upfront collaboration fee received in connection with our collaboration with Novartis AG (“Novartis”) in February of 2004. In February of 2007, we announced that pursuant to the terms of our collaboration agreement with Novartis, the mutual exclusivity obligation to conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation has no impact on the existing collaboration projects which have reached the development stage and the parties may continue to collaborate on a non-exclusive basis. Prior to the expiration of the exclusivity period, the upfront fee was being amortized over the expected five-year term of the exclusivity provision, or at a rate of \$0.5 million a quarter. The \$2.3 million decrease in license and collaborative fees revenues for 2006 compared with 2005 was primarily related to \$2.0 million from an out-licensing agreement with Merck & Co., Inc. which we recognized in 2005. There was no such agreement in 2006.

Contract and other revenues were \$31.1 million in 2007 compared with \$16.3 million in 2006 and \$7.4 million in 2005. The increase of \$14.8 million in 2007 resulted primarily from increased activities in our contracts with AVEO Pharmaceuticals, Inc. (“AVEO”), Schering Plough Research Institute (“SPRI”), Takeda Pharmaceutical Company Limited (“Takeda”) and our July 2006 contract with the National Institute of Allergy and Infectious Diseases (“NIAID”), a part of the National Institutes of Health, Department of Health and Human Services which is being funded with federal funds under Contract No. HHSN26620060008C/N01-A1-60008. This increase was partially offset by the completion of our contract, in October of 2006, with NIAID. The contract was entered into in March of 2005 and was 100% funded with federal funds from NIAID under Contract No. HHSN26620050004C.

The increase of \$8.9 million in 2006 partially resulted from contracts entered into in 2006 with SPRI, Taligen, Cubist, AVEO but was primarily caused by contract manufacturing process services performed under our contracts with NIAID entered into in March of 2005 and July of 2006. The increase from these contracts was partially offset by a reduction in clinical trial services performed on behalf of Genentech and Novartis in 2005. We recognized revenue from the March 2005 NIAID contract as work was being performed on a proportional performance basis over an eighteen month period until final acceptance of the contract which was achieved in October of 2006. During

## Table of Contents

2006 and 2005, respectively, we recorded revenues of \$9.8 million and \$5.2 million from this contract. The July 2006 NIAID contract work is being performed on a cost plus fixed fee basis, per the terms of the contract, over a three year period. We are recognizing revenue as the services are performed on a proportional performance basis of which \$11.3 million and \$1.9 million were recognized in 2007 and 2006, respectively.

We defer revenue until all requirements under our revenue recognition policy are met. In 2007, we deferred \$23.3 million of revenue from five contracts including SPRI, AVEO and Takeda and recognized \$22.2 million in revenue from the five contracts including amortization of \$4.3 million of the \$10.0 million in upfront payments received from Novartis for our February 2004 oncology collaboration contract. In 2006, we deferred \$25.2 million of revenue from eight contracts including SPRI, NIAID, Takeda and Taligen and recognized \$16.1 million in revenue from the eight contracts including the amortization of the Novartis upfront payments. The 2005 \$8.3 million beginning balance is the unamortized balance on the Novartis contract, the \$1.5 million of revenue deferred relates to NIAID and the \$2.0 million of revenue recognized is the Novartis amortization.

The following table shows the activity in deferred revenue for the years ended December 31, 2007, 2006 and 2005, (in thousands):

|                            | Year ended December 31, |                  |                 |
|----------------------------|-------------------------|------------------|-----------------|
|                            | 2007                    | 2006             | 2005            |
| Beginning deferred revenue | \$ 16,968               | \$ 7,860         | \$ 8,333        |
| Revenue deferred           | 23,254                  | 25,204           | 1,527           |
| Revenue recognized         | (22,158)                | (16,096)         | (2,000)         |
| Ending deferred revenue    | <u>\$ 18,064</u>        | <u>\$ 16,968</u> | <u>\$ 7,860</u> |

Of the \$18.1 million balance in deferred revenue at December 31, 2007, \$8.0 million is expected to be earned over the next year and the remaining \$10.1 million is expected to be earned over the next five years. Future amounts may be impacted by additional consideration received, if any, under existing or any future licensing or other collaborative arrangements as well as changes in the estimated period of obligation or services to be provided under the arrangements.

Revenues from royalties were \$16.7 million in 2007 compared with \$10.3 million in 2006 and \$6.2 million in 2005. The increase in royalty revenues from 2005 through 2007 resulted primarily from an increase in RAPTIVA® royalties and the inception of LUCENTIS® royalties, in June of 2006, earned under our royalty arrangements with Genentech.

Revenues for 2008 may decrease as a result of the expiration in July 2008 of certain European patents in our BCE patent portfolio, which currently cover LUCENTIS® and, to the extent approved, CIMZIA®. We received approximately \$2.0 million in royalties from the sale of LUCENTIS® in Europe in 2007. Any such decrease may be offset if worldwide sales of RAPTIVA® and U.S. sales of LUCENTIS® continue to increase and/or if CIMZIA® is approved for marketing in the U.S. and sales commence.

### Research and Development Expenses

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



## Table of Contents

In 2007, our research and development expenses were \$66.2 million compared with \$52.1 million in 2006 and \$39.9 million in 2005.

The \$14.1 million increase in 2007 compared with 2006 primarily reflects increased spending on development of XOMA 052, including Phase 1 clinical trials, and our contracts with NIAID, SPRI/AVEO and Takeda, partially offset by a decrease in our spending on Taligen. We recorded \$31.5 million in salaries and employee related expenses in 2007 compared with \$22.8 million in 2006. Included in these amounts were \$27.9 million for salaries and benefits, \$2.6 million for bonus awards, and \$1.0 million for share based compensation in 2007 compared with \$21.1 million, \$1.2 million and \$0.5 million, respectively, in 2006. The increase in bonus awards includes the implementation of the Bonus Compensation Plan ("BCP") in 2007. The BCP provides performance-based bonuses to be paid to employees that did not qualify under the Management Incentive Compensation Plan ("MICP") or CEO Incentive Compensation Plan ("CICP", collectively "Incentive Plans").

In July of 2007, we reached an agreement with a major collaborator regarding material cost charges previously recorded under the collaboration agreement of \$2.8 million. The impact of the resolution resulted in a \$2.8 million reduction in research and development for the year ended December 31, 2007 as the original charges were recorded to research and development expense.

The \$12.2 million increase in 2006 compared with 2005 primarily reflects increases in spending on our contracts with NIAID, Taligen and AVEO, our development of XOMA 052 and NEUPREX®, and our collaborations with SPRI and Lexicon, partially offset by decreased spending on our collaboration agreements with Novartis, Genentech, Apton and Millennium, our development of XOMA 629 and the termination of our agreement with Cubist.

During 2005, we completed an annual review of leasehold improvements. Based on our review, we decided to abandon our plan to add a fermentation unit to our existing research and development facility. As certain leasehold improvements related to this project no longer prolonged the life of the related building nor enhanced its functional use, we expensed approximately \$0.6 million to depreciation expense for research and development in December 2005.

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. Using the current costing methods, the costs associated with these programs approximate the following (in thousands):

|                        | Year ended December 31, |                  |                  |
|------------------------|-------------------------|------------------|------------------|
|                        | 2007                    | 2006             | 2005             |
| Earlier stage programs | \$ 57,027               | \$ 41,548        | \$ 30,113        |
| Later stage programs   | 9,188                   | 10,546           | 9,783            |
| Total                  | <u>\$ 66,215</u>        | <u>\$ 52,094</u> | <u>\$ 39,896</u> |

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

|                            | Year ended December 31, |                  |                  |
|----------------------------|-------------------------|------------------|------------------|
|                            | 2007                    | 2006             | 2005             |
| Internal projects          | \$ 45,804               | \$ 32,033        | \$ 23,285        |
| Collaborative arrangements | 20,411                  | 20,061           | 16,611           |
| Total                      | <u>\$ 66,215</u>        | <u>\$ 52,094</u> | <u>\$ 39,896</u> |

---

## **Table of Contents**

In 2007, two development programs (XOMA 052 and NIAID) 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. In 2006, three development programs (Novartis, NIAID and XOMA 052) 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. In 2005, one development program (Novartis) accounted for more than 30% but less than 40% and no development program accounted for more than 40% of our total research and development expenses.

We currently anticipate that research and development expenses will continue to increase in 2008 as compared with 2007. We expect our spending on our collaborations with Novartis and Lexicon to continue as well as increases in spending on our collaborations with SPR1 and Takeda, our contract with NIAID, our development of XOMA 052 and other new projects. Future research and development spending may also be impacted by potential new licensing or collaboration arrangements, as well as the termination of existing agreements. Beyond this, the scope and magnitude of future research and development expenses are difficult to predict at this time.

### ***General and Administrative Expenses***

General and administrative expenses include salaries and related personnel costs, facilities costs and professional fees. In 2007, general and administrative expenses were \$20.6 million compared with \$18.1 million in 2006 and \$14.8 million in 2005.

The increase of \$2.5 million compared with 2006 primarily relates to increased compensation costs. Compensation costs in 2007 include \$6.7 million in salaries, \$1.4 million in bonus awards and \$1.9 million in share based compensation in 2007 compared with \$6.2 million, \$0.8 million and \$0.5 million in 2006, respectively. The increase in share based compensation includes \$0.9 million in share-based compensation costs related to the CEO transition in the third quarter of 2007 and the increase in bonus awards includes the implementation of BCP.

The increase of \$3.3 million for 2006 compared with 2005 resulted primarily from increased employee related costs, principally from additional legal and business development staffing, debt issuance expenses related to our February 2006 convertible debt, and increased legal, audit and other consulting fees. In addition, during 2006, we recorded \$0.5 million of share-based compensation expense. No share-based compensation expense was recorded in 2005.

We anticipate that general and administrative expenses will increase in 2008 as a result of increases in salaries and other personnel-related costs.

### ***Investment and Interest Income***

In 2007, investment and interest income was \$1.9 million compared with \$1.7 million and \$1.9 million in 2006 and 2005, respectively. Investment and interest income consists primarily of interest earned on our cash and investment balances. The differences between 2007, 2006, and 2005 resulted from varying average cash balances and interest rates.

### ***Interest Expense***

In 2007, interest expense was \$11.6 million compared with \$12.9 million and \$4.3 million in 2006 and 2005, respectively. Interest expense for 2007 consisted of \$6.1 million from the revaluation of the embedded derivative related to the additional interest feature of our convertible debt, \$0.2 million of interest expense on our convertible debt, \$0.1 million in net amortization of debt issuance costs, discount and premium on our convertible debt, \$3.4 million of interest expense on our Goldman Sachs loan, \$0.4 million in amortization of debt issuance costs on Goldman Sachs loan and \$1.3 million of interest expense on our note with Novartis.

---

## **Table of Contents**

Interest expense for 2006 consisted of \$6.9 million from the revaluation to fair market value of the embedded derivative on our convertible debt, including \$4.8 million related to shares paid for the additional interest feature on converted debt, \$3.4 million of interest expense payable on our convertible debt, \$1.0 million in net amortization of debt issuance costs, discount and premium on our convertible debt, \$0.5 million of interest payable on our term loan, \$42,000 in amortization of debt issuance costs on our term loan and \$1.0 million of interest payable on our note with Novartis. Interest expense for 2005 consisted of \$3.5 million of interest on our convertible debt, \$0.5 million in amortization of debt issuance costs on our convertible debt and \$0.3 million of interest payable on our note with Novartis.

Interest expense for 2008 is expected to decrease compared to 2007 due to the elimination of our convertible debt, which represented \$6.5 million of interest expense in 2007. This decrease may be offset by additional interest expense in the event we obtain new financing.

### ***Income Taxes***

We have recorded cumulative net deferred tax assets of \$205.6 million and \$163.3 million at December 31, 2007 and 2006, respectively, principally attributable to the timing of the deduction of certain expenses associated with certain research and development expenses, net operating loss and other carryforwards. We also recorded corresponding valuation allowances of \$205.6 million and \$163.3 million at December 31, 2007 and 2006, respectively, to offset these deferred tax assets, as management cannot predict with reasonable certainty that the deferred tax assets to which the valuation allowance relates will be realized.

As of December 31, 2007, we had federal net operating loss carryforwards of approximately \$149.7 million to offset future taxable income. We also had federal research and development tax credit carryforwards of approximately \$11.3 million. If not utilized, these carryforwards will begin to expire in 2008. Our activities in Ireland and the adoption of FIN 48 in 2007 have allowed us to record previously unrecorded net operating losses related to our Irish subsidiary. These net operating losses are subject to a full valuation allowance. The availability of our net operating loss and tax credit carryforwards may be subject to substantial limitation if it is determined that our ownership has changed by more than 50% over a three year period.

In 2007, income tax expense was zero compared with zero in 2006 and \$3,000 in 2005. The expense in 2005 is related to activities of our foreign operations.

### **Accounting for Share-Based Compensation**

Prior to the adoption of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") on January, 1, 2006, we accounted for our share-based compensation plans under the intrinsic value method described in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and related Interpretations as permitted by 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" ("SFAS 148"). In general, as the exercise price of the options granted under our plans was equal to the market price of the underlying common shares on the grant date, no share-based employee compensation cost was recognized. As required by SFAS 148 prior to the adoption of SFAS 123R, we provided pro forma net income (loss) and pro forma net income (loss) per common share disclosures for share-based awards, as if SFAS 123 had been applied.

SFAS 123R requires all share based payments to be recognized in the financial statements based on their fair values. We elected to use the modified prospective transition method as permitted by SFAS 123R and, therefore, have not restated our financial results for prior periods to reflect expensing of share-based compensation. As a result, the results for the years ended December 31, 2007 and 2006 are not comparable to the year ended December 31, 2005.

In November of 2005, the FASB issued FASB Staff Position FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share Base Payment Awards," which allowed a one-time election to adopt one

---

## **Table of Contents**

of two acceptable methodologies for calculating the initial additional paid-in capital pool (“APIC pool”). We elected the “short-cut” method to establish our APIC pool required under FAS 123(R) for the year ended December 31, 2006. In subsequent periods, the APIC pool will be increased by tax benefits from share-based compensation and decreased by tax deficiencies caused when the recorded share-based compensation for book purposes exceeds the allowable tax deduction. As of December 31, 2007, we had not recorded any adjustments to the APIC pool due to our loss position and the balance remained zero.

Prior to the adoption of SFAS 123R, our Board of Directors approved the acceleration of vesting of all outstanding employee share options with an exercise price greater than \$3.00 per share. Because the exercise price of all the accelerated options exceeded the market price per share of the common shares as of the new measurement date, the acceleration had no impact on our earnings in 2005. Since the accelerated options had exercise prices in excess of the current market value of our common shares, the options had limited economic value and were not fully achieving their original objective of incentive compensation and employee retention. The modification allows expense recognized after the adoption of SFAS 123R to better reflect our compensation strategies.

During the year ended December 31, 2007, we recognized \$2.9 million in share-based compensation expense compared with \$1.0 million in 2006. The increase of \$1.9 million relates to annual grants in February 2007, a one-time employee grant in October 2007 (described below) and \$0.9 million in share-based compensation related to our CEO transition in the third quarter of 2007. At December 31, 2007, there was \$6.9 million of unrecognized share-based compensation expense related to unvested shares with a weighted-average remaining recognition period of 3.2 years.

On October 31, 2007, our Board of Directors, on the recommendation of its compensation committee, approved a company-wide grant to employees of additional options to purchase common shares. The purpose of the grant was to improve the level of employee ownership in the business by using existing share based option plans to bring the Company in line with competitive industry levels. Of the total of 6,635,000 options granted, 5,185,000 options were made subject to shareholder approval of a commensurate increase in the number of shares available for the grant of options under the Company’s existing share option plans. As of December 31, 2007, the 5,185,000 shares are not included in any of the options outstanding disclosures, options granted disclosures, or share-based compensation expense as they are not deemed granted for accounting purposes until shareholder approval is obtained, and we expect our share based compensation expense to increase in future years accordingly.

## **Liquidity and Capital Resources**

Cash, cash equivalents and short-term investments at December 31, 2007 was \$38.6 million compared with \$46.4 million and \$43.5 million at December 31, 2006 and 2005, respectively. The \$7.8 million decrease primarily reflects cash provided by operating activities of \$4.5 million and net proceeds from short-term investments of \$2.3 million offset by cash used in the purchase of fixed assets of \$9.5 million and \$4.7 million used in paying down the principal balance of the Goldman Sachs loan.

Net cash provided by operating activities was \$4.5 million in 2007 compared with net cash used in operations of \$33.3 million in 2006 and \$44.2 million in 2005.

Cash provided by operations for 2007 consisted of a net loss of \$12.3 million with non-cash addbacks for depreciation and amortization of \$6.2 million, the revaluation of our embedded derivative of \$6.1 million, equity share-based compensation of \$2.9 million, and the amortization of debt issuance costs and the premium or discount on convertible notes of \$0.6 million, as well as a net increase in liabilities of \$4.5 million, which was partially offset by cash payments for the additional interest feature of our convertible debt of \$5.2 million and \$0.4 million of accrued interest on convertible debt and other interest bearing obligations. During the year ended December 31, 2007, we made payments of \$6.6 million for interest on our convertible debt, \$3.1 million for interest on our Goldman Sachs term loan, and \$1.0 million for our Incentive Plans, which is paid in the first

---

## Table of Contents

quarter of each year. In October 2007, the Board of Directors approved amendments to the Incentive Plans eliminating the provisions requiring payments to be made partly in Common Shares. Beginning in 2008, bonuses awarded under the Incentive Plans will be paid entirely in cash.

Cash used in operations in 2006 consisted of a net loss of \$51.8 million with non-cash addbacks for the revaluation of our embedded derivative of \$6.9 million, depreciation and amortization of \$6.2 million, equity related compensation of \$2.1 million and accrued interest of \$1.2 million along with a net increase in liabilities of \$10.4 million partially offset by an increase in assets of \$8.2 million. During 2006, we made payments of \$2.7 million for debt issuance costs on our convertible debt of which \$2.0 million related to cash used in operations, \$3.8 million for interest on our convertible debt and \$1.1 million for our Incentive Plans.

Cash used in operations for 2005, consisted of a net income of \$2.8 million with non-cash deductions of \$40.9 million for a gain on the extinguishment of our debt with Genentech and a \$0.3 million gain on a sale of investments along with a net increase in assets of \$4.2 million and a net decrease in liabilities of \$10.4 million partially offset by non-cash addbacks for depreciation and amortization of \$5.8 million, equity related compensation of \$1.4 million and accrued interest of \$1.7 million. During 2005, we made payments of \$4.0 million on our Genentech collaboration liability, \$1.9 million for interest on our convertible debt and \$1.3 million for our Incentive Plans.

Net cash used in investing activities for 2007, 2006 and 2005 was \$8.8 million, \$8.4 million and \$27.4 million, respectively. Cash used in investing activities consisted of purchases of property and equipment of \$9.5 million, \$8.5 million and \$4.8 million and net proceeds from short-term investments of \$2.3 million, \$4.4 million and net purchases of short-term investments of \$22.5 million for 2007, 2006 and 2005, respectively. In addition, \$1.7 million was transferred to restricted cash in 2007.

Net cash provided by (used in) financing activities in 2007, 2006 and 2005 was \$(1.2) million, \$48.9 million and \$68.6 million, respectively. Financing activities in 2007 included \$4.7 million in principal pay down of the Goldman Sachs term loan offset by \$2.8 million of additional draw down of the Novartis note and \$0.7 million in proceeds from the issuance of common shares. Financing activities in 2006 consisted of \$35.0 million from our term loan with Goldman Sachs, offset by \$1.5 million in debt issuance costs, \$12.5 million in proceeds from the issuance of convertible notes, offset by \$0.5 million in debt issuance costs, a \$3.0 million advance on our line-of-credit with Novartis and \$0.4 million in proceeds from the issuance of common shares. Financing activities in 2005, consisted of an issuance of \$60.0 million of convertible senior notes for net proceeds of \$56.4 million, a \$12.4 million drawdown on our Novartis loan facility and \$0.2 million in proceeds from the issuance of common shares partially offset with principal payments on capital lease obligations of \$0.2 million and payments of short-term loan obligations of \$0.1 million.

Due to the recent adverse developments in the credit markets, we may experience reduced liquidity with respect to some of our short-term investments. These investments are generally held to maturity, which is generally less than one year. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation. As of December 31, 2007, we held \$8.6 million of auction rate securities, of which \$3.1 million failed at auction during the first quarter of 2008. As of March 7, 2008, we held \$4.1 million of these securities. To date we have not experienced any liquidity issues with respect to these securities, but should such issues arise, we may be required to hold some, or all, of these securities until maturity. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash and cash equivalents and short-term investments will be sufficient to meet our anticipated cash needs for at least the next twelve months. We have the ability and intent to hold our debt securities to maturity when they will be redeemed at full par value. Accordingly, we consider unrealized losses to be temporary and have not recorded a provision for impairment.

### *Goldman Sachs Term Loan*

On November 9, 2006, XOMA (US) LLC entered into a five-year, \$35.0 million term loan facility ("the facility") with Goldman Sachs and borrowed the full amount thereunder. The loan is guaranteed by XOMA.

---

## Table of Contents

Indebtedness under the facility will bear interest at an annual rate equal to six-month LIBOR plus 5.25%, which was 10.39% at December 31, 2007, and is secured by all rights to receive payments due XOMA (US) LLC relating to RAPTIVA<sup>®</sup>, LUCENTIS<sup>®</sup> and CIMZIA<sup>™</sup> and other assets. Payments received by XOMA (US) LLC in respect of these payment rights, in addition to a standing reserve of the next semi-annual interest payment, will be held in a custodial account which is classified as restricted cash. This cash account and the interest earned thereon can be used solely for the payment of the interest amounts in March and September of each year and, at that time, amounts in excess of the interest reserve requirement may be used to pay down principal or be distributed back to us, at the discretion of the lender. XOMA (US) LLC may prepay indebtedness under the facility at any time, subject to certain prepayment premiums. XOMA (US) LLC is required to comply with a debt covenant determined by the ratio of royalties collected to interest payable. Proceeds from the loan will be used for general corporate purposes.

At December 31, 2007, the outstanding principal amount under this loan totaled \$30.3 million and the balance in restricted cash was \$6.0 million. Debt issuance costs of \$1.5 million are being amortized on a straight-line basis over the five year life of the loan and are disclosed as current and long-term debt issuance costs on the balance sheet. In 2007, we incurred interest expense payable of \$3.4 million and amortization of debt issuance costs of \$0.3 million.

### *Novartis Note*

In May of 2005, we executed a secured note agreement with Novartis. Under the note agreement, Novartis agreed to make semi-annual loans to us, to fund up to 75% of our research and development and commercialization costs under the collaboration arrangement, not to exceed \$50.0 million in an aggregate principal amount. Any unpaid principal amount together with accrued and unpaid interest shall be due and payable in full on June 21, 2015, the tenth anniversary date of the advance date on which the first loan was made. Interest on the unpaid balance of the principal amount of each loan shall accrue at a floating rate per annum which was equal to 6.75% at December 31, 2007, and is payable semi-annually in June and December of each year. At our election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed \$50.0 million. Loans under the note agreement are secured by our interest in the collaboration with Novartis, including our share of any profits arising therefrom. At December 31, 2007, the outstanding principal balance under this note agreement totaled \$20.6 million and for the years ended December 31, 2007, 2006 and 2005, we incurred and capitalized interest expense of \$1.3 million, \$1.0 million and \$0.3 million, respectively.

### *Convertible Debt*

In February of 2006, we completed an exchange offer with holders of our 6.5% convertible senior notes due 2012 in which we exchanged \$60.0 million aggregate principal amount of our new 6.5% Convertible SNAPS<sub>SM</sub> due 2012 (the "New Notes") for all \$60.0 million aggregate principal amount of our then outstanding convertible senior notes due 2012. We also issued an additional \$12.0 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million. The New Notes were initially convertible into approximately 38.4 million common shares at a conversion rate of 533.4756 of common shares per \$1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately \$1.87 per common share.

We separately accounted for the additional interest payment feature of the New Notes as an embedded derivative instrument, which was measured at fair value and classified on the balance sheet with the convertible debt. Changes in the fair value of the embedded derivative were recognized in earnings as a component of other income (expense). The initial fair value of the derivative was subtracted from the carrying value of the debt, reflected as a debt discount, which was amortized as interest expense using the effective interest method through the date the notes were scheduled to mature, and separately reported as a derivative liability.

## Table of Contents

The additional New Notes were issued to the initial purchasers for net proceeds of \$11.8 million. Debt issuance costs related to the New Notes of approximately \$0.7 million were being amortized on a straight-line basis over the original 72 month life of the notes. Additional debt issuance costs of \$2.0 million, related to the modification of the existing debt, were expensed as incurred with \$1.1 million and \$0.9 million expensed during the quarters ended March 31, 2006 and December 31, 2005, respectively.

At the time of note conversion, unamortized discount, premium and debt issuance costs related to the converted notes was charged to shareholder's equity.

For the year ended December 31, 2006, \$27.5 million of New Notes were converted into 18,262,264 common shares including 3,602,879 shares related to the additional interest payment feature of the notes. As of December 31, 2006, we have elected to pay all additional interest owed in common shares. We recorded a \$6.9 million charge to interest expense during the year ended December 31, 2006, as a result of an increase in the fair value of the embedded derivative on our convertible debt including \$4.8 million related to the additional interest feature of the converted notes. The remaining principal for the New Notes was \$44.5 million as of December 31, 2006.

During the first quarter of 2007, \$42.0 million of New Notes were voluntarily converted by holders through March 7, 2007, at which time we announced that we had elected to automatically convert 100% of the remaining \$2.5 million of New Notes outstanding. As a result, during the quarter 25,640,187 shares were issued to effect the conversion of the principal balances. Additionally, we issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted New Notes. We recorded a \$6.1 million charge to interest expense during the first quarter of 2007 as a result of the revaluation of the embedded derivative related to the additional interest feature of the convertible notes.

For the years ended December 31, 2007, 2006 and 2005, we incurred \$0.2 million, \$3.4 million and \$3.5 million, respectively, in interest expense on our convertible debt. Additionally, we amortized a net of \$0.1 million, \$1.0 million and \$0.5 million in debt issuance costs, premium and discount for the years ended December 31, 2007, 2006, and 2005, respectively.

### Purchase Obligations

In September of 2007, we entered into a five year purchase agreement for custom cell culture medium for use in our research and development activities. Under the terms of the agreement we are obligated to meet certain annual purchase commitments. These commitments are included in the schedule of contractual obligations below.

### Schedule of Contractual Obligations

Payments by period due under contractual obligations at December 31, 2007, mature as follows (in thousands):

| Contractual Obligations | Total           | Less than 1 year | 1 to 3 years     | 3 to 5 years     | More than 5 years |
|-------------------------|-----------------|------------------|------------------|------------------|-------------------|
| Operating leases        | \$10,365        | \$ 2,287         | \$ 3,389         | \$ 2,890         | \$ 1,799          |
| Purchase obligations    | 550             | 110              | 220              | 220              | —                 |
| Debt Obligations (a)    |                 |                  |                  |                  |                   |
| Principal               | 50,850          | —                | —                | 30,293           | 20,557            |
| Interest                | 23,614          | 4,605            | 9,159            | 6,381            | 3,469             |
| Total                   | <u>\$85,379</u> | <u>\$ 7,002</u>  | <u>\$ 12,768</u> | <u>\$ 39,784</u> | <u>\$ 25,825</u>  |

- (a) See "Item 7A—Quantitative and Qualitative Disclosures about Market Risk" and Note 4—"Convertible Notes and Other Arrangements" to the accompanying consolidated financial statements for further discussion of our debt obligations.

---

## **Table of Contents**

In addition to the above, we have committed to make potential future “milestone” payments to third parties as part of licensing and development programs. Payments under these agreements become due and payable only upon the achievement of certain developmental, regulatory and/or commercial milestones. Because it is *uncertain* if and when these milestones will be achieved, such contingencies, aggregating up to \$58.3 million have not been recorded on our consolidated balance sheet. We are unable to determine precisely when and if our payment obligations under the agreements will become due as these obligations are based on milestone events, the achievement of which is subject to a significant number of risks and uncertainties.

We currently anticipate continued losses in 2008. Our strategy is to attempt to continue broadening our product pipeline through internal development, additional collaborations such as our arrangements with SPRI and Takeda and additional government and other external contracts such as those with NIAID; and to increase revenues or benefits from cost sharing arrangements which take advantage of our manufacturing and development capabilities.

We expect our cash, cash equivalents and short-term investments to decrease during 2008 as a result of the use of cash to fund ongoing operations and capital investments. Additional licensing, antibody discovery collaboration agreements and potential financing agreements may positively impact our cash balances.

Based on current spending levels, anticipated revenues, collaborator funding, and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. 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 “Risk Factors” included in Item 1A.

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.

### **Recent Accounting Pronouncements**

#### *Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157 “Fair Value Measurements” (SFAS No. 157). SFAS No. 157 establishes a common definition for fair value, creates a framework for measuring fair value, and expands disclosure requirements about such fair value measurements. SFAS No. 157 is effective for the first quarter of 2008. We are in the process of studying the impact of this interpretation on our financial accounting and reporting, however, we do not expect the adoption of SFAS No. 157 to have a material impact on our financial position or results of operations.

#### *Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the FASB issued FASB No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115” (SFAS No. 159). SFAS No. 159 provides companies with an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 will be effective for the Company beginning on January 1, 2008. We are in the process of studying the impact of this interpretation on our financial accounting and reporting, however, we do not expect the adoption of SFAS No. 159 to have a material impact on our financial position or results of operations.



---

## **Table of Contents**

### *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*

In June 2007, the Emerging Issues Task Force issued EITF Issue 07-03, “Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development” (EITF No. 07-03). EITF No. 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under EITF No. 07-03, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF No. 07-03 is effective for fiscal years beginning after December 15, 2007 and interim periods within those years. We do not expect the adoption of EITF No. 07-03 to have a material impact on our financial position or results of operations.

### *Accounting for Collaborative Agreements*

In December of 2007, the EITF reached a consensus on EITF 07-01 “Accounting for Collaborative Agreements” (“EITF 07-01”). EITF 07-01 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, and other applicable accounting literature. The consensus should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. The consensus is effective for fiscal years beginning after December 15, 2008. We are currently evaluating EITF 07-01 and its impact, if any, on our consolidated results of operations and financial condition.

### **Subsequent Events**

As of March 7, 2008 we had \$4.1 million of our investment portfolio invested in auction rate securities. These auction rate securities provide liquidity through an auction process that resets the applicable interest rate at predetermined calendar intervals, usually every 35 days. If the auctions for the securities we own fail, the investments may not be readily convertible to cash until a future auction of these investments is successful. During the first quarter of 2008, auctions for \$3.1 million of our investments in auction rate securities failed. Based on our ability to access our cash and other short-term investments, our expected operating cash flows, and our other sources of cash, we do not expect the current lack of liquidity on these investments will affect our ability to operate our business.

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

Certain statements contained herein related to the sufficiency of our cash resources, levels of future revenues, losses, expenses and cash, future sales of approved products, 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 period for which our cash resources are sufficient could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated, if anticipated revenues or cost sharing arrangements do not materialize, if funds are not otherwise available on acceptable terms; revenue levels may be other than as expected if sales of approved products are lower than expected; losses may be other than as expected for any of the reasons affecting revenues and expenses; expense levels and cash utilization may be other than as expected due to unanticipated changes in our research and

---

## Table of Contents

development programs; and the sales efforts for approved products may not be successful if the parties responsible for marketing and sales fail to meet their commercialization goals, due to the strength of the competition, if physicians do not adopt the product as treatment for their patients or if remaining 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 existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; our ability to meet the demand of the United States government agency with which we have entered our first government contract; competition; market demands 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 “Item 1A—Risk Factors”.

### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

#### ***Interest Rate Risk***

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

In November of 2006, we entered into a five-year senior term loan facility in the aggregate amount of \$35.0 million with the principal due at maturity. Interest on the facility will be at a rate of USD six month LIBOR plus 5.25%, which was 10.39% at December 31, 2007.

As of December 31, 2007, we have drawn down \$20.6 million against the Novartis \$50.0 million loan facility that is due in 2015 at an interest rate of USD six month LIBOR plus 2 percent which was 6.75% at December 31, 2007.

We estimate that a hypothetical 100 basis point change in interest rates could increase or decrease our interest expense by approximately \$516,000 on an annualized basis.

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

Due to the recent adverse developments in the credit markets, we may experience reduced liquidity with respect to some of our short-term investments. These investments are generally held to maturity, which is generally less than one year. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation. As of December 31, 2007, we held \$8.6 million of auction rate securities, of which \$3.1 million failed at auction during the first quarter of 2008. As of March 7, 2008, we held \$4.1 million of these securities. To date we have not experienced any liquidity issues with respect to these securities, but should such issues arise, we may be required to hold some, or all, of these securities until maturity. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash and cash equivalents and short-term investments will be sufficient to meet our anticipated cash needs for at least the next twelve months. We have the ability and intent to hold our debt securities to maturity when they will be redeemed at full par value. Accordingly, we consider unrealized losses to be temporary and have not recorded a provision for impairment.

## Table of Contents

The following table presents the amounts and related weighted interest rates of our cash and investments at December 31, 2007 and 2006, (in thousands, except interest rate):

|                           | <u>Maturity</u>                | <u>Carrying Amount<br/>(in thousands)</u> | <u>Fair Value<br/>(in thousands)</u> | <u>Average<br/>Interest Rate</u> |
|---------------------------|--------------------------------|---|--------------------------------------|----------------------------------|
| December 31, 2007         |                                |   |                                      |                                  |
| Cash and cash equivalents | Daily to 90 days               | \$ 22,504                                 | \$ 22,500                            | 5.01%                            |
| Short-term investments    | 91 days to less than 18 months | 16,072                                    | 16,067                               | 5.19%                            |
| December 31, 2006         |                                |   |                                      |                                  |
| Cash and cash equivalents | Daily to 90 days               | \$ 28,000                                 | \$ 28,002                            | 4.91%                            |
| Short-term investments    | 91 days to less than 18 months | 18,392                                    | 18,381                               | 4.30%                            |

### **Item 8. Financial Statements and Supplementary Data**

The following consolidated financial statements of the registrant, related notes and report of independent registered public accounting firm are set forth beginning on page F-1 of this report.

|  |     |
|--|-----|
| <a href="#">Report of Independent Registered Public Accounting Firm</a>                  | F-2 |
| <a href="#">Consolidated Balance Sheets</a>  | F-3 |
| <a href="#">Consolidated Statements of Operations</a>                                    | F-4 |
| <a href="#">Consolidated Statements of Shareholders' Equity (Net Capital Deficiency)</a> | F-5 |
| <a href="#">Consolidated Statements of Cash Flows</a>                                    | F-6 |
| <a href="#">Notes to the Consolidated Financial Statements</a>                           | F-7 |

### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

### **Item 9A. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chairman of the Board, Chief Executive Officer and President 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-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Our disclosure controls and procedures are intended to ensure that the information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to our management, including the Chairman of the Board, Chief Executive Officer and President and Vice President, Finance and Chief Financial Officer, as the principal executive and financial officers, respectively, to allow timely decisions regarding required disclosures. Based on this evaluation, our Chairman of the Board, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

We continue to enhance 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 2007 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial accounting.

---

## [Table of Contents](#)

### ***Management's Report on Internal Control over Financial Reporting***

Management, including our Chairman of the Board, President and Chief Executive Officer and our Vice President, Finance and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Exchange Act Rules 13a-159f). The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements in accordance with accounting principles generally accepted in the United States.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. In making this assessment, Management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment we believe that, as of December 31, 2007, our internal control over financial reporting is effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2007, has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Ernst & Young's attestation report on the Company's internal control over financial reporting follows.

### **Changes in Internal Control over Financial Reporting**

Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated any changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2007, and has concluded that there was no change during such quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders of XOMA Ltd.**

We have audited XOMA Ltd.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). XOMA Ltd.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, XOMA Ltd. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of XOMA Ltd. as of December 31, 2007 and 2006 and the related consolidated statements of operations, shareholders' equity (net capital deficiency) and cash flows for each of the three years in the period ended December 31, 2007 of XOMA Ltd., and our report dated March 10, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Palo Alto, California  
March 10, 2008

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers, Corporate Governance**

The section labeled “Item 1—Election of Directors” appearing in our proxy statement for the 2008 Annual General Meeting of Shareholders is incorporated herein by reference. Certain information concerning our executive officers is set forth in Part I of this Form 10-K.

**Item 11. Executive Compensation**

The section labeled “Compensation of Executive Officers” appearing in our proxy statement for the 2008 Annual General Meeting of Shareholders is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

The section labeled “Share Ownership” appearing in our proxy statement for the 2008 Annual General Meeting of Shareholders is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Not applicable.

**Item 14. Principal Accounting Fees and Services**

The section labeled “Item 2—Appointment of Independent Auditors” appearing in our proxy statement for the 2008 Annual General Meeting of Shareholders is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

- (a) The following documents are included as part of this Annual Report on Form 10-K:
- (1) Financial Statements:  
All financial statements of the registrant referred to in Item 8 of this Report on Form 10-K.
  - (2) Financial Statement Schedules:  
All financial statements schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto or is not applicable or required.
  - (3) Exhibits:  
See “Index to Exhibits” On page i of this report.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, on this 11<sup>th</sup> day of March 2008.

XOMA LTD.

By:                                 /s/ STEVEN B. ENGLE  
  **Steven B. Engle**  
  **Chairman of the Board, Chief Executive**  
  **Officer and President**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u>  | <u>Title</u>  | <u>Date</u>    |
|---|---|----------------|
| <u>                                /s/ STEVEN B. ENGLE</u><br><b>(Steven B. Engle)</b>                    | Chairman of the Board, Chief Executive Officer and<br>President                                     | March 11, 2008 |
| <u>                                /s/ J. DAVID BOYLE II</u><br><b>(J. David Boyle II)</b>                | Vice President, Finance and Chief Financial Officer<br>(Principal Financial and Accounting Officer) | March 11, 2008 |
| <u>                                /s/ PATRICK J. SCANNON</u><br><b>(Patrick J. Scannon, M.D., Ph.D.)</b> | Executive Vice President and Chief Biotechnology Officer  | March 11, 2008 |
| <u>                                /s/ W. DENMAN VAN NESS</u><br><b>(W. Denman Van Ness)</b>              | Director  | March 11, 2008 |
| <u>                                (James G. Andress)</u>   | Director  |                |
| <u>                                /s/ WILLIAM K. BOWES, JR.</u><br><b>(William K. Bowes, Jr.)</b>        | Director  | March 11, 2008 |
| <u>                                /s/ CHARLES J. FISHER</u><br><b>(Charles J. Fisher, M.D.)</b>          | Director  | March 11, 2008 |
| <u>                                /s/ PETER BARTON HUTT</u><br><b>(Peter Barton Hutt)</b>                | Director  | March 11, 2008 |
| <u>                                /s/ PATRICK J. ZENNER</u><br><b>(Patrick J. Zenner)</b>                | Director  | March 11, 2008 |



---

[Table of Contents](#)

**Index to Consolidated Financial Statement s**

|  |     |
|--|-----|
| <a href="#">Report of Independent Registered Public Accounting Firm</a>                  | F-2 |
| <a href="#">Consolidated Balance Sheets</a>  | F-3 |
| <a href="#">Consolidated Statements of Operations</a>                                    | F-4 |
| <a href="#">Consolidated Statements of Shareholders' Equity (Net Capital Deficiency)</a> | F-5 |
| <a href="#">Consolidated Statements of Cash Flows</a>                                    | F-6 |
| <a href="#">Notes to the Consolidated Financial Statements</a>                           | F-7 |

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Shareholders of XOMA Ltd.**

We have audited the accompanying balance sheets of XOMA Ltd. as of December 31, 2007 and 2006, and the related statements of operations, shareholders' equity (net capital deficiency), and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of XOMA Ltd.'s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of XOMA Ltd. at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in 2006 XOMA Ltd. changed its method of accounting for stock-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), XOMA Ltd.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2008 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Palo Alto, California  
March 10, 2008

[Table of Contents](#)

**XOMA Ltd.**  
**CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except share and per share amounts)**

|   | December 31,     |                  |
|---|------------------|------------------|
|   | 2007             | 2006             |
| <b>ASSETS</b>   |                  |                  |
| Current assets:   |                  |                  |
| Cash and cash equivalents   | \$ 22,500        | \$ 28,002        |
| Short-term investments  | 16,067           | 18,381           |
| Restricted cash   | 6,019            | 4,330            |
| Receivables   | 12,135           | 12,045           |
| Prepaid expenses  | 1,113            | 1,061            |
| Debt issuance costs   | 254              | 668              |
| Total current assets  | <u>58,088</u>    | <u>64,487</u>    |
| Property and equipment, net   | 25,603           | 22,434           |
| Debt issuance costs—long-term   | 722              | 2,661            |
| Other assets  | 402              | 495              |
| Total assets  | <u>\$ 84,815</u> | <u>\$ 90,077</u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b><br><b>(NET CAPITAL DEFICIENCY)</b>  |                  |                  |
| Current liabilities:  |                  |                  |
| Accounts payable  | \$ 6,995         | \$ 4,186         |
| Accrued liabilities   | 7,710            | 7,086            |
| Accrued interest  | 878              | 1,794            |
| Deferred revenue  | 8,017            | 8,200            |
| Total current liabilities   | 23,600           | 21,266           |
| Deferred revenue—long-term  | 10,047           | 8,768            |
| Convertible debt—long-term  | —                | 46,823           |
| Interest bearing obligation—long-term   | 50,850           | 51,393           |
| Total liabilities   | <u>84,497</u>    | <u>128,250</u>   |
| Commitments and contingencies (Note 6)  |                  |                  |
| Shareholders' equity (net capital deficiency):  |                  |                  |
| Preference shares, \$.05 par value, 1,000,000 shares authorized   |                  |                  |
| Series A, 210,000 designated, no shares issued and outstanding at December 31, 2007 and 2006  | —                | —                |
| Series B, 8,000 designated, 2,959 shares issued and outstanding at December 31, 2007 and 2006; aggregate liquidation preference of \$29.6 million           | 1                | 1                |
| Common shares, \$.0005 par value, 210,000,000 shares authorized, 131,957,774 and 105,454,389 shares outstanding at December 31, 2007 and 2006, respectively | 66               | 53               |
| Additional paid-in capital  | 740,119          | 689,315          |
| Accumulated comprehensive loss  | (9)              | (9)              |
| Accumulated deficit   | <u>(739,859)</u> | <u>(727,533)</u> |
| Total shareholders' equity (net capital deficiency)   | 318              | (38,173)         |
| Total liabilities and shareholders' equity (net capital deficiency)   | <u>\$ 84,815</u> | <u>\$ 90,077</u> |

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

[Table of Contents](#)

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

|   | Year Ended December 31, |                    |                 |
|---|-------------------------|--------------------|-----------------|
|   | 2007                    | 2006               | 2005            |
| <b>Revenues:</b>  |                         |                    |                 |
| License and collaborative fees  | \$ 36,460               | \$ 2,846           | \$ 5,061        |
| Contract and other revenue  | 31,057                  | 16,329             | 7,392           |
| Royalties   | 16,735                  | 10,323             | 6,216           |
| Total revenues  | <u>84,252</u>           | <u>29,498</u>      | <u>18,669</u>   |
| <b>Operating costs and expenses:</b>  |                         |                    |                 |
| Research and development (including contract related of \$17,032, \$10,909, and \$5,536, respectively, for the years ended December 31, 2007, 2006, and 2005) | 66,215                  | 52,094             | 39,896          |
| General and administrative  | 20,581                  | 18,088             | 14,798          |
| Total operating costs and expenses  | <u>86,796</u>           | <u>70,182</u>      | <u>54,694</u>   |
| Loss from operations  | (2,544)                 | (40,684)           | (36,025)        |
| <b>Other income (expense):</b>  |                         |                    |                 |
| Investment and interest income  | 1,866                   | 1,675              | 1,882           |
| Interest expense  | (11,585)                | (12,932)           | (4,254)         |
| Gain on extinguishment of debt  | —                       | —                  | 40,935          |
| Other income (expense)  | (63)                    | 100                | 244             |
| Net income (loss) before taxes  | (12,326)                | (51,841)           | 2,782           |
| Income tax expense  | —                       | —                  | 3               |
| Net income (loss)   | <u>\$ (12,326)</u>      | <u>\$ (51,841)</u> | <u>\$ 2,779</u> |
| Basic net income (loss) per common share  | <u>\$ (0.10)</u>        | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  |
| Diluted net income (loss) per common share  | <u>\$ (0.10)</u>        | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  |
| Shares used in computing basic net income (loss) per common share   | <u>127,946</u>          | <u>95,961</u>      | <u>86,141</u>   |
| Shares used in computing diluted net income (loss) per common share   | <u>127,946</u>          | <u>95,961</u>      | <u>90,063</u>   |

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

**XOMA Ltd.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**(NET CAPITAL DEFICIENCY)**  
**(in thousands)**

|  | Preferred Shares |             | Common Shares  |              | Paid-In Capital  | Accumulated Comprehensive Income | Accumulated Deficit | Total Shareholders' Equity (Net Capital Deficiency) |
|--|------------------|-------------|----------------|--------------|------------------|----------------------------------|---------------------|---|
|  | Shares           | Amount      | Shares         | Amount       |                  |                                  |                     |   |
| Balance, December 31, 2004   | 3                | \$ 1        | 85,587         | \$ 43        | \$653,537        | \$ 280                           | \$ (678,471)        | \$ (24,610)   |
| Exercise of share options, contributions to 401(k) and incentive plans | —                | —           | 726            | —            | 1,504            | —                                | —                   | 1,504   |
| Comprehensive income:  |                  |             |                |              |                  |                                  |                     |   |
| Net change in unrealized loss on investments                           | —                | —           | —              | —            | —                | (346)                            | —                   | (346)   |
| Net income   | —                | —           | —              | —            | —                | —                                | 2,779               | 2,779   |
| Comprehensive income   | —                | —           | —              | —            | —                | —                                | —                   | 2,433   |
| Balance, December 31, 2005   | 3                | 1           | 86,313         | 43           | 655,041          | (66)                             | (675,692)           | (20,673)  |
| Exercise of share options, contributions to 401(k) and incentive plans | —                | —           | 879            | 1            | 1,489            | —                                | —                   | 1,490   |
| Share-based compensation expense under SFAS 123R                       | —                | —           | —              | —            | 978              | —                                | —                   | 978   |
| Conversion of convertible debt   | —                | —           | 18,262         | 9            | 31,807           | —                                | —                   | 31,816  |
| Comprehensive income:  |                  |             |                |              |                  |                                  |                     |   |
| Net change in unrealized loss on investments                           | —                | —           | —              | —            | —                | 57                               | —                   | 57  |
| Net loss   | —                | —           | —              | —            | —                | —                                | (51,841)            | (51,841)  |
| Comprehensive loss   | —                | —           | —              | —            | —                | —                                | —                   | (51,784)  |
| Balance, December 31, 2006   | 3                | 1           | 105,454        | 53           | 689,315          | (9)                              | (727,533)           | (38,173)  |
| Exercise of share options, contributions to 401(k) and incentive plans | —                | —           | 864            | —            | 1,976            | —                                | —                   | 1,976   |
| Share-based compensation expense under SFAS 123R                       | —                | —           | —              | —            | 2,858            | —                                | —                   | 2,858   |
| Conversion of convertible debt   | —                | —           | 25,640         | 13           | 45,970           | —                                | —                   | 45,983  |
| Comprehensive income:  |                  |             |                |              |                  |                                  |                     |   |
| Net change in unrealized loss on investments                           | —                | —           | —              | —            | —                | —                                | —                   | —   |
| Net loss   | —                | —           | —              | —            | —                | —                                | (12,326)            | (12,326)  |
| Comprehensive loss   | —                | —           | —              | —            | —                | —                                | —                   | (12,326)  |
| Balance, December 31, 2007   | <u>3</u>         | <u>\$ 1</u> | <u>131,958</u> | <u>\$ 66</u> | <u>\$740,119</u> | <u>\$ (9)</u>                    | <u>\$ (739,859)</u> | <u>\$ 318</u>                                       |

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

[Table of Contents](#)

**XOMA Ltd.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(in thousands)**

|  | Year Ended December 31, |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2007                    | 2006             | 2005             |
| Cash flows from operating activities:  |                         |                  |                  |
| Net income (loss)  | \$ (12,326)             | \$ (51,841)      | \$ 2,779         |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |                         |                  |                  |
| Depreciation and amortization  | 6,155                   | 5,117            | 5,083            |
| Common shares contribution to 401(k) and management incentive plans                                | 1,321                   | 1,088            | 1,353            |
| Share-based compensation expense   | 2,858                   | 978              | —                |
| Accrued interest on convertible notes and other interest bearing obligations                       | 408                     | 1,159            | 1,652            |
| Revaluation of embedded derivative   | 6,101                   | 6,945            | —                |
| Interest paid on conversion of convertible debt  | (5,172)                 | —                | —                |
| Amortization of discount, premium and debt issuance costs of convertible debt                      | 584                     | 1,035            | 451              |
| Amortization of premiums on short-term investments   | (5)                     | 18               | 240              |
| Gain on extinguishment of debt   | —                       | —                | (40,935)         |
| Loss on disposal/retirement of property and equipment  | 146                     | 11               | 11               |
| (Gain) loss on sale of investments   | —                       | —                | (271)            |
| Other non-cash adjustments   | (7)                     | (3)              | 3                |
| Changes in assets and liabilities:   |                         |                  |                  |
| Receivables  | (52)                    | (6,706)          | (4,315)          |
| Prepaid expenses   | (52)                    | (86)             | 440              |
| Other assets   | 55                      | —                | (323)            |
| Accounts payable   | 2,809                   | (1,462)          | 3,729            |
| Accrued liabilities  | 624                     | 1,369            | (13,614)         |
| Deferred revenue   | 1,096                   | 9,108            | (473)            |
| Net cash provided by (used in) operating activities  | <u>4,543</u>            | <u>(33,270)</u>  | <u>(44,190)</u>  |
| Cash flows from investing activities:  |                         |                  |                  |
| Proceeds from sales/maturities of investments  | 35,320                  | 32,784           | 9,224            |
| Purchase of investments  | (32,994)                | (28,391)         | (31,763)         |
| Transfer of restricted cash  | (1,689)                 | (4,330)          | —                |
| Purchase of property and equipment   | (9,469)                 | (8,506)          | (4,844)          |
| Net cash used in investing activities  | <u>(8,832)</u>          | <u>(8,443)</u>   | <u>(27,383)</u>  |
| Cash flows from financing activities:  |                         |                  |                  |
| Principal payments of short-term loan  | —                       | —                | (115)            |
| Payments under capital lease obligations   | —                       | —                | (237)            |
| Principal payments of long-term debt   | (4,707)                 | —                | —                |
| Proceeds from issuance of long-term debt   | 2,840                   | 36,541           | 12,373           |
| Proceeds from issuance of convertible notes  | —                       | 11,969           | 56,397           |
| Proceeds from issuance of common shares  | 654                     | 401              | 151              |
| Net cash provided by (used in) financing activities  | <u>(1,213)</u>          | <u>48,911</u>    | <u>68,569</u>    |
| Net increase (decrease) in cash and cash equivalents   | (5,502)                 | 7,198            | (3,004)          |
| Cash and cash equivalents at the beginning of the period   | 28,002                  | 20,804           | 23,808           |
| Cash and cash equivalents at the end of the period   | <u>\$ 22,500</u>        | <u>\$ 28,002</u> | <u>\$ 20,804</u> |

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

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Business and Summary of Significant Accounting Policies**

**Business**

XOMA Ltd. ("XOMA" or the "Company"), a Bermuda company, is a biopharmaceutical company that discovers and 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 receives royalties from Genentech, Inc. ("Genentech") on two approved products, RAPTIVA<sup>®</sup>, for the treatment of moderate-to-severe plaque psoriasis, and LUCENTIS<sup>®</sup>, for the treatment of neovascular (wet) age-related macular degeneration. XOMA's pipeline includes both proprietary products and collaborative programs at various stages of preclinical and clinical development.

The Company may be required to raise additional funds through public or private financings, strategic relationships, or other arrangements. The Company cannot assure that the funding, if needed, will be available on terms attractive to it, or at all. Furthermore, any additional equity financings may be dilutive to stockholders and debt financing, if available, may involve restrictive covenants. The Company's failure to raise capital as and when needed could have a negative impact on its financial condition and its ability to pursue business strategy. If adequate funds are not available, the Company may be required to delay, reduce the scope of, or eliminate one or more of its development programs. The Company's expense structure includes discretionary expenditures that are within the Company's control.

**Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates and Reclassifications**

The preparation of these Consolidated Financial Statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. On an on-going basis, management evaluates its estimates, including those related to revenue recognition, research and development expense, long-lived assets and stock-based compensation. The Company bases its estimates on historical experience and on various other market specific and other relevant assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates.

Certain reclassifications of prior period amounts have been made to our consolidated financial statements to conform to the current period presentation.

**Concentration of Risk**

Cash, cash equivalents, short-term investments, restricted cash and accounts receivable are financial instruments, which potentially subject the Company to concentrations of credit risk. The Company maintains money market funds and short-term investments that bear minimal risk. The Company has not experienced any significant credit losses and does not generally require collateral on receivables. In 2007, four customers represented 36%, 20%, 16% and 13% of total revenues and as of December 31, 2007, there were billed and unbilled receivables of \$10.9 million outstanding from three of these customers representing 42%, 31% and 26% of the accounts receivable balance. In 2006, two customers represented 40% and 35% of total revenues and as of December 31, 2006, there were billed and unbilled receivables of \$11.2 million outstanding from these customers and one additional customer representing 45%, 26% and 13% of the balance. In 2005, four customers represented

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

39%, 28%, 14%, and 11% of total revenues and as of December 31, 2005, and there were billed and unbilled receivables of \$4.6 million outstanding from three of these customers representing 52%, 22%, and 15% of the balance.

**Significant Accounting Policies**

The following policies are critical to an understanding of the Company's financial condition and results of operations because they require it to make estimates, assumptions and judgments about matters that are inherently uncertain.

***Revenue Recognition***

Revenue is generally recognized when the four basic criteria of revenue recognition are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criteria (3) and (4) are based on management's judgments regarding the nature of the fee charged for products or services delivered and the collectibility of those fees.

The Company recognizes revenue from its license and collaboration arrangements, contract services, product sales and royalties. Revenue arrangements with multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units based on their respective fair values and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

***License and Collaborative Fees***

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

Milestone payments under collaborative arrangements are recognized as revenue upon completion of the milestone events, which represent the culmination of the earnings process because the Company has no future performance obligations related to the payment. Milestone payments that require a continuing performance obligation on the part of the Company are recognized over the expected period of the continuing performance obligation. Amounts received in advance are recorded as deferred revenue until the related milestone is completed.

***Contract Revenue***

Contract revenue for research and development involves the Company providing research and development and contract manufacturing services for collaborative partners, biodefense contracts or others. Revenues for these contracts are accounted for by a proportional performance, or output based, method where performance is based on estimated progress made toward elements defined in the contract. The Company recognizes revenue under



XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

these arrangements as the related research and development costs are incurred and collectibility is reasonably assured. The amount of contract revenue and related costs recognized in each accounting period are based on management's estimates of the proportional performance during the period towards elements defined in the contract. Adjustments to management's estimates based on actual performance are recognized on a prospective basis and do not result in reversal of revenues should the estimate to complete be extended.

***Royalty Revenue***

Royalty revenue and royalty receivables are generally recorded in the periods these royalties are earned, in advance of collection. The royalty revenue and receivables in these instances is based upon communication with collaborative partners, historical information and forecasted sales trends. Under some of XOMA's agreements with licensees that include receipt of royalty revenue, the Company does not have sufficient historical information to estimate royalty revenues or receivables in the period that these royalties are earned. For these contracts, the Company records royalty revenue upon cash receipt.

***Research and Development***

The Company expenses research and development costs as incurred. Research and development expenses consist of direct and research-related allocated overhead costs such as facilities costs, salaries and related personnel costs, patent costs and material and supply costs. In addition, research and development expenses include costs related to clinical trials to validate the Company's testing processes and procedures and related overhead expenses. Under cost sharing arrangements with collaborative partners, differences between the Company's actual research and development spending and its share of such spending under the collaboration agreement will also be included as a cost sharing adjustment in its research and development expense. Expenses resulting from clinical trials are recorded when incurred based in part on estimates as to the status of the various trials. From time to time, research and development expenses may include upfront fees and milestones paid to collaborative partners for the purchase of rights to in-process research and development.

***Long-Lived Assets***

In accordance with Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" the Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

***Share-Based Compensation***

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which requires the measurement and recognition of compensation expense for all share-based payment awards made to the Company's employees and directors, including employee share options and employee share purchases related to the Employee Share Purchase Plan ("ESPP"), on estimated fair values.

Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for its share-based compensation plans under the intrinsic value method described in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and related interpretations as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" ("SFAS 148"). In general, as the

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

exercise price of the options granted under the Company's plans was equal to the market price of the underlying common shares on the grant date, no share-based employee compensation cost was recognized. As required by SFAS 148 prior to the adoption of SFAS 123R, the Company provided pro forma net income (loss) and pro forma net income (loss) per common share disclosures for share-based awards, as if SFAS 123 had been applied.

SFAS 123R requires all share based payments to be recognized in the financial statements based on their fair values. The Company is using the modified prospective transition method. Under this method, compensation cost recognized during the years ended December 31, 2007 and 2006, include compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123 amortized on a graded vesting basis over the options' vesting period, and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R amortized on a straight-line basis over the options' vesting period. The Company elected to use the modified prospective transition method as permitted by SFAS 123R and, therefore, has not restated its financial results for prior periods to reflect expensing of share-based compensation. As a result, the results for the years ended December 31, 2007 and 2006 are not comparable to the earlier years.

In November of 2005, the FASB issued FASB Staff Position SFAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share Base Payment Awards," which allowed a one-time election to adopt one of two acceptable methodologies for calculating the initial additional paid-in capital pool ("APIC pool"). The Company elected the "short-cut" method to establish its APIC pool required under SFAS 123(R) for the year ended December 31, 2006. In subsequent periods, the APIC pool will be increased by tax benefits from share-based compensation and decreased by tax deficiencies caused when the recorded share-based compensation for book purposes exceeds the allowable tax deduction. As of December 31, 2007, the Company had not recorded any adjustments to the APIC pool due to its loss position and the balance remained zero.

The following table illustrates the effect on net income (loss) and net income (loss) per share had the Company applied the fair value recognition provisions of SFAS 123 to account for its share plans and ESPP for the year ended December 31, 2005, (in thousands, except per share amounts):

|  | Year ended<br>December 31, 2005 |
|--|---------------------------------|
| Net income—as reported   | \$ 2,779                        |
| Deduct: Total share-based employee compensation expense under SFAS 123 | (3,633)                         |
| Pro forma net loss   | <u>\$ (854)</u>                 |
| Net income (loss) per common share:                                    |                                 |
| Basic and diluted—as reported  | \$ 0.03                         |
| Basic and diluted—pro forma  | \$ (0.01)                       |

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

|  | Year Ended December 31, |               |
|--|-------------------------|---------------|
|  | 2007                    | 2006          |
| Research and development               | \$ 1,005                | \$ 468        |
| General and administrative             | 1,853                   | 510           |
| Total share-based compensation expense | <u>\$ 2,858</u>         | <u>\$ 978</u> |

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Basic and diluted net loss per common share is \$0.02 and \$0.01 lower for the years ended December 31, 2007 and December 31, 2006, respectively, as a result of implementing SFAS 123R. There was no capitalized share-based compensation cost as of December 31, 2007. There were no recognized tax benefits during the year ended December 31, 2007 and 2006. The adoption of SFAS 123R had no impact on cash flows from operations, investing or financing.

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

The fair value of share based awards was estimated using a Black-Scholes model with the following weighted-average assumptions for the years ended December 31, 2007, 2006 and 2005.

|                         | Year Ended December 31, |           |           |
|-------------------------|-------------------------|-----------|-----------|
|                         | 2007                    | 2006      | 2005      |
| Dividend yield          | 0%                      | 0%        | 0%        |
| Expected volatility     | 67%                     | 79%       | 83%       |
| Risk-free interest rate | 4.22%                   | 4.65%     | 4.11%     |
| Expected life           | 5.3 years               | 5.3 years | 4.4 years |

Prior to the adoption of SFAS 123R, the Company's Board of Directors (the "Board of Directors") approved the acceleration of vesting of all outstanding employee share options with an exercise price greater than \$3.00 per share. Because the exercise price of all the accelerated options exceeded the market price per share of the common shares as of the new measurement date, the acceleration had no impact on the Company's earnings in 2005. Since the accelerated options had exercise prices in excess of the current market value of the Company's common shares, the options had limited economic value and were not fully achieving their original objective of incentive compensation and employee retention. The modification allows expense recognized after the adoption of SFAS 123R to better reflect the Company's compensation strategies.

Unvested share activity for the year ended December 31, 2007, is summarized below:

|                                       | Unvested<br>Number of<br>Shares | Weighted-<br>Average Grant-<br>Date Fair Value |
|---------------------------------------|---------------------------------|--|
| Unvested balance at December 31, 2006 | 1,984,128                       | \$ 1.66  |
| Granted                               | 6,045,850                       | 3.12   |
| Vested                                | (1,819,875)                     | 2.88   |
| Forfeited                             | (363,382)                       | 2.33   |
| Unvested balance at December 31, 2007 | <u>5,846,721</u>                | <u>2.75</u>                                    |

At December 31, 2007, there was \$6.9 million of unrecognized share-based compensation expense related to unvested share options with a weighted-average remaining recognition period of 3.2 years. The estimated fair value of options vested during 2007 and 2006 \$0.4 million and \$0.5 million, respectively. Total intrinsic value of options exercised was \$0.4 million in 2007 and \$1,400 during 2006 as few employees elected to exercise options due to the nature of vested options being out of the money. Total cash received from share option exercises during 2007 was \$0.4 million.

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Income Taxes**

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

**Net Income (Loss) Per Common Share**

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

The following outstanding securities were considered in the computation of diluted net income (loss) per share. Those that are antidilutive were not included in the computation of diluted net income (loss) per share (in thousands):

|  | December 31, |        |        |
|--|--------------|--------|--------|
|  | 2007         | 2006   | 2005   |
| Options for common shares  | 11,108       | 6,230  | 5,422  |
| Warrants for common shares   | 125          | 125    | 125    |
| Convertible preference shares, notes and related interest, as if converted | —            | 29,459 | 38,827 |

The following is a reconciliation of the numerators and denominators of the basic and diluted net income (loss) per share (in thousands):

|  | Year ended December 31, |               |               |
|--|-------------------------|---------------|---------------|
|  | 2007                    | 2006          | 2005          |
| <b>Numerator</b>   |                         |               |               |
| Net income (loss) used for basic and diluted net income (loss) per share                                 | \$ (12,326)             | \$ (51,841)   | \$ 2,779      |
| <b>Denominator</b>   |                         |               |               |
| Weighted average shares outstanding used for basic net income (loss) per share                           | 127,946                 | 95,961        | 86,141        |
| Effect of dilutive share options   | —                       | —             | 104           |
| Effect of convertible preference shares  | —                       | —             | 3,818         |
| Weighted-average shares outstanding and dilutive securities used for diluted net income (loss) per share | <u>127,946</u>          | <u>95,961</u> | <u>90,063</u> |

**Cash and Cash Equivalents**

The Company considers all highly liquid debt instruments with maturities of three months or less at the time the Company acquires them to be cash equivalents. At December 31, 2007 and 2006, cash and cash equivalents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

consisted of overnight deposits, money market funds, commercial paper, repurchase agreements and debt securities with maturities of less than 90 days and are reported at fair value. Cash and cash equivalent balances were as follows as of December 31, 2007 and 2006 (in thousands):

|                                 | December 31, 2007 |                  |                   |                      |
|---------------------------------|-------------------|------------------|-------------------|----------------------|
|                                 | Cost Basis        | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Cash                            | \$ 5,011          | \$ —             | \$ —              | \$ 5,011             |
| Cash equivalents                | 17,493            | 1                | (5)               | 17,489               |
| Total cash and cash equivalents | <u>\$22,504</u>   | <u>\$ 1</u>      | <u>\$ (5)</u>     | <u>\$ 22,500</u>     |

|                                 | December 31, 2006 |                  |                   |                      |
|---------------------------------|-------------------|------------------|-------------------|----------------------|
|                                 | Cost Basis        | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Cash                            | \$ 7,585          | \$ —             | \$ —              | \$ 7,585             |
| Cash equivalents                | 20,415            | 2                | —                 | 20,417               |
| Total cash and cash equivalents | <u>\$28,000</u>   | <u>\$ 2</u>      | <u>\$ —</u>       | <u>\$ 28,002</u>     |

**Short-term Investments**

Short-term investments include debt securities classified as available-for-sale. Available-for-sale securities are stated at fair value, with unrealized gains and losses, net of tax, if any, reported in other comprehensive income (loss). Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in investment and other income. The cost of investments sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are also included in investment and other income. At December 31, 2007, \$0.6 million in short-term investments had maturities of one year to 18 months. The Company has recorded these investments as current as these investments are available for current operations and management's intent is to realize these investments as required to fund current operations.

Short-term investments by security type at December 31, 2007 and 2006 were as follows (in thousands):

|                                     | December 31, 2007 |                  |                   |                      |
|-------------------------------------|-------------------|------------------|-------------------|----------------------|
|                                     | Cost Basis        | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Corporate notes and bonds           | \$ 7,447          | \$ —             | \$ (5)            | \$ 7,442             |
| State and municipal debt securities | 8,625             | —                | —                 | 8,625                |
| Government sponsored enterprises    | —                 | —                | —                 | —                    |
| Total Short-Term Investments        | <u>\$16,072</u>   | <u>\$ —</u>      | <u>\$ (5)</u>     | <u>\$ 16,067</u>     |

|                                     | December 31, 2006 |                  |                   |                      |
|-------------------------------------|-------------------|------------------|-------------------|----------------------|
|                                     | Cost Basis        | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
| Corporate notes and bonds           | \$ 3,097          | \$ —             | \$ (9)            | \$ 3,088             |
| State and municipal debt securities | 14,595            | —                | —                 | 14,595               |
| Government sponsored enterprises    | 700               | —                | (2)               | 698                  |
| Total Short-Term Investments        | <u>\$18,392</u>   | <u>\$ —</u>      | <u>\$ (11)</u>    | <u>\$ 18,381</u>     |

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

State and municipal debt securities as of December 31, 2007 and 2006 included \$8.6 million and \$14.6, respectively, in auction securities with average ratings by Standard & Poors/Moody's of Aaa. See further discussion of the Company's auction securities in Note 10, "Subsequent Events," to the Consolidated Financial Statements.

The Company reviews its instruments for other-than-temporary impairment whenever the value of the instrument is less than the amortized cost. All such investments have been or were in an unrealized loss position for less than twelve months. The Company has not sold similar investments at a loss and currently has the financial ability to hold short-term investments with an unrealized loss until maturity or recovery and not incur any recognized losses. As a result, the Company does not believe any unrealized losses represent an other-than-temporary impairment. During the years ended December 31, 2007, 2006 and 2005, there were zero, zero and \$0.3 million in realized gains on short-term investments. The 2005 gain was related to equity securities. Gains and losses are determined on a specific identification basis.

The estimate of fair value is based on publicly available market information.

***Restricted Cash***

Under the terms of its loan agreement with Goldman Sachs Specialty Lending Holdings, Inc. ("Goldman Sachs"), the Company maintains a custodial account for the deposit of RAPTIVA<sup>®</sup>, LUCENTIS<sup>®</sup> and CIMZIA<sup>™</sup> royalty revenues in addition to a standing reserve of the next semi-annual interest payment due on the loan. This cash account and the interest earned thereon can be used solely for the payment of the semi-annual interest amounts due in March and September of each year and, at that time, amounts in excess of the interest reserve requirement may be used to pay down principal or be distributed back to the Company, at the discretion of the lender. At December 31, 2007, the restricted cash was invested in money market funds.

See Note 4, "Convertible Notes and Other Arrangements," for additional discussion of the Goldman Sachs term loan.

***Receivables***

Receivables consisted of the following at December 31, 2007 and 2006, (in thousands):

|                      | December 31,     |                  |
|----------------------|------------------|------------------|
|                      | 2007             | 2006             |
| Trade receivables    | \$ 11,655        | \$ 11,458        |
| Unbilled receivables | —                | 148              |
| Other receivables    | 480              | 439              |
| Total                | <u>\$ 12,135</u> | <u>\$ 12,045</u> |

***Property and Equipment***

Property and equipment is stated at cost. Equipment depreciation is calculated using the straight-line method over the estimated useful lives of the assets (three to seven years). Leasehold improvements, buildings and building improvements are amortized and depreciated using the straight-line method over the shorter of the lease terms or the useful lives (one to fifteen years).

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Property and equipment consisted of the following at December 31, 2007 and 2006, (in thousands):

|   | December 31,     |                  |
|---|------------------|------------------|
|   | 2007             | 2006             |
| Furniture and equipment                         | \$ 34,618        | \$ 27,373        |
| Buildings, leasehold and building improvements  | 19,969           | 18,669           |
| Construction-in-progress                        | 1,845            | 1,644            |
| Land  | 310              | 310              |
|   | <u>56,742</u>    | <u>47,996</u>    |
| Less: Accumulated depreciation and amortization | (31,139)         | (25,562)         |
| Property and equipment, net                     | <u>\$ 25,603</u> | <u>\$ 22,434</u> |

At December 31, 2007 and 2006, there was no property and equipment acquired under capital lease obligations.

Depreciation and amortization expense was \$6.2 million, \$5.1 million and \$5.1 million for the years ended December 31, 2007, 2006 and 2005, respectively.

During 2005, the Company completed an annual review of leasehold improvements. Based on this review, the Company decided to abandon its plan to add a fermentation unit to its existing research and development facility. As certain leasehold improvements related to this project no longer prolonged the life of the related building nor enhanced its functional use, the Company expensed approximately \$0.6 million to depreciation expense for research and development in December 2005.

**Accrued Liabilities**

Accrued liabilities consisted of the following at December 31, 2007 and 2006, (in thousands):

|   | December 31,    |                 |
|---|-----------------|-----------------|
|   | 2007            | 2006            |
| Accrued management incentive compensation | \$ 4,135        | \$ 2,053        |
| Accrued payroll costs                     | 2,635           | 2,015           |
| Accrued co-development                    | —               | 1,952           |
| Accrued professional fees                 | 617             | 876             |
| Other                                     | 323             | 190             |
| Total                                     | <u>\$ 7,710</u> | <u>\$ 7,086</u> |

**Deferred Revenue**

The Company defers revenue until all requirements under its revenue recognition policy are met. In 2007, the Company deferred \$23.3 million of revenue from five contracts including Schering Plough Research Institute ("SPRI") and Takeda Pharmaceutical Company Limited ("Takeda") and recognized \$22.2 million of revenue from the five contracts including the amortization of the \$4.3 million from the \$10.0 million in upfront payments received from Novartis AG ("Novartis," formerly known as Chiron Corporation) for our February 2004 oncology collaboration contract.

**XOMA Ltd.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

In February of 2007, the Company announced that pursuant to the terms of its February 2004 collaboration agreement with Novartis, the parties' mutual exclusivity obligation to conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation has no impact on the existing collaboration projects which have reached the development stage and the parties may continue to collaborate on a non-exclusive basis. The entire remaining unamortized balance of \$4.3 million, at December 31, 2006, associated with the upfront collaboration fee of \$10.0 million was recognized in 2007 due to the change in estimate from five years to three years.

In 2006, the Company deferred \$25.2 million of revenue from eight contracts including SPRI, NIAID, Takeda and Taligen Therapeutics, Inc. and recognized \$16.1 million in revenue from the eight contracts including \$2.0 million in amortization of the \$10.0 million in upfront payments received from Novartis. The following table shows the activity in deferred revenue for the years ended December 31, 2007 and 2006, (in thousands):

|                            | Year ended December 31, |                  |
|----------------------------|-------------------------|------------------|
|                            | 2007                    | 2006             |
| Beginning deferred revenue | \$ 16,968               | \$ 7,860         |
| Revenue deferred           | 23,254                  | 25,204           |
| Revenue recognized         | (22,158)                | (16,096)         |
| Ending deferred revenue    | <u>\$ 18,064</u>        | <u>\$ 16,968</u> |

Of the \$18.1 million balance in deferred revenue at December 31, 2007, \$8.0 million is expected to be earned over the next year and the remaining \$10.1 million is expected to be earned over the next five years.

***Fair Value of Financial Instruments***

The fair value of marketable debt securities is based on quoted market prices. The carrying value of these securities approximates their fair value.

***Supplemental Cash Flow Information***

Cash paid for interest was \$3.1 million, \$3.8 million and \$2.4 million during the years ended December 31, 2007, 2006 and 2005, respectively. Cash paid for income taxes was approximately zero, zero and \$3,000 during the years ended December 31, 2007, 2006 and 2005, respectively. Income taxes paid are related to activities of the Company's foreign operations.

Non-cash transactions from financing activities consisted of the conversion of \$44.5 million in convertible notes to equity and payment of \$1.9 million of the additional interest feature in common shares for the year ended December 31, 2007. In addition, interest of \$1.3 million, \$1.0 million and \$0.3 million on the Novartis secured loan was capitalized for the years ended December 31, 2007, 2006 and 2005, respectively. See Note 4, "Convertible Notes and Other Arrangements," to the Consolidated Financial Statements for additional discussion of the convertible debt and Novartis loan.



## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Segment Information**

The Company currently operates in a single business segment as there is only one measurement of profit (loss) for its operations. The Company's property and equipment is held entirely in the United States. Revenues attributed to the following countries for each of the years ended December 31, 2007, 2006 and 2005, were as follows (in thousands):

|               | Year ended December 31, |                  |                  |
|---------------|-------------------------|------------------|------------------|
|               | 2007                    | 2006             | 2005             |
| United States | \$ 46,029               | \$ 26,642        | \$ 15,475        |
| Ireland       | 32,088                  | 645              | 3,042            |
| Bermuda       | 6,135                   | 2,211            | 152              |
| Total         | <u>\$ 84,252</u>        | <u>\$ 29,498</u> | <u>\$ 18,669</u> |

**Recent Accounting Pronouncements***Fair Value Measurements*

In September of 2006, the FASB issued SFAS 157 "Fair Value Measurements" ("SFAS 157"). SFAS 157 establishes a common definition for fair value, creates a framework for measuring fair value, and expands disclosure requirements about such fair value measurements. SFAS 157 is effective for the Company's first quarter of 2008. The Company is in the process of studying the impact of this interpretation on its financial accounting and reporting, however, the Company does not expect the adoption of SFAS 157 to have a material impact on its financial position or results of operations.

*Fair Value Option for Financial Assets and Financial Liabilities*

In February of 2007, FASB issued SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of SFAS 115" ("SFAS 159"). SFAS 159 provides companies with an option to report selected financial assets and liabilities at fair value. Furthermore, SFAS 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. SFAS 159 will be effective for the Company beginning on January 1, 2008. The Company is in the process of studying the impact of this interpretation on its financial accounting and reporting, however, the Company does not expect the adoption of SFAS 159 to have a material impact on its financial position or results of operations.

*Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development*

In June of 2007, the Emerging Issues Task Force issued EITF Issue 07-03, "Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development" ("EITF 07-03"). EITF 07-03 addresses the diversity which exists with respect to the accounting for the non-refundable portion of a payment made by a research and development entity for future research and development activities. Under EITF 07-03, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for fiscal years beginning after December 15, 2007 and interim periods within those years. The Company does not expect the adoption of EITF 07-03 to have a material impact on its financial position or results of operations.

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

*Accounting for Collaborative Agreements*

In December of 2007, the EITF reached a consensus on EITF 07-01, “Accounting for Collaborative Agreements” (“EITF 07-01”). EITF 07-01 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenues and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in EITF Issue 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, and other applicable accounting literature. The consensus should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. The consensus is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating EITF 07-01 and its impact, if any, on our consolidated results of operations and financial condition.

**2. License Agreements**

XOMA has granted over 50 licenses to biotechnology and pharmaceutical companies for use of patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. Eight of these are license arrangements related to the use of XOMA’s Bacterial Cell Expression (“BCE”) system technology in phage display. As part of these arrangements, Affimed Therapeutics AG, Affitech AS, BioInvent International AB, Biosite Incorporated, Cambridge Antibody Technology Limited, Diversa Corporation, Dyax Corp. and MorphoSys AG received licenses to use XOMA’s antibody expression technology for developing products using phage display-based antibody libraries (except in the case of MorphoSys AG, whose library license with XOMA has expired). XOMA, in exchange, receives license and other fees as well as access to these companies’ antibody display libraries, intellectual property and/or services that complement XOMA’s existing development capabilities and support the Company’s own antibody product development pipeline.

These agreements also generally provide releases of the licensee companies and their collaborators from claims under the XOMA patents arising from past activities using the companies’ respective technologies to the extent they also used XOMA’s antibody expression technology. Licensees are generally also allowed to use XOMA’s technology in combination with their own technology in future collaborations.

**3. Collaborative and Licensing Agreements**

Total research and development expenses incurred related to the Company’s collaborative agreements were approximately \$20.4 million, \$20.1 million and \$16.6 million in 2007, 2006 and 2005, respectively.

*Genentech*

In April of 1996, the Company entered into a collaboration agreement with Genentech for the development of RAPTIV<sup>®</sup>. In March of 2003, it entered into amended and expanded agreements related to all aspects of the collaboration, to reflect the then current understanding between the companies. The agreements called for the Company to share in the development costs and to receive a 25% share of future United States operating profits and losses and a royalty on sales outside the United States. The agreements also called for Genentech to finance the Company’s share of development costs up until first FDA marketing approval via a convertible subordinated loan, and its share of pre-launch marketing and sales costs via an additional commercial loan facility. Under the loan agreement, upon FDA approval of the product, which occurred October 27, 2003, the Company elected to pay \$29.6 million of the development loan in convertible preference shares and to defer repayment of the remaining \$40.0 million as an offset against future proceeds from the Company’s 25% share of United States

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

operating profits on the product. On December 22, 2003, the Company issued the preference shares to Genentech which are convertible into approximately 3.8 million common shares at a price of \$7.75 per common share. The \$13.4 million of outstanding principal and interest on the commercial loan was payable only in cash and was paid in January and May of 2004.

In January of 2005, the Company announced a restructuring of its arrangement with Genentech on RAPTIVA®. Under the restructured arrangement, effective January 1, 2005, the Company is entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA® in all indications. The previous cost and profit sharing arrangement for RAPTIVA® in the United States was discontinued and Genentech is responsible for all operating and development costs associated with the product. Genentech may elect and the Company may agree to provide further clinical trial or other development services at Genentech's expense. In addition, the Company's obligation to pay the outstanding balance to Genentech of \$40.9 million under the development loan, including accrued interest, was extinguished.

See Note 4, "Convertible Notes and Other Arrangements," for additional discussion of the financing arrangement between XOMA and Genentech.

In December of 1998, the Company licensed its BCE technology to Genentech, which utilized it to develop LUCENTIS® for the treatment of neovascular (wet) age-related macular degeneration. The Company is entitled to receive an undisclosed royalty on worldwide sales of LUCENTIS®.

The Company is recognizing RAPTIVA® and LUCENTIS® royalty revenue when the underlying sales occur. Total royalties recognized for the years ended December 31, 2007, 2006 and 2005 were \$16.7 million, \$10.3 million, and \$6.2 million, respectively.

***Novartis***

In February of 2004, XOMA entered into an exclusive multi-product collaboration with Novartis for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies agreed to share costs and profits on a 70-30 basis, with XOMA's share being 30%. Novartis' profit share is subject to a limited upward adjustment, which, in turn, may be reduced if the Company achieves certain milestones. XOMA received initial payments totaling \$10.0 million in 2004 which originally was being recognized ratably over five years, the expected term of the agreement, as license and collaborative fees.

In February of 2007, the Company announced the parties' mutual exclusivity obligation to conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation had no impact on the existing collaboration projects which had reached the development stage and the parties continue to collaborate on a non-exclusive basis. The entire remaining unamortized balance of \$4.3 million, at December 31, 2006, associated with the upfront collaboration fee of \$10.0 million was recognized in 2007 due to the change in estimate from five years to three years.

A loan facility of up to \$50.0 million is available to the Company to fund up to 75% of its share of development expenses incurred beginning in 2005. See Note 4, "Convertible Notes and Other Arrangements," for additional discussion of the financing arrangement between XOMA and Novartis.

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

***NIAID***

In July of 2006, the Company was awarded a \$16.3 million contract (Contract No. HHSN266200600008C/N01-AI-60008) funded with Federal funds from NIAID, a part of the National Institutes of Health, Department of Health and Human Services, to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. The contract work is being performed on a cost plus fixed fee basis over a three year period. The Company is recognizing revenue as the services are being performed on a proportional performance basis.

In March of 2005, the Company was awarded a \$15.0 million contract from NIAID to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics. The contract work was performed over an 18-month period and was 100% funded with Federal funds from NIAID under Contract No. HHSN266200500004C. The Company recognized revenue over the life of the contract as the services were performed on a proportional performance basis, and, as per the terms of the contract, a 10% retention on all revenue was deferred and classified as a receivable until final acceptance of the contract which was achieved in October of 2006.

***Schering Plough***

In May of 2006, the Company entered into a collaboration agreement with the Schering Plough Research Institute (“SPRI”) division of Schering Corporation for therapeutic monoclonal antibody discovery and development. Under the agreement, SPRI will make upfront, annual maintenance and milestone payments to the Company, fund the Company’s research and development and manufacturing activities related to the agreement and pay the Company royalties on sales of products resulting from the collaboration. During the collaboration, the Company will discover therapeutic antibodies against one or more targets selected by SPRI, use the Company’s proprietary HE™ technology to humanize antibody candidates generated by hybridoma techniques, perform pre-clinical studies to support regulatory filings, cell line and process development and produce antibodies for initial clinical trials. The Company will recognize revenue on the upfront payments on a straight-line basis over the expected term of each target antibody discovery, on the research and development and manufacturing services as they are performed, on the maintenance fees when they are due, on the milestones when they are achieved and on the royalties when the underlying sales occur.

***Schering Plough/AVEO***

In April of 2006, XOMA entered into an agreement with AVEO Pharmaceuticals, Inc (“AVEO”) to utilize XOMA’s HE’ technology to humanize AV-299 under which AVEO paid XOMA an up-front license fee and development milestones. Under this agreement XOMA created four HE™ versions of the original AV-299, all of which met design goals and from which AVEO selected one as its lead development candidate. In the future, AVEO will pay annual maintenance fees, additional development milestones and royalties.

In September of 2006, as a result of the successful humanization of AV-299, XOMA entered into a second agreement with AVEO to manufacture and supply AV-299, AVEO’s novel anti-HGF antibody, in support of early clinical trials. Under the agreement, XOMA will create AV-299 production cell lines and conduct process and assay development as well as Good Manufacturing Practices (“cGMP”) manufacturing activities in support of AVEO’s Investigational New Drug (“IND”) filing and early clinical trials. As between AVEO and XOMA, AVEO retains all development and commercialization rights to AV-299.

In April of 2007, SPRI entered into a research, development and license agreement with AVEO concerning AV-299 and other anti-HGF molecules. In connection with the aforementioned license agreement, AVEO has assigned its entire right, title and interest in, to and under its manufacturing agreement with XOMA to SPRI.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Takeda*

In November of 2006, the Company entered into a collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development. Under the agreement, Takeda will make upfront, annual maintenance and milestone payments to the Company, fund its research and development and manufacturing activities for preclinical and early clinical supplies and pay royalties on sales of products resulting from the collaboration. Takeda will be responsible for clinical trials and commercialization of drugs after a Investigational New Drug Application (“IND”) submission and is granted the right to manufacture once the product enters into Phase 2 clinical trials. During the collaboration, the Company will discover therapeutic antibodies against multiple targets selected by Takeda. The Company will recognize revenue on the upfront payments on a straight-line basis over the expected term of each target antibody discovery, on the research and development and manufacturing services as they are performed, on the maintenance fees when they are due, on the milestones when they are achieved and on the royalties when the underlying sales occur.

*Lexicon*

In June of 2005, XOMA entered into a collaboration agreement with Lexicon Pharmaceuticals, Inc. (“Lexicon”) to jointly develop and commercialize antibody drugs for certain targets discovered by Lexicon. The initial term of the collaboration is three years and it is designed to combine Lexicon’s target discovery and biotherapeutics capabilities with XOMA’s antibody generation, process development and manufacturing expertise to accelerate the development and commercialization of novel therapeutic antibodies. The Company will generate or engineer antibodies that modulate the collaboration’s targets using phage display libraries and its proprietary Human Engineering (“HE<sup>™</sup>”) technology and will have principal responsibility for manufacturing antibodies for use in clinical trials and commercial sales. Lexicon and XOMA will share the responsibility and costs for research, preclinical, clinical and commercialization activities on a 65-35 basis, with the Company’s share being 35%.

*Pfizer*

In August of 2007, XOMA entered into a license agreement with Pfizer, Inc. (“Pfizer”) for non-exclusive, worldwide rights for XOMA’s patented bacterial cell expression (BCE) technology for research (including phage display), development and manufacturing of antibody products. Under the terms of the agreement, XOMA received an initial license fee payment of \$30 million and will receive milestone (licensee achievement based), royalty and other fees on future sales of all products subject to this license, including products currently in late-stage clinical development. The Company has no further obligations under the license agreement. As such, the \$30.0 million was recorded as license fee revenue in the accompanying statement of operations.

*Other*

In July of 2007 the Company reached an agreement with a major collaborator to resolve its liability for material cost charges incurred pursuant to the collaboration arrangement. As a result, the Company reduced its research and development costs by \$2.8 million included in the statement of operations for the year ended December 31, 2007. Additionally, as of September 30, 2007, the Company eliminated an approximate \$1.8 million liability carried on the balance sheet since December 31, 2006 and established a collaboration receivable balance of \$1.0 million for the remaining balance related to the material cost charges liability resolution, which was collected prior to December 31, 2007.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**4. Convertible Notes and Other Arrangements**

As of December 31, 2007, the Company had long-term debt of \$50.9 million, including \$30.3 million outstanding from the Goldman Sachs term loan and \$20.6 million outstanding from the Novartis note. In 2007 XOMA incurred interest expense of \$11.6 million, including \$3.8 million related to Goldman Sachs, \$1.3 million related to Novartis, and \$6.5 million related to the convertible debt. In 2007, the Company eliminated all of its convertible debt, the details of which are disclosed in the section titled, “Convertible Senior Notes”.

*Term Loan*

On November 9, 2006, the Company entered into a five-year, \$35.0 million term loan facility (“the facility”) with Goldman Sachs and borrowed the full amount thereunder. Indebtedness under the facility will bear interest at an annual rate equal to six-month LIBOR plus 5.25%, which was 10.39% at December 31, 2007, and is secured by all rights to receive payments due the Company relating to RAPTIVA®, LUCENTIS® and CIMZIA™ and other assets of the Company. Payments received by the Company in respect of these payment rights, in addition to a standing reserve of the next semi-annual interest payment, will be held in a custodial account which is classified as restricted cash. This cash account and the interest earned thereon can be used solely for the payment of the semi-annual interest amounts due in March and September of each year and, at that time, amounts in excess of the interest reserve requirement may be used to pay down principal or be distributed back to the Company, at the discretion of the lender. The Company may prepay indebtedness under the facility at any time, subject to certain prepayment premiums. The Company is required to comply with a debt covenant determined by the ratio of royalties collected to interest payable and XOMA is in compliance with the covenant as of December 31, 2007. Proceeds from the loan will be used for general corporate purposes.

At December 31, 2007, the outstanding principal amount under this loan totaled \$30.3 million and related restricted cash was \$6.0 million. Debt issuance costs of \$1.5 million are being amortized on a straight-line basis over the five year life of the loan and are disclosed as current and long-term debt issuance costs on the balance sheet. For the years ended December 31, 2007 and 2006, the Company incurred interest expense of \$3.4 million and \$0.5 million, respectively and amortization of debt issuance costs of \$0.3 million and \$42,000, respectively.

*Novartis*

In May of 2005, the Company executed a secured note agreement with Novartis. Under the note agreement, Novartis agreed to make semi-annual loans to the Company, to fund up to 75% of the Company’s research and development and commercialization costs under the collaboration arrangement, not to exceed \$50.0 million in an aggregate principal amount. Any unpaid principal amount together with accrued and unpaid interest shall be due and payable in full on June 21, 2015, the tenth anniversary date of the advance date on which the first loan was made. Interest on the unpaid balance of the principal amount of each loan shall accrue six-month LIBOR plus 2%, which was equal to 6.75% at December 31, 2007, and is payable semi-annually in June and December of each year. At the Company’s election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed \$50.0 million. Loans under the note agreement are secured by the Company’s interest in its collaboration with Novartis, including its share of any profits arising therefrom. At December 31, 2007, the outstanding principal balance under this note agreement totaled \$20.6 million and for the years ended December 31, 2007, 2006 and 2005, the Company incurred interest expense of \$1.3 million, \$1.0 million and \$0.3 million, respectively, all of which was added to the outstanding principal balance.

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Convertible Senior Notes*

In February of 2006, the Company completed an exchange offer with holders of its 6.5% convertible senior notes due 2012 in which the Company exchanged \$60.0 million aggregate principal amount of its new 6.5% Convertible SNAP<sub>SM</sub> due 2012 (the “New Notes”) for all \$60.0 million aggregate principal amount of its then outstanding convertible senior notes due 2012. The Company also issued an additional \$12.0 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million. The New Notes were initially convertible into approximately 38.4 million common shares at a conversion rate of 533.4756 of common shares per \$1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately \$1.87 per common share.

The Company separately accounted for the additional interest payment feature of the New Notes as an embedded derivative instrument, which was measured at fair value and classified on the balance sheet with the convertible debt. Changes in the fair value of the embedded derivative were recognized in earnings as a component of other income (expense). The initial fair value of the derivative was subtracted from the carrying value of the debt, reflected as a debt discount, which was amortized as interest expense using the effective interest method through the date the notes were scheduled to mature, and separately reported as a derivative liability.

The additional New Notes were issued to the initial purchasers for net proceeds of \$11.8 million. Debt issuance costs related to the New Notes of approximately \$0.7 million were being amortized on a straight-line basis over the original 72 month life of the notes. Additional debt issuance costs of \$2.0 million, related to the modification of the existing debt, were expensed as incurred with \$1.1 million and \$0.9 million expensed during the quarters ended March 31, 2006 and December 31, 2005, respectively.

At the time of note conversion, unamortized discount, premium and debt issuance costs related to the converted notes were charged to shareholders’ equity.

At December 31, 2007 and 2006, convertible debt consisted of the following (in thousands):

|                     | December 31, |                 |
|---------------------|--------------|-----------------|
|                     | 2007         | 2006            |
| Convertible debt    | \$—          | \$41,363        |
| Embedded derivative | —            | 5,207           |
| Premium             | —            | 253             |
| Total               | <u>\$—</u>   | <u>\$46,823</u> |

During the first quarter of 2007, \$42.0 million of New Notes were voluntarily converted by holders through March 7, 2007, at which time the Company announced that it had elected to automatically convert all of the remaining \$2.5 million of New Notes outstanding. As a result, during the first quarter of 2007, 25,640,187 of common shares were issued to effect the conversion of the principal balances. Additionally, the Company issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted New Notes. The Company recorded a \$6.1 million charge to interest expense as a result of the revaluation of the embedded derivative related to the additional interest feature of the convertible notes.

For the year ended December 31, 2006, \$27.5 million of New Notes were converted into 18,262,264 common shares including 3,602,879 shares related to the additional interest payment feature of the notes. As of December 31, 2006, the Company elected to pay all additional interest owed in common shares. The Company

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

recorded a \$6.9 million charge to interest expense during the year ended December 31, 2006, as a result of an increase in the fair value of the embedded derivative on its convertible debt including \$4.8 million related to the additional interest feature of the converted notes.

For the years ended December 31, 2007, 2006 and 2005, the Company incurred \$0.2 million, \$3.4 million and \$3.5 million, respectively, in interest expense on its convertible debt. Interest expense was payable on a semi-annual basis. Additionally, the Company amortized a net of \$0.1 million, \$1.0 million, and \$0.5 million in debt issuance costs, premium and discount for the year ended December 31, 2007, 2006 and 2005, respectively.

***Genentech***

Under an arrangement with Genentech, the Company received financing for its share of RAPTIVA® development costs through the issuance of convertible subordinated notes due at the earlier of April of 2005 or upon first regulatory approval of RAPTIVA®, which occurred on October 27, 2003. The interest rate was LIBOR plus 1%.

The agreement was amended on March 31, 2003, to provide the following terms:

- The credit limit under the convertible subordinated debt agreement to finance XOMA's share of development costs was increased to \$80.0 million. The convertible subordinated note was to mature upon the earlier of (a) April of 2005, except for advances made after April of 2003, in which case payment would be due on the second anniversary date(s) of such advances or (b) within 90 days after first product approval which occurred on October 27, 2003. At XOMA's election, the convertible subordinated note was to be repaid in cash or with shares with the conversion price to be calculated at the time of payment based on the fair market value at the time of election. If repayment were triggered by product approval, XOMA could elect to defer payment of up to \$40.0 million as an offset against the Company's proceeds from its 25% share of United States operating profits on the product. Following product approval, on November 3, 2003, XOMA announced its election to defer payment of approximately \$40.0 million of this debt as provided above and on December 22, 2003, the Company issued 2,959 of convertible preference shares to repay the approximately \$29.6 million remaining outstanding balance.
- An additional \$15.0 million debt facility was established to finance XOMA's share of United States commercialization costs. The note payable was to mature upon the earlier of (a) April of 2005, except for advances made after April of 2003 in which case payment was due on the second anniversary date(s) of such advances or (b) within 90 days after first product approval by the FDA which occurred on October 27, 2003. At December 31, 2003, the outstanding balance under this note totaled approximately \$13.2 million. Under the terms of the agreement, the outstanding balance of \$3.0 million related to 2002 commercialization costs was repaid in cash in January of 2004. The balance of \$10.2 million which relates to 2003 commercialization costs was repaid in cash in May of 2004.
- XOMA granted Genentech a security interest in the Company's profit share on RAPTIVA® as collateral against any unpaid past due amounts of the loans.

The agreement was further amended in January of 2005, wherein XOMA's liability for the remaining \$40.9 million balance outstanding under the development loan, including accrued interest, was extinguished and the profit sharing arrangement was terminated. The Company recorded a one-time gain to other income of \$40.9 million related to the extinguishment of the loan. The Company has no further obligation under the loan arrangement.



XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**5. Share Capital**

**Common Shares**

As of December 31, 2007, the Company had the authority to issue 210,000,000 common shares with a par value \$0.0005 per share of which 131,957,774 were outstanding.

**Preference Shares**

As of December 31, 2007, the Company has the authority to issue 1,000,000 preference shares, par value \$0.05 per share. Of these, 210,000 preference shares have been designated Series A Preference Shares and 8,000 preference shares have been designated Series B Preference Shares.

- Series A: As of December 31, 2007, the Company has authorized 210,000 Series A Preference Shares of which none were outstanding at December 31, 2007 and 2006. (See “Shareholder Rights Plan” below.)
- Series B: As of December 31, 2007, the Company has authorized 8,000 Series B Preference Shares. In December of 2003, the Company issued 2,959 of the Series B preference shares to Genentech in repayment of \$29.6 million of the outstanding balance under the convertible subordinated debt agreement. Pursuant to the rights of the Series B preference shares, the holders of Series B preference shares will not be entitled to receive any dividends on the Series B preference shares. The Series B preference shares will rank senior with respect to rights on liquidation, winding-up and dissolution of XOMA to all classes of common shares. Upon any voluntary or involuntary liquidation, dissolution or winding-up of XOMA, holders of Series B preference shares will be entitled to receive \$10,000 per share of Series B preference shares before any distribution is made on the common shares. The holder of the Series B preference shares has no voting rights, except as required under Bermuda law.

The holder of Series B preference shares has the right to convert Series B preference shares into common shares at a conversion price equal to \$7.75 per common share, subject to adjustment in certain circumstances. Accordingly, the 2,959 issued Series B preference shares are convertible into 3,818,395 common shares.

The Series B preference shares will be automatically converted into common shares at their then effective conversion rate immediately upon the transfer by the initial holder to any third party which is not an affiliate of such holder. The Company will have the right, at any time and from time to time, to redeem any or all Series B preference shares for cash in an amount equal to the conversion price multiplied by the number of common shares into which each such share of Series B preference shares would then be convertible.

**Incentive Compensation Plans**

The Board of Directors established a Management Incentive Compensation Plan (“MICP”) effective July 1, 1993, in which management employees (other than the Chief Executive Officer), as well as certain additional discretionary participants chosen by the Chief Executive Officer, are eligible to participate. The Chief Executive Officer is covered under a CEO Incentive Compensation Plan (“CICP”) which was established by the Board of Directors effective January 1, 2004. Employees that do not qualify under the MICP or CICP are covered under the Bonus Compensation Plan (“BCP”) effective January 1, 2007.

As of January 1, 2007, awards earned under the MICP and CICP are payable in cash during the first quarter of the following fiscal year so long as the participant remains an employee of the Company. Awards earned

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

under the MICP prior to 2004 vested over a three-year period with 50% of each award payable during the first quarter of the following fiscal year and 25% payable on each of the next two annual distribution dates, so long as the participant remained an employee of the Company. The 50% on the first distribution date was payable half in cash and half in common shares. The balance on the next two annual distribution dates was payable, at the election of the participant, all in cash, all in common shares or half in cash and half in common shares or, for elections not made in a timely manner, all in common shares. The final payout under this plan occurred in 2006.

In October of 2007, the Board of Directors approved amendments to the incentive plans eliminating the requirement for bonus awards to be paid partially in shares. Beginning with awards related to the year ended December 31, 2007, the bonus awards are paid entirely in cash. The number of common shares issued pursuant to awards made for the year ended December 31, 2006 was 177,180, and these shares were reserved under the Restricted Plan (as defined below).

The amounts charged to expense under the incentive plans were \$4.0 million, \$1.9 million and \$1.5 million for the plan years 2007, 2006 and 2005, respectively. As of December 31, 2007, \$4.1 million was accrued related to these plans.

**Employee Share Purchase Plan**

In 1998, the Company's shareholders approved the 1998 Employee Share Purchase Plan ("Share Purchase Plan") which provides employees of the Company the opportunity to purchase common shares through payroll deductions. Up to 1,500,000 common shares are authorized for issuance under the Share Purchase Plan. An employee may elect to have payroll deductions made under the Share Purchase Plan for the purchase of common shares in an amount not to exceed 15% of the employee's compensation.

Prior to December 31, 2004, the purchase price per common share was either (i) an amount equal to 85% of the fair market value of a common share on the first day of a 24-month offering period or on the last day of such offering period, whichever was lower, or (ii) such higher price as may be set by the Compensation Committee of the Board at the beginning of such offering period.

Effective January 1, 2005, the plan was amended to reduce future offering periods to three months and to change the purchase price per common share to 95% of the closing price of XOMA shares on the exercise date.

In 2007, 2006, and 2005, employees purchased 83,338, 234,535 and 129,433 common shares, respectively under the Share Purchase Plan. Net payroll deductions under the Share Purchase Plan totaled \$0.3 million, \$0.4 million and \$47,000 for 2007, 2006 and 2005, respectively.

**Shareholder Rights Plan**

On February 26, 2003, the Company's Board of Directors unanimously adopted a Shareholder Rights Plan ("Rights Plan"), which is designed to extend the provisions of a similar rights plan originally adopted in October of 1993. Under the Rights Plan, Preference Share Purchase Rights ("Rights") are authorized and granted at the rate of one Right for each outstanding common share. Each Right entitles the registered holder of common shares to buy a fraction of a share of the new series of Preference Shares ("Series A Preference Shares") at an exercise price of \$30.00, subject to adjustment. The Rights will be exercisable and will detach from the common share, only if a person or group acquires 20 percent or more of the common shares, announces a tender or exchange offer that if consummated will result in a person or group beneficially owning 20 percent or more of the common shares or if the Board of Directors declares a person or group owning 10 percent or more of the outstanding

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

common shares to be an Adverse Person (as defined in the Rights Plan). Once exercisable, each Right will entitle the holder (other than the acquiring person) to purchase units of Series A Preference Share (or, in certain circumstances, common shares of the acquiring person) with a value of twice the Rights exercise price. The Company will generally be entitled to redeem the Rights at \$0.001 per Right at any time until the close of business on the tenth day after the Rights become exercisable. The Rights will expire at the close of business on February 26, 2013.

**Shares Reserved for Future Issuance**

The Company has reserved common shares for future issuance as of December 31, 2007, as follows:

|                               |                   |
|-------------------------------|-------------------|
| Share option plans            | 12,558,076        |
| Convertible preference shares | 3,818,395         |
| Employee share purchase plan  | 472,216           |
| Warrants                      | <u>125,000</u>    |
| Total                         | <u>16,973,687</u> |

**Share Options and Warrants**

At December 31, 2007, the Company had share-based compensation plans, as described below. The aggregate number of common shares that may be issued under these plans is 16,315,000 shares.

On October 31, 2007, the Board of Directors, on the recommendation of its compensation committee, approved a company-wide grant to employees of additional options to purchase common shares. The purpose of the grant was to improve the level of employee ownership in the business by using existing share based option plans to bring the Company in line with competitive industry levels. Of the total of 6,635,000 options granted, 5,185,000 options were made subject to shareholder approval of a commensurate increase in the number of shares available for the grant of options under the Company's existing share option plans. As of December 31, 2007, the 5,185,000 shares are not included in any of the options outstanding disclosures, options granted disclosures, or share-based compensation expense as they are not deemed granted for accounting purposes until shareholder approval is obtained.

**Share Option Plan**

Under the Company's amended 1981 Share Option Plan ("Option Plan") the Company grants qualified and non-qualified share options to employees and other individuals, as determined by the Board of Directors, at exercise prices of not less than the fair market value of the Company's common shares on the date of grant. Options granted under the Option Plan may be exercised when vested and generally expire ten years from the date of the grant or three months from the date of termination of employment (longer in case of death or certain retirements). Options granted generally vest over four years and certain options may fully vest upon a change of control of the Company. The Option Plan will terminate on November 15, 2011.

Up to 14,600,000 shares are authorized for issuance under the Option Plan. As of December 31, 2007, options covering 9,051,720 common shares were outstanding under the Option Plan, excluding the 5,185,000 million shares subject to shareholder approval of the increase in number of shares available under the plan.

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Restricted Share Plan**

The Company also has a Restricted Share Plan (“Restricted Plan”) which provides for the issuance of options or grants of common shares to certain employees and other individuals as determined by the Board of Directors at fair market value of the common shares on the grant date. Prior to 2005, options or shares could be granted at not less than 85% of fair market value of the common shares on the grant date. Each option issued under the Restricted Plan will be a non-statutory share option under federal tax laws and will have a term not in excess of ten years from the grant date or three months from the date of termination of employment (longer in the case of death or certain retirements). Options granted generally vest over four years and certain options may fully vest upon a change of control of the Company. The Restricted Plan will terminate on November 15, 2011.

Up to 2,250,000 shares are authorized for issuance under the Restricted Plan, subject to the condition that not more than 14,600,000 shares are authorized under both the Option Plan and the Restricted Plan. As of December 31, 2007, options covering 563,900 common shares were outstanding under the Restricted Plan.

**Directors Share Option Plan and Other Options**

In 1992, the shareholders approved a Directors Share Option Plan (“Directors Plan”) which provides for the issuance of options to purchase common shares to non-employee directors of the Company at 100% of the fair market value of the shares on the date of the grant. Up to 600,000 shares are authorized for issuance during the term of the Directors Plan. Options generally vest on the date of grant and have a term of up to ten years. As of December 31, 2007, options for 377,500 common shares were outstanding under the Directors Plan.

In addition, in July of 2002, the Company granted a non-qualified fully-vested option to a director to purchase 15,000 common shares at 100% of the fair market value of the shares on the date of grant, which will expire in ten years. This option was not issued as part of the Directors Plan.

In August of 2007, the Company granted a non-qualified option to Steven B. Engle, the newly appointed CEO, to purchase 1,100,000 common shares at 100% of the fair market value of the shares on the date of grant. The option is subject to the Company’s typical four year vesting schedule and will expire 10 years from the date of issuance. The option was not issued as part of the Company’s Option Plan or the Restricted Plan.

**XOMA Ltd.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Share Option Plans Summary**

A summary of the status of the all of Company's share option plans as of December 31, 2007, 2006 and 2005, and changes during years ended on those dates is presented below:

| Options:                                       | 2007              |         | 2006             |         | 2005             |         |
|--|-------------------|---------|------------------|---------|------------------|---------|
|  | Shares            | Price*  | Shares           | Price*  | Shares           | Price*  |
| Outstanding at beginning of year               | 6,229,864         | \$ 4.22 | 5,422,096        | \$ 4.96 | 5,789,555        | \$ 5.42 |
| Granted  |                   |         |                  |         |                  |         |
| (1)  | —                 | —       | —                | —       | 2,000            | 1.52    |
| (2)  | 5,545,850         | 2.95    | 1,480,300        | 1.70    | 1,376,000        | 1.50    |
| (3)  | 500,000           | 5.00    | —                | —       | —                | —       |
| Exercised                                      | (252,920)         | 1.60    | (3,733)          | 1.41    | —                | —       |
| Forfeited, expired or cancelled (4)            | (914,674)         | 4.50    | (668,799)        | 4.68    | (1,745,459)      | 3.78    |
| Outstanding at end of year                     | <u>11,108,120</u> | 3.66    | <u>6,229,864</u> | 4.22    | <u>5,422,096</u> | 4.96    |
| Exercisable at end of year                     | <u>5,261,399</u>  |         | <u>4,245,736</u> |         | <u>4,187,258</u> |         |
| Weighted average fair value of options granted |                   |         |                  |         |                  |         |
| (1)  |                   | —       |                  | —       |                  | \$ 0.96 |
| (2)  |                   | \$ 1.80 |                  | \$ 1.16 |                  | \$ 0.96 |
| (3)  |                   | \$ 0.89 |                  | —       |                  | —       |

\* Weighted-average exercise price:

- (1) Option price less than market price on date of grant as provided for in the Restricted Share Plan; shares issued in 2005 were canceled in order to conform to revised terms of the plan, applied retroactively.
- (2) Option price equal to market price on date of grant.
- (3) Option price greater than market price on date of grant.
- (4) The Company adjusts for forfeitures as they occur.

The following table summarizes information about share options outstanding at December 31, 2007:

| Range of Exercise Prices            | Options Outstanding |             |             | Options Exercisable |             |
|-------------------------------------|---------------------|-------------|-------------|---------------------|-------------|
|                                     | Number              | Life*       | Price**     | Number              | Price**     |
| \$1.08 – \$1.68                     | 1,671,217           | 7.73        | \$ 1.56     | 1,031,568           | \$ 1.53     |
| 1.69 – 2.05                         | 393,075             | 7.93        | 1.79        | 217,992             | 1.80        |
| 2.08 – 2.17                         | 2,352,500           | 9.51        | 2.17        | 198,733             | 2.15        |
| 2.18 – 3.38                         | 777,400             | 6.12        | 3.16        | 588,228             | 3.24        |
| 3.39 – 3.39                         | 1,299,250           | 9.14        | 3.39        | 162,000             | 3.39        |
| 3.40 – 3.65                         | 434,678             | 4.89        | 3.52        | 310,078             | 3.54        |
| 3.67 – 3.67                         | 1,477,200           | 9.83        | 3.67        | 50,000              | 3.67        |
| 3.84 – 5.63                         | 1,318,450           | 6.01        | 5.00        | 1,318,450           | 5.00        |
| 5.64 – 10.16                        | 1,284,350           | 4.02        | 8.32        | 1,284,350           | 8.32        |
| 10.45 – 12.99                       | 100,000             | 3.35        | 11.33       | 100,000             | 11.33       |
| \$1.08 – \$12.99                    | <u>11,108,120</u>   | <u>7.66</u> | <u>3.66</u> | <u>5,261,399</u>    | <u>4.67</u> |
| Options vested and expected to vest | 9,911,260           |             | 3.77        |                     |             |

\* Weighted-average remaining contractual life

\*\* Weighted-average exercise price

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The weighted-average remaining contractual term of outstanding share options at December 31, 2007, was 7.7 years and the aggregate intrinsic value was \$6.7 million. The weighted-average remaining contractual term of exercisable share options at December 31, 2007, was 5.8 years and the aggregate intrinsic value was \$2.6 million.

**Warrants**

In July of 1998, warrants to purchase 250,000 common shares at \$6.00 per share were issued to Incyte Corporation in partial payment of license fees. The warrants were exercisable upon issuance. These warrants expire in July of 2008. As of December 31, 2007, there were 125,000 of these warrants outstanding.

**6. Commitments and Contingencies**

**Collaborative Agreements, Royalties and Milestone Payments**

The Company is obligated to pay royalties, ranging generally from 1.5% to 5% of the selling price of the licensed component and up to 40% of any sublicense fees to various universities and other research institutions based on future sales or licensing of products that incorporate certain products and technologies developed by those institutions.

In addition, the Company has committed to make potential future “milestone” payments to third parties as part of licensing and development programs. Payments under these agreements become due and payable only upon the achievement of certain developmental, regulatory and/or commercial milestones. Because it is uncertain if and when these milestones will be achieved, such contingencies, aggregating up to \$58.3 million have not been recorded on the consolidated balance sheet. The Company is unable to determine precisely when and if payment obligations under the agreements will become due as these obligations are based on milestone events, the achievement of which is subject to a significant number of risks and uncertainties.

**Purchase Obligations**

In September of 2007, XOMA entered into a five year purchase agreement for custom cell culture medium for use in research and development activities. Under the terms of the agreement the Company is obligated to meet certain purchase commitments of approximately \$0.1 million per year over the next five years. These amounts are not included in the Consolidated Balance Sheet as of December 31, 2007.

**Leases**

As of December 31, 2007, the Company leased administrative, research facilities, and office equipment under operating leases expiring on various dates through May of 2014.

Future minimum lease commitments are as follows (in thousands):

|                        | <b>Operating<br/>Leases</b> |
|------------------------|-----------------------------|
| 2008                   | \$ 2,287                    |
| 2009                   | 1,675                       |
| 2010                   | 1,714                       |
| 2011                   | 1,610                       |
| 2012                   | 1,279                       |
| Thereafter             | 1,800                       |
| Minimum lease payments | <u>\$ 10,365</u>            |

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Total rental expense was approximately \$3.6 million, \$3.1 million and \$2.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. Rental expense based on leases allowing for escalated rent payments are recognized on a straight-line basis. The Company is required to restore certain of its leased property to certain conditions in place at the time of lease. The Company believes these costs would not be material to its operations.

**Legal Proceedings**

In September of 2004, XOMA (US) LLC entered into a collaboration with Aphton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware, No. 06-10510 (CSS). XOMA (US) LLC filed a proof of claim in the proceeding, as an unsecured creditor of Aphton, for approximately \$594,000. Aphton and the Official Committee of Unsecured Creditors filed a Proposed Plan of Reorganization that would result in a liquidation of Aphton. The creditors have voted in favor of the plan, and the bankruptcy court has confirmed it. It is not presently known what, if any, distributions will be made to holders of unsecured claims.

**7. Income Taxes**

The significant components of net deferred tax assets as of December 31, 2007 and 2006 are as follows (in millions):

|   | December 31, |         |
|---|--------------|---------|
|   | 2007         | 2006    |
| Capitalized research and development expenses           | \$ 80.3      | \$ 70.9 |
| Net operating loss carryforwards                        | 93.6         | 65.3    |
| Research and development and other credit carryforwards | 21.2         | 20.4    |
| Other   | 10.5         | 6.7     |
| Total deferred tax assets                               | 205.6        | 163.3   |
| Valuation allowance                                     | (205.6)      | (163.3) |
| Net deferred tax assets                                 | \$ —         | \$ —    |

The net increase (decrease) in the valuation allowance was \$42.3 million, \$5.9 million and \$(15.8) million for the years ended December 31, 2007, 2006 and 2005, respectively. Approximately \$23.1 million and \$28.1 million in unutilized federal net operating loss carryforwards expired in 2007 and 2006, respectively. An additional \$10.9 million in California net operating loss carryforwards expired in 2007.

SFAS 109 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes the Company's historical operating performance and carryback potential, the Company has determined that total deferred tax assets should be fully offset by a valuation allowance.

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

XOMA's accumulated federal, state, and foreign tax net operating loss carryforwards and credit carryforwards as of December 31, 2007, are as follows:

|         | Amounts<br>(in millions) | Expiration<br>Dates |
|---------|--------------------------|---------------------|
| Federal |                          |                     |
| NOLs    | \$ 149.7                 | 2008 – 2027         |
| Credits | 11.3                     | 2008 – 2027         |
| State   |                          |                     |
| NOLs    | 96.3                     | 2012 – 2017         |
| Credits | 14.9                     | Do not expire       |
| Foreign |                          |                     |
| NOLs    | 296.7                    | Do not expire       |

The Company's activities in Ireland and the adoption of FIN 48 in 2007 have allowed it to record previously unrecorded net operating losses related to its Irish subsidiary. The availability of the Company's net operating loss and tax credit carryforwards may be subject to substantial limitation if it should be determined that there has been a change in ownership of more than 50% of the value of the Company's shares over a three year period.

There was no income tax expense for the years 2007 and 2006, compared with \$3,000 in 2005.

On January 1, 2007 the Company adopted FIN 48 which clarifies the accounting for uncertainty in income taxes recognized in the Company's financial statements in accordance with SFAS 109 and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition and measurement of a tax position taken or expected to be taken in a tax return. The adoption of FIN 48 did not have a material effect on the Company.

The Company files income tax returns in the U.S. federal jurisdiction, state of California and Ireland. The Company's federal income tax returns for tax years 2004 and beyond remain subject to examination by the Internal Revenue Service. The Company's California and Irish income tax returns of the tax years 2003 and beyond remain subject to examination by the Franchise Tax Board and Irish Revenue Commissioner. In addition, all of the net operating losses and research and development credit carryforwards that may be used in future years are still subject to adjustment.

The Company did not have unrecognized tax benefits as of December 31, 2007 and does not expect this to change significantly over the next 12 months. In connection with the adoption of FIN 48, the Company will recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2007, the Company has not accrued interest or penalties related to uncertain tax positions.

#### 8. Related Party Transactions

Related party transactions consist of relocation loans to two employees. The initial loans of \$70,000 and \$150,000 were granted in 2001 and 2004, respectively, and are being forgiven, along with related interest, over five and two-thirds and four years, respectively, contingent on the employees continued employment with the Company. The final forgiveness will be in November of 2008. Total related party balances as of December 31, 2007 and 2006 were \$38,000 and \$94,000, respectively.



**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**9. Deferred Savings Plan**

Under section 401(k) of the Internal Revenue Code of 1986, the Board of Directors adopted, effective June 1, 1987, a tax-qualified deferred compensation plan for employees of the Company. Participants may make contributions which defer up to 50% of their eligible compensation per payroll period, up to a maximum for 2007 of \$15,500 (or \$20,500 for employees over 50 years of age). The Company may, at its sole discretion, make contributions each plan year, in cash or in the Company's common shares, in amounts which match up to 50% of the salary deferred by the participants. The expense related to these contributions was \$1.0 million, \$0.8 million and \$0.6 million for the years ended December 31, 2007, 2006 and 2005, respectively, and 100% was paid in common shares in each year.

**10. Subsequent Events**

As of March 7, 2008 the Company had \$4.1 million invested in auction rate securities, of which \$3.1 million failed to settle at auction. The Company continues to earn interest on the investments that failed to settle at auction, at the maximum contractual rate. As of December 31, 2007 the carrying value of these investments was equal to the fair value based on successful auctions proceeding and subsequent to year end. The Company will continue to monitor the value of its auction rate securities each reporting period for a possible impairment if a decline in fair value occurs.

**Index to Exhibits**

| <u>Exhibit Number</u> |   |
|-----------------------|---|
| 3.1                   | Memorandum of Continuance of XOMA Ltd. (Exhibit 3.4) <sup>1</sup>   |
| 3.2                   | Bye-Laws of XOMA Ltd. (as amended) (Exhibit 3.2) <sup>2</sup>   |
| 4.1                   | Shareholder Rights Agreement dated as of February 26, 2003, by and between XOMA Ltd. and Mellon Investor Services LLC as Rights Agent (Exhibit 4.1) <sup>3</sup>                                  |
| 4.2                   | Resolution Regarding Preferences and Rights of Series A Preference Shares (Exhibit 4.2) <sup>2</sup>  |
| 4.3                   | Resolution Regarding Preferences and Rights of Series B Preference Shares (Exhibit 4.3) <sup>3</sup>  |
| 4.4                   | Form of Common Stock Purchase Warrant (Incyte Warrants) (Exhibit 2) <sup>4</sup>  |
| 4.5                   | Indenture between XOMA Ltd. and Wells Fargo Bank, National Association, as trustee, relating to the Company's 6.50% Convertible SNAP <sub>SSM</sub> due February 1, 2012 (Exhibit 2) <sup>5</sup> |
| 10.1                  | 1981 Share Option Plan as amended and restated (Exhibit 10.1) <sup>6</sup>  |
| 10.1A                 | Form of Share Option Agreement for 1981 Share Option Plan*  |
| 10.1B                 | Amendment to 1981 Share Option Plan (Exhibit 10.1B) <sup>7</sup>  |
| 10.1C                 | Amendment No. 2 to 1981 Share Option Plan (Exhibit 10.1C) <sup>7</sup>  |
| 10.1D                 | Amendment No. 3 to 1981 Share Option Plan (Exhibit 10.1) <sup>8</sup>   |
| 10.2                  | Restricted Share Plan as amended and restated (Exhibit 10.3) <sup>6</sup>   |
| 10.2A                 | Form of Share Option Agreement for Restricted Share Plan*   |
| 10.2B                 | Amendment to Restricted Share Plan (Exhibit 10.2C) <sup>7</sup>   |
| 10.2C                 | Amendment No. 2 to Restricted Share Plan (Exhibit 10.2D) <sup>7</sup>   |
| 10.2D                 | Amendment No. 3 to Restricted Share Plan*   |
| 10.2E                 | Amendment No. 4 to Restricted Share Plan (Exhibit 10.2) <sup>8</sup>  |
| 10.2F                 | 2007 CEO Share Option Plan (Exhibit 10.7) <sup>9</sup>  |
| 10.3                  | 1992 Directors Share Option Plan as amended and restated (Exhibit 10.3)*  |
| 10.3A                 | Form of Share Option Agreement for 1992 Directors Share Option Plan (initial grants)*   |
| 10.3B                 | Form of Share Option Agreement for 1992 Directors Share Option Plan (subsequent grants)*  |
| 10.3C                 | 2002 Director Share Option Plan (Exhibit 10.10) <sup>6</sup>  |
| 10.4                  | Management Incentive Compensation Plan as amended and restated (Exhibit 10.6) <sup>8</sup>  |
| 10.4A                 | CEO Incentive Compensation Plan*  |
| 10.4B                 | Bonus Compensation Plan*  |
| 10.5                  | 1998 Employee Share Purchase Plan (Exhibit 10.11) <sup>6</sup>  |
| 10.5A                 | Amendment to 1998 Employee Share Purchase Plan (Exhibit 10.5A) <sup>7</sup>   |
| 10.5B                 | Amendment No. 2 to 1998 Employee Share Purchase Plan (Exhibit 10.5B) <sup>7</sup>   |
| 10.6                  | Form of Amended and Restated Indemnification Agreement for Officers (Exhibit 10.6) <sup>10</sup>  |
| 10.6A                 | Form of Amended and Restated Indemnification Agreement for Employee Directors (Exhibit 10.7) <sup>10</sup>  |
| 10.6B                 | Form of Amended and Restated Indemnification Agreement for Non-employee Directors (Exhibit 10.8) <sup>10</sup>  |
| 10.7                  | Form of Employment Agreement entered into between XOMA (US) LLC and certain of its executives, with reference schedule (Exhibit 10.1) <sup>1</sup>  |

---

## Table of Contents

| <u>Exhibit<br/>Number</u> |   |
|---------------------------|---|
| 10.7A                     | Consulting Agreement effective as of August 3, 2007 between XOMA (US) LLC and John L. Castello (Exhibit 10.8) <sup>9</sup>  |
| 10.8                      | Form of Change of Control Severance Agreement entered into between XOMA Ltd. and certain of its executives, with reference schedule (Exhibit 10.2) <sup>9</sup>   |
| 10.9                      | Lease of premises at 890 Heinz Street, Berkeley, California dated as of July 22, 1987 (Exhibit 10.12) <sup>2</sup>  |
| 10.1                      | Lease of premises at Building E at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of April 21, 1988 (Exhibit 10.13) <sup>12</sup>   |
| 10.11                     | Lease of premises at Building C at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of August 26, 1987 (Exhibit 10.14) <sup>12</sup>  |
| 10.12                     | Letter of Agreement regarding CPI adjustment dates for leases of premises at Buildings C, E and F at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 (Exhibit 10.15) <sup>12</sup>  |
| 10.13                     | Lease of premises at 2910 Seventh Street, Berkeley, California dated March 25, 1992 (Exhibit 10.16) <sup>2</sup>  |
| 10.13A                    | Fifth amendment to lease of premises at 2910 Seventh Street, Berkeley, California dated June 1, 2006 (Exhibit 10.58) <sup>3</sup>   |
| 10.14                     | Lease of premises at 5860 and 5864 Hollis Street, Emeryville, California dated as of November 2, 2001 (with addendum) (Exhibit 10.19) <sup>4</sup>  |
| 10.15                     | Lease of premises at 2850 Seventh Street, Second Floor, Berkeley, California dated as of December 28, 2001 (with addendum and guaranty) (Exhibit 10.20) <sup>4</sup>  |
| 10.16                     | Amended and Restated Research and License Agreement dated September 1, 1993, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28) <sup>12</sup>                                |
| 10.16A                    | Third Amendment to License Agreement dated June 12, 1997, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28A) <sup>12</sup>  |
| 10.16B                    | Fourth Amendment to License Agreement dated December 23, 1998, between the Company and New York University (Exhibit 10.22B) <sup>5</sup>  |
| 10.16C                    | Fifth Amendment to License Agreement dated June 25, 1999, between the Company and New York University (Exhibit 10.21C) <sup>6</sup>   |
| 10.16D                    | Sixth Amendment to License Agreement dated January 25, 2000, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.1) <sup>17</sup>   |
| 10.16E                    | Seventh Amendment to License Agreement by and among New York University, XOMA Technology Limited and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3) <sup>18</sup> |

---

## Table of Contents

| <u>Exhibit<br/>Number</u> |  |
|---------------------------|--|
| 10.17                     | Technology Acquisition Agreement dated June 3, 1994, between Connective Therapeutics, Inc. (now called Connetics Corporation) and the Company (with certain confidential information deleted) (Exhibit 10.46) <sup>19</sup>  |
| 10.17A                    | Amendment Number One to Technology Acquisition Agreement dated December 8, 1999, between Connetics Corporation and XOMA (US) LLC (with certain confidential information deleted) (Exhibit 10.23A) <sup>16</sup>  |
| 10.17B                    | Agreement dated December 8, 1999, by and between The Immune Response Corporation and XOMA (US) LLC (with certain confidential information deleted) (Exhibit 10.23B) <sup>16</sup>  |
| 10.18                     | Second Amended and Restated Collaboration Agreement dated January 12, 2005, by and between XOMA (US) LLC and Genentech, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.26C) <sup>7</sup>                         |
| 10.19                     | License Agreement between Incyte Pharmaceuticals, Inc. and XOMA Corporation effective as of July 9, 1998 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 1) <sup>4</sup>  |
| 10.19A                    | Amendment No. 1 to License Agreement by and among Incyte Corporation, XOMA Technology Limited and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3) <sup>18</sup> |
| 10.19B                    | Registration Rights Agreement dated as of July 9, 1998, by and among the Company and Incyte Pharmaceuticals, Inc. (Exhibit 3) <sup>†</sup>   |
| 10.2                      | Development and License Agreement, dated November 26, 2001, by and among XOMA (US) LLC, XOMA Ireland Limited and Millennium Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>20</sup>        |
| 10.20A                    | Omnibus Agreement dated as of October 8, 2004, by and among XOMA (US) LLC, XOMA Ireland Limited and Millennium Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10) <sup>21</sup>                    |
| 10.20B                    | Investment Agreement, dated as of November 26, 2001, by and among XOMA, Millennium Pharmaceuticals, Inc. and mHoldings Trust (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3) <sup>20</sup>                             |
| 10.20C                    | Letter Agreement, dated May 16, 2003, by and among XOMA Ltd., Millennium Pharmaceuticals, Inc. and mHoldings Trust (Exhibit 6) <sup>2</sup>  |
| 10.20D                    | Letter Agreement, dated February 24, 2004, by and between XOMA Ltd. and Millennium Pharmaceuticals, Inc. (Exhibit 8) <sup>3</sup>  |
| 10.20E                    | Convertible Subordinated Promissory Note dated November 26, 2001 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 4) <sup>20</sup>   |
| 10.20F                    | Amendment No. 1 to Convertible Subordinated Promissory Note dated November 5, 2002 (Exhibit 10.3A) <sup>†</sup>  |

---

## Table of Contents

| <u>Exhibit<br/>Number</u> |  |
|---------------------------|--|
| 10.20G                    | Registration Rights Agreement dated as of November 26, 2001, by and among XOMA, Millennium Pharmaceuticals, Inc. and mHoldings Trust (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 5) <sup>20</sup>             |
| 10.21                     | License Agreement by and between XOMA Ireland Limited and MorphoSys AG, dated as of February 1, 2002 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.43) <sup>25</sup>   |
| 10.22                     | Amended and Restated License Agreement by and between XOMA Ireland Limited and DYAX Corp., dated as of October 27, 2006 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.32) <sup>10</sup>                      |
| 10.23                     | License Agreement by and between XOMA Ireland Limited and Cambridge Antibody Technology Limited, dated as of December 22, 2002 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.46) <sup>2</sup>                |
| 10.24                     | Co-Development and Co-Commercialization Agreement, dated as of December 17, 2003, by and between Alexion Pharmaceuticals, Inc. and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>26</sup> |
| 10.25                     | License Agreement, dated as of December 29, 2003, by and between Diversa Corporation and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>27</sup>                                    |
| 10.26                     | Agreement, dated February 27, 2004, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.50) <sup>28</sup>  |
| 10.26A                    | Research, Development and Commercialization Agreement, dated as of May 26, 2005, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.2) <sup>29</sup>          |
| 10.26B                    | Secured Note Agreement, dated as of May 26, 2005, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.3) <sup>29</sup>   |
| 10.27                     | Collaboration Agreement, dated as of September 23, 2004, by and between Apton Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>30</sup>                                      |
| 10.28                     | License Agreement by and between Zephyr Sciences Inc. and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>18</sup>                                 |

---

## Table of Contents

| <u>Exhibit<br/>Number</u> |  |
|---------------------------|--|
| 10.29                     | Agreement dated March 8, 2005, between XOMA (US) LLC and the National Institute of Allergy and Infectious Diseases (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.53) <sup>7</sup>  |
| 10.29A                    | Agreement dated July 28, 2006, between XOMA (US) LLC and the National Institute of Allergy and Infectious Diseases (Exhibit 10.60) <sup>3</sup>  |
| 10.3                      | License Agreement, effective as of June 20, 2005, by and between Merck & Co., Inc. and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.4) <sup>29</sup>   |
| 10.31                     | Letter Agreement dated September 20, 2005, between XOMA (US) LLC and Cubist Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.54) <sup>31</sup>  |
| 10.32                     | Form of Dealer Manager Agreement relating to the Company's 6.50% Convertible SNAPS <sup>SM</sup> due February 1, 2012 (Exhibit 1.1) <sup>32</sup>  |
| 10.32A                    | Form of Placement Agreement relating to the Company's 6.50% Convertible SNAPS <sup>SM</sup> due February 1, 2012 (Exhibit 1.2) <sup>32</sup>   |
| 10.33                     | Collaboration Agreement dated as of May 22, 2006, by and between Schering Corporation, acting through its Schering-Plough Research Institute division, and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.59) <sup>13</sup> |
| 10.34                     | Collaboration Agreement, dated as of November 1, 2006, between the Company and Takeda Pharmaceutical Company Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.46) <sup>10</sup>   |
| 10.34A                    | First Amendment to Collaboration Agreement, effective as of February 28, 2007, between the Company and Takeda Pharmaceutical Company Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.48) <sup>33</sup>                             |
| 10.35                     | Loan Agreement, dated as of November 9, 2006, between Goldman Sachs Specialty Lending Holdings, Inc., XOMA (US) LLC and XOMA Ltd. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.47) <sup>10</sup>  |
| 10.36                     | License Agreement, effective as of August 27, 2007, by and between Pfizer Inc. and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>34</sup>  |
| 21.1                      | Subsidiaries of the Company*   |
| 23.1                      | Consent of Independent Registered Public Accounting Firm*  |
| 31.1                      | Certification of Steven B. Engle, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*   |
| 31.2                      | Certification of J. David Boyle II, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*   |

---

## Table of Contents

| <u>Exhibit<br/>Number</u> |  |
|---------------------------|--|
| 32.1                      | Certification of Steven B. Engle, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*   |
| 32.2                      | Certification of J. David Boyle II, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002* |
| 99.1                      | Press Release dated March 11, 2008, furnished herewith   |

### Footnotes:

- \* Filed herewith.
- 1 Incorporated by reference to the referenced exhibit to the Company's Registration Statement on Form S-4 filed November 17, 1998, as amended.
- 2 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.
- 3 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 to Form 8-K/A filed April 18, 2003.
- 4 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed July 16, 1998.
- 5 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed February 13, 2006.
- 6 Incorporated by reference to the referenced exhibit to the Company's Registration Statement on Form S-8 filed August 28, 2003.
- 7 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.
- 8 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed November 6, 2007.
- 9 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed August 7, 2007.
- 10 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007.
- 11 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed August 16, 2007.
- 12 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, as amended.
- 13 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006.
- 14 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.
- 15 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.
- 16 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.
- 17 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000.
- 18 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 on Form 8-K/A filed November 30, 2004.
- 19 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1994.
- 20 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 to Current Report on Form 8-K/A filed December 13, 2001, as amended by Amendment No. 2 to Current Report on Form 8-K/A filed October 24, 2002.

---

## Table of Contents

- 21 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 6 on Form 8-K/A filed October 20, 2004.
- 22 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 3 on Form 8-K/A filed May 21, 2003.
- 23 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 4 on Form 8-K/A filed February 24, 2004.
- 24 Incorporated by reference to the referenced exhibit to the Company's Registration Statement on Form S-3 filed November 6, 2002.
- 25 Incorporated by reference to the referenced exhibit to Amendment No. 2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2002 filed on December 12, 2002.
- 26 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 2 on Form 8-K/A filed March 19, 2004.
- 27 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 2 on Form 8-K/A filed March 19, 2004.
- 28 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
- 29 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005.
- 30 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed October 26, 2004.
- 31 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2005.
- 32 Incorporated by reference to the referenced exhibit to Amendment No. 2 to the Company's Registration Statement on Form S-4 filed January 11, 2006.
- 33 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007.
- 34 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed September 13, 2007.



Share Option Agreement

Under the XOMA Ltd.

1981 Share Option Plan

(A) Optionee:

(B) Grant Date:

(C) Shares:

(D) Share Installments:

\_\_\_\_\_ shares vest \_\_\_\_\_  
\_\_\_\_\_ shares become exercisable in 36  
monthly installments beginning  
\_\_\_\_\_

(E) Payroll Number:

(F) Expiration Date:

(G) Exercise Price:

\$

(H) Option Type:

Incentive Share Option

XOMA Ltd. (the "Company") has granted you an option to purchase the number of Common Shares shown in item (C) above (the "Optioned Shares") at the Exercise Price per share shown in item (G) above. This option is subject to the terms of the Company's 1981 Share Option Plan, as amended through October 31, 2007 (the "Plan") and to the terms and conditions set forth in this Share Option Agreement under the XOMA Ltd. 1981 Share Option Plan (the "Agreement").

The details of your option are as follows:

**1. Term; Transfer.** The term of this option commences on the Grant Date shown in item (B) above and, except as provided in Section 3 and Subsection 5(a) hereof, expires at the close of business on the Expiration Date shown in item (F) above, which is 10 years from the Grant Date.

If this option is a non-statutory share option, it may be transferred or assigned to your spouse or descendent (any such spouse or descendent, your "Immediate Family Member") or a corporation, partnership, limited liability company or trust so long as all of the shareholders, partners, members or beneficiaries thereof, as the case may be, are either you or your Immediate Family Member, provided that (i) there may be no consideration for any such transfer and (ii) subsequent transfers of the transferred option will be prohibited other than by will or the laws

---

of descent and distribution. Following transfer, the option will continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that for purposes of this Agreement any references to "you" will refer to the transferee. The events of termination of employment will continue to be applied with respect to you, following which the option will be exercisable by the transferee only to the extent, and for the periods specified, in this Agreement.

If this option is an incentive share option, the option shall be exercisable during your lifetime only by you and shall not be assignable or transferable otherwise than by will or by the laws of descent and distribution.

**2. Exercise Schedule.** Provided that you remain an employee of or consultant to the Company (as determined in accordance with Subsection 3(f) hereof), the option granted herein will become exercisable (a) as to 25% of such number of shares (rounded to the nearest whole integer), upon the first anniversary of this date of grant, and (b) as to the remaining 75% of such number of shares (rounded to the nearest whole integer), in thirty-six (36) equal and consecutive monthly installments beginning one year and one month after this date of grant.

Exercisable installments may be exercised in whole or in part in increments of 25 or more shares and, to the extent not exercised, will accumulate and be exercisable at any time on or before the Expiration Date or sooner termination of the option term.

**3. Effect of Termination of Employment**

(a) If you cease to be an employee of the Company at any time during the option term for any reason other than as provided in Subsections (b), (c), (d) or (e) below, then the period for exercising this option will be limited to the three-month period commencing with the date of such cessation of employee status; provided that, notwithstanding the foregoing, if you cease to be an employee of the Company and immediately thereafter become a consultant to the Company at any time during the option term, then the period for exercising this option will not be limited as aforesaid but will be limited to the three-month period commencing with the date of cessation of consultant status, if during the option term; and provided further, that in no event will this option be exercisable at any time after the Expiration Date. During any such limited period of exercisability, this option may not be exercised for more than the number of Optioned Shares (if any) for which it is exercisable at the date of your cessation of employee or consultant status, as the case may be. Upon the expiration of any such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding.

(b) If you die and cease by reason thereof to be either an employee of or a consultant to the Company at any time during the option term, then this option will become fully exercisable on the date of death even if the option was not fully exercisable prior to death, and will remain exercisable for a twelve-month period following the date of death; provided, however, that in no event shall this option be exercisable at any time after the Expiration Date. Upon the expiration of such twelve-month period or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. Upon your death, the option will be exercisable by the personal

---

representative of your estate or by the person or persons to whom the option is transferred pursuant to Section 1 above, provided any such exercise occurs prior to the earlier of (i) the expiration of the twelve-month period following the date of your death or (ii) the specified Expiration Date of the option term.

(c) If you become permanently disabled and cease by reason thereof to be either an employee of or a consultant to the Company at any time during the option term, then you will have a period of twelve months (commencing with the date of such cessation of employee or consultant status, as the case may be) during which to exercise this option; provided, however, that in no event shall this option be exercisable at any time after the Expiration Date. During such limited period of exercisability, this option may not be exercised for more than the number of Optioned Shares (if any) for which this option is exercisable at the date of your cessation of employee or consultant status, as the case may be. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. You will be deemed to be permanently disabled if you are, by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of not less than twelve consecutive months or more, unable to perform your usual duties for the Company or its subsidiaries.

(d) If you retire at or after age fifty-five (55) and the sum of your age on the date of retirement plus years of full-time employment or consultancy with the Company exceeds seventy (70) ("Retirement") and if by reason thereof you cease to be either an employee of or consultant to the Company, at any time during the option term, then this option will become fully exercisable as of the date of Retirement (even if the option was not fully exercisable prior to Retirement) and will remain exercisable for the full option term until the Expiration Date as if you had continued in employment or consultancy. On the Expiration Date, the option will terminate and cease to be outstanding.

(e) Should (i) your status as either an employee or a consultant be terminated for cause (including, but not limited to, any act of dishonesty, willful misconduct, fraud or embezzlement or any unauthorized disclosure or use of confidential information or trade secrets), or (ii) you make or attempt to make any unauthorized use or disclosure of confidential information or trade secrets of the Company or its subsidiaries, then in any such event this option will terminate and cease to be exercisable immediately upon the date of such termination of employee or consultant status, as the case may be, or such unauthorized use or disclosure of confidential or secret information or attempt thereat.

(f) For purposes of this Agreement, you will be deemed to be an employee of the Company for so long as you remain in the employ of the Company or one or more of its subsidiaries, and you will be deemed to be a consultant to the Company for so long as you are actively rendering consulting services on a periodic basis to the Company or one or more of its subsidiaries. A legal entity will be deemed to be a subsidiary of the Company if it is a member of an unbroken chain of legal entities beginning with the Company, provided that each such legal entity in the chain (other than the last legal entity) owns, at the time of determination, shares

---

possessing 50% or more of the total combined voting power of all classes of shares in one of the other legal entities in such chain.

#### **4. Adjustment in Option Shares.**

(a) If any change is made to the Common Shares issuable under the Plan, whether by reason of any share dividend, share split, combination of shares, recapitalization or other change affecting the outstanding Common Shares as a class without receipt of consideration, then appropriate adjustments will be made to (i) the total number of Optioned Shares subject to this option and (ii) the Exercise Price payable per share, in order to reflect such change and thereby preclude the dilution or enlargement of benefits under this Agreement. The adjustments determined by the plan administrator (the "Plan Administrator") will be final, binding and conclusive.

(b) If the Company is the surviving or continuing entity in any merger, amalgamation or other business combination, then this option, if outstanding under the Plan immediately after such merger, amalgamation or other business combination, will be appropriately adjusted to apply and pertain to the number and class of securities which the holder of the same number of Common Shares as are subject to this option immediately prior to such merger, amalgamation or other business combination would have been entitled to receive in the consummation of such merger, amalgamation or other business combination, and an appropriate adjustment will be made to the Exercise Price payable per share, provided the aggregate Exercise Price payable hereunder will remain the same.

#### **5. Corporate Transaction.**

(a) In the event of one or more of the following transactions ("Corporate Transaction"):

(i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company's incorporation;

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company; or

(iii) any other business combination in which fifty percent (50%) or more of the Company's outstanding voting shares is transferred to different holders in a single transaction or a series of related transactions,

then each option at the time outstanding under the Plan and not then otherwise fully exercisable shall, immediately prior to the specified effective date for the Corporate Transaction, become fully exercisable for up to the total number of Common Shares purchasable under such option and may be exercised for all or any portion of the shares for which the option is so accelerated. However, an outstanding option shall not be so accelerated if and to the extent such option is in connection with the Corporate Transaction either to be assumed by the successor corporation or parent thereof or to be replaced with comparable options to purchase capital stock of the successor corporation or parent thereof, such comparability to be determined by the Plan Administrator.

---

(a) The exercisability of this option as an incentive share option under the Federal tax laws (if designated as such above) will be subject to the applicable dollar limitation of Section 16 hereof.

(b) The Plan Administrator will use its best efforts to provide you with written notice of a Corporate Transaction at least ten business days prior to the effective date.

(c) This Agreement will not in any way affect the right of the Company to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, amalgamate, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

**6. Privilege of Share Ownership.** The holder of this option will not have any rights of a shareholder with respect to the Optioned Shares until such individual has exercised the option, paid the Exercise Price and been issued a certificate for the purchased shares.

**7. Manner of Exercising Option.**

(a) In order to exercise this option with respect to all or any part of the Optioned Shares for which this option is at the time exercisable, you (or in the case of exercise after your death, your executor, administrator, heir, legatee or transferee as the case may be) must take the following actions:

(i) Provide the Secretary of the Company with written notice of such exercise, specifying the number of Optioned Shares with respect to which the option is being exercised.

(ii) Pay the Exercise Price for the purchased Optioned Shares in one or more of the following alternative forms: (A) full payment in cash or by check payable to the Company's order; (B) full payment in Common Shares of the Company valued at fair market value on the exercise date (as such terms are defined below); (C) full payment in combination of Common Shares of the Company valued at fair market value on the exercise date and cash or check payable to the Company's order; (D) payment effected through a broker-dealer sale and remittance procedure pursuant to which you (I) will provide irrevocable written instructions to the designated broker-dealer to effect the immediate sale of the purchased shares and remit to the Company, out of the sale proceeds, an amount equal to the aggregate Exercise Price payable for the purchased shares plus all applicable Federal and State income and employment taxes required to be withheld by the Company by reason of such purchase and (II) will provide written directives to the Company to deliver the certificates for the purchased shares directly to such broker-dealer; or, to the extent the Plan Administrator specifically authorizes such method of payment at the time of exercise, (E) payment by a full-recourse promissory note. Any such promissory note authorized by the Plan Administrator will be substantially in the form approved by the Plan Administrator, will bear interest at the minimum per annum rate necessary to avoid the imputation of interest income to the Company and compensation income to you under the Federal tax laws and will become due in full (in one or more consecutive annual installments measured from the execution date of the note) not later than the Expiration Date of this option. Payment of the note will

---

be secured by the pledge of the purchased shares, and the pledged shares will be released only as the note is paid.

(iii) Furnish to the Company appropriate documentation that the person or persons exercising the option, if other than you, have the right to exercise this option.

(b) For purposes of Subsection 7(a) hereof, the fair market value per Common Share on any relevant date will be determined in accordance with Subsections (i) through (iii) below, and the exercise date will be the date on which you exercise this option in compliance with the provisions of Subsection 7(a).

(i) If the Common Shares are not listed or admitted to trading on any stock exchange on the date in question, but is traded in the over-the-counter market, the fair market value will be the closing selling price per share of such shares on such date, as such price is reported by the National Association of Securities Dealers through its Nasdaq National Market. If there is no reported closing selling price of the shares on the date in question then the closing selling price on the last preceding date for which such quotation exists will be determinative of fair market value.

(ii) If the Common Shares are listed or admitted to trading on any stock exchange on the date in question, the fair market value will be the closing selling price per share of such shares on such date on the stock exchange determined by the Plan Administrator to be the primary market for such shares, as such price is officially quoted on such exchange. If there is no reported closing selling price of such shares on such exchange on the date in question, the fair market value will be the closing selling price on the exchange on the last preceding date for which such quotation exists.

(iii) If the Common Shares are neither listed nor admitted to trading on any stock exchange nor traded in the over-the-counter market on the date in question or if the Plan Administrator determines that the quotations under Subsections (i) or (ii) above do not accurately reflect the fair market value of such shares, the fair market value will be determined by the Plan Administrator after taking into account such factors as the Plan Administrator may deem appropriate, including one or more independent professional appraisals.

(c) In no event may this option be exercised for any fractional share.

#### **8. Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of Optioned Shares upon such exercise will be subject to compliance by the Company and by you with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange on which the Company's Common Shares may be listed at the time of such exercise and issuance.

(b) In connection with the exercise of this option, you will execute and deliver to the Company such representations in writing as may be requested by the Company in order for it to comply with the applicable requirements of Federal and State securities laws.

---

**9. Restrictive Legends.** If and to the extent any Optioned Shares acquired under this option are not registered under the Securities Act of 1933, the certificates for such Optioned Shares will be endorsed with restrictive legends, including (without limitation) the following:

“The Shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a ‘no action’ letter of the Securities and Exchange Commission with respect to such sale or offer, or (c) an opinion of counsel to the Company that registration under such Act is not required with respect to such sale or offer.”

**10. Successors and Assigns.** Except to the extent otherwise provided in Section 1 and Subsection 5(a), the provisions of this Agreement will inure to the benefit of, and be binding upon your successors, administrators, heirs, legal representatives and assigns and the successors and assigns of the Company.

**11. Liability of the Company.**

(a) If the Optioned Shares covered by this Agreement exceed, as of the Grant Date, the number of Common Shares which may without shareholder approval be issued under the Plan, then this option will be void with respect to such excess shares unless shareholder approval of an amendment sufficiently increasing the number of Common Shares issuable under the Plan is obtained in accordance with the provisions of the Plan.

(b) The inability of the Company to obtain approval from any regulatory body having authority deemed by the Company to be necessary to the lawful issuance and sale of any Common Shares pursuant to this option will relieve the Company of any liability in respect of the non-issuance or sale of such shares as to which such approval will not have been obtained.

**12. No Employment or Consulting Contract.** Nothing in this Agreement or in the Plan will confer upon you any right to continue in the employ or service of the Company for any period of time or interfere with or otherwise restrict in any way the rights of the Company (or any subsidiary of the Company employing or retaining you) or you, which rights are hereby expressly reserved by each, to terminate your employee or consultant status as the case may be, at any time for any reason whatsoever, with or without cause.

**13. Notices.** Any notice required to be given or delivered to the Company under the terms of this Agreement will be in writing and addressed to the Company in care of its Secretary at its principal offices. Any notice required to be given or delivered to you will be in writing and addressed to you at the address indicated below your signature line herein. All notices will be deemed to be given or delivered upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

---

**14. Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the express terms and provisions of the Plan. Any dispute regarding the interpretation of this Agreement will be submitted to the Plan Administrator for resolution. The decision of the Plan Administrator will be final, binding and conclusive. Questions regarding this option or the Plan should be referred to the Legal Department of the Company.

**15. Governing Law.** The interpretation, performance, and enforcement of this Agreement will be governed by the laws of the State of California.

**16. Additional Terms Applicable to an Incentive Share Option** In the event this option is an incentive share option, the following terms and conditions will apply to the grant:

(a) This option will cease to qualify for favorable tax treatment as an incentive share option under the Federal tax laws if (and to the extent) this option is exercised for Optioned Shares: (i) more than three months after the date you cease to be an employee for any reason other than death or permanent disability (as defined in Section 3) or (ii) more than one (1) year after the date you cease to be an employee by reason of permanent disability.

(b) Except in the event of a Corporate Transaction under Section 5, this option will not become exercisable in the calendar year in which granted if (and to the extent) the aggregate fair market value (determined at the Grant Date) of the Company's Common Shares for which this option would otherwise first become exercisable in such calendar year would, when added to the aggregate fair market value (determined as of the respective date or dates of grant) of the Company's Common Shares for which this option or one or more other post-1986 incentive share options granted to you prior to the Grant Date (whether under the Plan or any other option plan of the Company or any parent or subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate. To the extent the exercisability of this option is deferred by reason of the foregoing limitation, the deferred portion will first become exercisable in the first calendar year or years thereafter in which the One Hundred Thousand Dollar (\$100,000) limitation of this Section 16(b) would not be contravened.

(c) Should the exercisability of this option be accelerated upon a Corporate Transaction in accordance with Section 5, then this option will qualify for favorable tax treatment as an incentive share option under the Federal tax laws only to the extent the aggregate fair market value (determined at the Grant Date) of the Company's Common Shares for which this option first becomes exercisable in the calendar year in which the Corporate Transaction occurs does not, when added to the aggregate fair market value (determined as of the respective date or dates of grant) of the Company's Common Shares for which this option or one or more other post-1986 incentive share options granted to you prior to Grant Date (whether under the Plan or any other option plan of the Company or any parent or subsidiary) first become exercisable during the same calendar year, exceed One Hundred Thousand Dollars (\$100,000) in the aggregate.



---

(d) To the extent that this option fails to qualify as an incentive share option under the Federal tax laws, you will recognize compensation income in connection with the acquisition of one or more Optioned Shares hereunder, and you must make appropriate arrangements for the satisfaction of all Federal, State or local income tax withholding requirements and Federal social security employee tax requirements applicable to such compensation income.

**17. Additional Terms Applicable to a Non-Statutory Share Option** In the event this option is a non-statutory share option, you hereby agree to make appropriate arrangements with the Company or subsidiary thereof by which you are employed or retained for the satisfaction of all Federal, State or local income tax withholding requirements and Federal social security employee tax requirements applicable to the exercise of this option.

---

XOMA LTD.

By: \_\_\_\_\_  
Steven B.Engle  
Chairman of the Board  
Chief Executive Officer and President

Dated: \_\_\_\_\_

I hereby agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

If the optionee resides in California or another community property jurisdiction, I, as the optionee's spouse, also agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

**Non-Qualified Share Option Agreement****Under the XOMA Ltd.****Restricted Share Plan**

- |                                |                             |
|--------------------------------|-----------------------------|
| (A) <b>Optionee:</b>           | (E) <b>Payroll Number:</b>  |
| (B) <b>Grant Date:</b>         | (F) <b>Expiration Date:</b> |
| (C) <b>Shares:</b>             | (G) <b>Exercise Price:</b>  |
|                                | \$                          |
| (D) <b>Share Installments:</b> | (H) <b>Option Type:</b>     |
|                                | Non-Qualified Share Option  |

XOMA Ltd. (the "Company") has granted you a non-qualified option to purchase the number of Common Shares shown in item (C) above (the "Optioned Shares") at the Exercise Price per share shown in item (G) above. This option is subject to the terms of the Company's Restricted Share Plan, as amended through May 23, 2006 (the "Plan") and to the terms and conditions set forth in this Non-Qualified Share Option Agreement Under the XOMA Ltd. Restricted Share Plan (the "Agreement").

The details of your option are as follows:

**1. Term; Transfer.** The term of this option commences on the Grant Date shown in item (B) above and, except as provided in Section 3 and Subsection 5(a) hereof, expires at the close of business on the Expiration Date shown in item (F) above, which is 10 years from the Grant Date.

This option may be transferred or assigned to your spouse or descendent (any such spouse or descendent, your "Immediate Family Member") or a corporation, partnership, limited liability company or trust so long as all of the shareholders, partners, members or beneficiaries thereof, as the case may be, are either you or your Immediate Family Member, provided that (i) there may be no consideration for any such transfer and (ii) subsequent transfers of the transferred option will be prohibited other than by will or the laws of descent and distribution. Following transfer, the option will continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that for purposes of this Agreement any references to "you" will refer to the transferee. The events of termination of employment will continue to be

---

applied with respect to you, following which the option will be exercisable by the transferee only to the extent, and for the periods specified, in this Agreement.

**1. Exercise Schedule.** Provided that you remain an employee of or consultant to the Company (as determined in accordance with Subsection 3(f) hereof), the option granted herein will become exercisable (a) as to 25% of such number of shares (rounded to the nearest whole integer), upon the first anniversary of this date of grant, and (b) as to the remaining 75% of such number of shares (rounded to the nearest whole integer), in thirty-six (36) equal and consecutive monthly installments beginning one year and one month after this date of grant.

Exercisable installments may be exercised in whole or in part in increments of 25 or more shares and, to the extent not exercised, will accumulate and be exercisable at any time on or before the Expiration Date or sooner termination of the option term.

**1. Effect of Termination of Employment**

(a) If you cease to be an employee of the Company at any time during the option term for any reason other than as provided in Subsections (b), (c), (d) or (e) below, then the period for exercising this option will be limited to the three-month period commencing with the date of such cessation of employee status; provided that, notwithstanding the foregoing, if you cease to be an employee of the Company and immediately thereafter become a consultant to the Company at any time during the option term, then the period for exercising this option will not be limited as aforesaid but will be limited to the three-month period commencing with the date of cessation of consultant status, if during the option term; and provided further, that in no event will this option be exercisable at any time after the Expiration Date. During any such limited period of exercisability, this option may not be exercised for more than the number of Optioned Shares (if any) for which it is exercisable at the date of your cessation of employee or consultant status, as the case may be. Upon the expiration of any such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding.

(b) If you die and cease by reason thereof to be either an employee of or a consultant to the Company at any time during the option term, then this option will become fully exercisable on the date of death even if the option was not fully exercisable prior to death, and will remain exercisable for a twelve-month period following the date of death; provided, however, that in no event shall this option be exercisable at any time after the Expiration Date. Upon the expiration of such twelve-month period or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. Upon your death, the option will be exercisable by the personal representative of your estate or by the person or persons to whom the option is transferred pursuant to Section 1 above, provided any such exercise occurs prior to the earlier of (i) the expiration of the twelve-month period following the date of your death or (ii) the specified Expiration Date of the option term.

(c) If you become permanently disabled and cease by reason thereof to be either an employee of or a consultant to the Company at any time during the option term, then you will have a period of twelve months (commencing with the date of such cessation of employee or consultant status, as the case may be) during which to exercise this option; provided, however,

---

that in no event shall this option be exercisable at any time after the Expiration Date. During such limited period of exercisability, this option may not be exercised for more than the number of Optioned Shares (if any) for which this option is exercisable at the date of your cessation of employee or consultant status, as the case may be. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. You will be deemed to be permanently disabled if you are, by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of not less than twelve consecutive months or more, unable to perform your usual duties for the Company or its subsidiaries.

(d) If you retire at or after age fifty-five (55) and the sum of your age on the date of retirement plus years of full-time employment or consultancy with the Company exceeds seventy (70) ("Retirement") and if by reason thereof you cease to be either an employee of or consultant to the Company at any time during the option term, then this option will become fully exercisable as of the date of Retirement (even if the option was not fully exercisable prior to Retirement) and will remain exercisable for a twelve-month period following the date of Retirement. Upon the expiration of such twelve-month or shorter period or (if earlier) on the Expiration Date, the option will terminate and cease to be outstanding.

(e) Should (i) your status as either an employee or a consultant be terminated for cause (including, but not limited to, any act of dishonesty, willful misconduct, fraud or embezzlement or any unauthorized disclosure or use of confidential information or trade secrets), or (ii) you make or attempt to make any unauthorized use or disclosure of confidential information or trade secrets of the Company or its subsidiaries, then in any such event this option will terminate and cease to be exercisable immediately upon the date of such termination of employee or consultant status, as the case may be, or such unauthorized use or disclosure of confidential or secret information or attempt thereat.

(f) For purposes of this Agreement, you will be deemed to be an employee of the Company for so long as you remain in the employ of the Company or one or more of its subsidiaries, and you will be deemed to be a consultant to the Company for so long as you are actively rendering consulting services on a periodic basis to the Company or one or more of its subsidiaries. A legal entity will be deemed to be a subsidiary of the Company if it is a member of an unbroken chain of legal entities beginning with the Company, provided that each such legal entity in the chain (other than the last legal entity) owns, at the time of determination, shares possessing 50% or more of the total combined voting power of all classes of shares in one of the other legal entities in such chain.

## **2. Adjustment in Option Shares.**

(a) If any change is made to the Common Shares issuable under the Plan, whether by reason of any share dividend, share split, combination of shares, recapitalization or other change affecting the outstanding Common Shares as a class without receipt of consideration, then appropriate adjustments will be made to (i) the total number of Optioned Shares subject to this option and (ii) the Exercise Price payable per share, in order to reflect such change and thereby preclude the dilution or enlargement of benefits under this Agreement. The adjustments

---

determined by the plan administrator (the "Plan Administrator") will be final, binding and conclusive.

(b) If the Company is the surviving or continuing entity in any merger, amalgamation or other business combination, then this option, if outstanding under the Plan immediately after such merger, amalgamation or other business combination, will be appropriately adjusted to apply and pertain to the number and class of securities which the holder of the same number of Common Shares as are subject to this option immediately prior to such merger, amalgamation or other business combination would have been entitled to receive in the consummation of such merger, amalgamation or other business combination, and an appropriate adjustment will be made to the Exercise Price payable per share, provided the aggregate Exercise Price payable hereunder will remain the same.

### **3. Corporate Transaction.**

(a) In the event of one or more of the following transactions ("Corporate Transaction"):

- (i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company's organization,
- (ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company, or
- (iii) any other reorganization or business combination in which fifty percent (50%) or more of the Company's outstanding voting shares are transferred to different holders in a single transaction or a series of related transactions,

then the exercisability of this option will automatically be accelerated so that such option may be exercised simultaneously with consummation of such Corporate Transaction for any or all of the Optioned Shares. No such acceleration of this option will occur, however, if and to the extent: (x) the terms of the agreement for such Corporate Transaction provide as a prerequisite to the consummation of such Corporate Transaction that outstanding options under the Plan (including this option) are to be assumed by the successor or parent thereof or are to be replaced with the comparable options to purchase shares of capital stock of the successor or parent thereof, such comparability to be determined by the Plan Administrator, or (y) the acceleration of this option would, when added to the present value of certain other payments in the nature of compensation which become due and payable to you in connection with the Corporate Transaction, result in the payment to you of excess parachute payments under Section 280G(b) of the Internal Revenue Code. The existence of such excess parachute payments will be determined by the Plan Administrator in the exercise of its reasonable business judgment and on the basis of tax counsel provided to the Company. Immediately following consummation of the Corporate Transaction, this option will, to the extent not previously exercised or assumed by the successor or its parent, terminate and cease to be exercisable.

---

(b) The Plan Administrator will use its best efforts to provide you with written notice of a Corporate Transaction at least ten business days prior to the effective date.

(c) This Agreement will not in any way affect the right of the Company to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, amalgamate, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

**4. Privilege of Share Ownership.** The holder of this option will not have any rights of a shareholder with respect to the Optioned Shares until such individual has exercised the option, paid the Exercise Price and been issued a certificate for the purchased shares.

**5. Manner of Exercising Option.**

(a) In order to exercise this option with respect to all or any part of the Optioned Shares for which this option is at the time exercisable, you (or in the case of exercise after your death, your executor, administrator, heir, legatee or transferee as the case may be) must take the following actions:

(i) Provide the Secretary of the Company with written notice of such exercise, specifying the number of Optioned Shares with respect to which the option is being exercised.

(ii) Pay the Exercise Price for the purchased Optioned Shares in one or more of the following alternative forms: (A) full payment in cash or by check payable to the Company's order; (B) full payment in Common Shares of the Company valued at fair market value on the exercise date (as such terms are defined below); (C) full payment in combination of Common Shares of the Company valued at fair market value on the exercise date and cash or check payable to the Company's order; (D) payment effected through a broker-dealer sale and remittance procedure pursuant to which you (I) will provide irrevocable written instructions to the designated broker-dealer to effect the immediate sale of the purchased shares and remit to the Company, out of the sale proceeds, an amount equal to the aggregate Exercise Price payable for the purchased shares plus all applicable Federal and State income and employment taxes required to be withheld by the Company by reason of such purchase and (II) will provide written directives to the Company to deliver the certificates for the purchased shares directly to such broker-dealer; or, to the extent the Plan Administrator specifically authorizes such method of payment at the time of exercise, (E) payment by a full-recourse promissory note. Any such promissory note authorized by the Plan Administrator will be substantially in the form approved by the Plan Administrator, will bear interest at the minimum per annum rate necessary to avoid the imputation of interest income to the Company and compensation income to you under the Federal tax laws and will become due in full (in one or more consecutive annual installments measured from the execution date of the note) not later than the Expiration Date of this option. Payment of the note will be secured by the pledge of the purchased shares, and the pledged shares will be released only as the note is paid.

---

(iii) Furnish to the Company appropriate documentation that the person or persons exercising the option, if other than you, have the right to exercise this option.

(b) For purposes of Subsection 7(a) hereof, the fair market value per Common Share on any relevant date will be determined in accordance with Subsections (i) through (iii) below, and the exercise date will be the date on which you exercise this option in compliance with the provisions of Subsection 7(a).

(i) If the Common Shares are not listed or admitted to trading on any stock exchange on the date in question, but is traded in the over-the-counter market, the fair market value will be the closing selling price per share of such shares on such date, as such price is reported by the National Association of Securities Dealers through its Nasdaq National Market. If there is no reported closing selling price of the shares on the date in question then the closing selling price on the last preceding date for which such quotation exists will be determinative of fair market value.

(ii) If the Common Shares are listed or admitted to trading on any stock exchange on the date in question, the fair market value will be the closing selling price per share of such shares on such date on the stock exchange determined by the Plan Administrator to be the primary market for such shares, as such price is officially quoted on such exchange. If there is no reported closing selling price of such shares on such exchange on the date in question, the fair market value will be the closing selling price on the exchange on the last preceding date for which such quotation exists.

(iii) If the Common Shares are neither listed nor admitted to trading on any stock exchange nor traded in the over-the-counter market on the date in question or if the Plan Administrator determines that the quotations under Subsections (i) or (ii) above do not accurately reflect the fair market value of such shares, the fair market value will be determined by the Plan Administrator after taking into account such factors as the Plan Administrator may deem appropriate, including one or more independent professional appraisals.

(c) In no event may this option be exercised for any fractional share.

**6. Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of Optioned Shares upon such exercise will be subject to compliance by the Company and by you with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange on which the Company's Common Shares may be listed at the time of such exercise and issuance.

(b) In connection with the exercise of this option, you will execute and deliver to the Company such representations in writing as may be requested by the Company in order for it to comply with the applicable requirements of Federal and State securities laws.



---

**7. Restrictive Legends.** If and to the extent any Optioned Shares acquired under this option are not registered under the Securities Act of 1933, the certificates for such Optioned Shares will be endorsed with restrictive legends, including (without limitation) the following:

“The Shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a ‘no action’ letter of the Securities and Exchange Commission with respect to such sale or offer, or (c) an opinion of counsel to the Company that registration under such Act is not required with respect to such sale or offer.”

**8. Successors and Assigns.** Except to the extent otherwise provided in Section 1 and Subsection 5(a), the provisions of this Agreement will inure to the benefit of, and be binding upon your successors, administrators, heirs, legal representatives and assigns and the successors and assigns of the Company.

**9. Liability of the Company.**

(a) If the Optioned Shares covered by this Agreement exceed, as of the Grant Date, the number of Common Shares which may without shareholder approval be issued under the Plan, then this option will be void with respect to such excess shares unless shareholder approval of an amendment sufficiently increasing the number of Common Shares issuable under the Plan is obtained in accordance with the provisions of the Plan.

(b) The inability of the Company to obtain approval from any regulatory body having authority deemed by the Company to be necessary to the lawful issuance and sale of any Common Shares pursuant to this option will relieve the Company of any liability in respect of the non-issuance or sale of such shares as to which such approval will not have been obtained.

**10. No Employment or Consulting Contract.** Nothing in this Agreement or in the Plan will confer upon you any right to continue in the employ or service of the Company for any period of time or interfere with or otherwise restrict in any way the rights of the Company (or any subsidiary of the Company employing or retaining you) or you, which rights are hereby expressly reserved by each, to terminate your employee or consultant status as the case may be, at any time for any reason whatsoever, with or without cause.

**11. Notices.** Any notice required to be given or delivered to the Company under the terms of this Agreement will be in writing and addressed to the Company in care of its Secretary at its principal offices. Any notice required to be given or delivered to you will be in writing and addressed to you at the address indicated below your signature line herein. All notices will be deemed to be given or delivered upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

**12. Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the express terms

---

and provisions of the Plan. Any dispute regarding the interpretation of this Agreement will be submitted to the Plan Administrator for resolution. The decision of the Plan Administrator will be final, binding and conclusive. Questions regarding this option or the Plan should be referred to the Legal Department of the Company.

---

**13. Governing Law.** The interpretation, performance, and enforcement of this Agreement will be governed by the laws of the State of California.

**14. Tax Arrangements.** You hereby agree to make appropriate arrangements with the Company or subsidiary thereof by which you are employed or retained for the satisfaction of all Federal, State or local income tax withholding requirements and Federal social security employee tax requirements applicable to the exercise of this option.

XOMA Ltd.

By: \_\_\_\_\_  
Steven B.Engle  
Chairman of the Board  
Chief Executive Officer and President

Date: \_\_\_\_\_

I hereby agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Date: \_\_\_\_\_

If the optionee resides in California or another community property jurisdiction, I, as the optionee's spouse, also agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Date: \_\_\_\_\_

**Amendment No. 3 to the  
XOMA LTD.  
RESTRICTED SHARE PLAN**

Effective May 23, 2006 and pursuant to Board action, the XOMA Ltd. Restricted Share Plan (the "Plan") is hereby amended as follows:

1. Section 5(a) of Article I of the Plan is amended to read as follows:

(a) The shares issuable under the Plan shall be shares of the Company's authorized but unissued common shares ("Common Shares"). The maximum number of shares issuable over the term of the Plan shall not exceed 2,250,000 shares, subject to adjustment as provided in Section 5(c) of this Article I. In no event, however, shall more than 14,600,000 shares (subject to adjustment under Section 5(c) of this Article I) be issued in the aggregate over the term of this Plan and the Company's 1981 Share Option Plan ("1981 Plan").

2. The following sentence is added at the end of Section 4(a) of Article IV:

Amendments to the Plan were adopted by the Board and approved by the Company's shareholders on May 23, 2006 to increase the number of shares issuable under the Plan and to eliminate the provisions that permit a discount to the fair market price of the common shares on the date of issuance or grant.

The terms of the options granted to employees of the Company from and after January 1, 2005 under the Plan are hereby amended as follows:

1. Sections 2(a) and 2(b) of Article I of the Plan is amended to read as follows:

(a) The Plan shall be divided into two separate components: the Option Grant Program specified in Article II and the Share Issuance Program specified in Article III. Under the Option Grant Program, eligible individuals may be granted options to purchase Common Shares of the Company 100% of the fair market value of such shares on the grant date.

(b) The Share Issuance Program shall allow eligible individuals to acquire Common Shares of the Company either through direct purchases or upon the exercise of option grants. Such shares may be purchased at 100% of their fair market value on the issue date (for direct issuances) or 100% of such fair market value on the option grant date (for shares acquired upon the exercise of granted options). The purchased shares may be issued as fully-vested shares or as shares which are to vest over time. Issuances may be effected either through direct purchases or upon the exercise of option grants. Any or all of the issued shares may be subject to a permanent right of first refusal binding all holders of the shares to offer such shares for sale to the Company at a formula price prior to any sale or other disposition to a third party. The fair market value of shares subject to such first refusal rights shall be appropriately discounted to reflect this non-

---

lapse restriction.

2. Section 1(a)(1) of Article II of the Plan is amended to read as follows:

(a) Option Price

(1) Subject to the provisions of Section (a)(2) below, the option price per share shall be fixed by the Plan Administrator but in no event shall it be less than one hundred percent (100%) of the fair market value per Common Share on the date of the option grant.

3. Section 1(a)(1) of Article III of the Plan is amended to read as follows:

(a) Share Price

(1) The purchase price per share shall be fixed by the Plan Administrator, but in no event shall it be less than one hundred percent (100%) of the fair market value per Common Share on the date of issuance (or, if an option is utilized, on the grant date of such option). However, if the individual to whom the share issuance is made is at such time a 10% Shareholder (as defined in Article II, Section 1(a)(2)), then the purchase price per share shall not be less than one hundred ten percent (110%) of the fair market value per Common Share on the date of issuance (or, if an option is utilized, on the grant date of such option). Fair market value shall be determined in accordance with Article II, Section 1(a)(4); provided, however, if any shares issued under the Plan are subject to the permanent right of first refusal of the Company or its assigns under subsection 1(d) below, then the fair market value shall be appropriately adjusted to reflect the effect of such non-lapse restriction.

## XOMA LTD.

## 1992 DIRECTORS SHARE OPTION PLAN

(As Amended and Restated Through May 19, 2004)

1. **General.** The XOMA Ltd. 1992 Directors Share Option Plan (the "Plan") was adopted on February 20, 1992 (the "Adoption Date") by the Board of Directors of XOMA Ltd. (the "Company"), subject to the approval of the Company's shareholders at its 1992 annual meeting. A total of 600,000 of the Company's Common Shares, par value \$.0005 per share ("Common Shares"), have been reserved for issuance hereunder. The Plan provides for the granting to non-employee directors of the Company of non-qualified options ("Options" or "Option") to purchase Common Shares.

2. **Purposes.** The purposes of the Plan are to increase the proprietary interest of non-employee directors in the Company by granting them non-qualified options to purchase Common Shares, to promote long-term shareholder value through the potential for increased ownership of Common Shares by non-employee directors, and to encourage the continued service on the Board of Directors (the "Board") of non-employee directors.

3. **Administration.** The Plan is designed to operate automatically and not require administration. However, to the extent that administration is necessary, the Plan shall be administered by those members of the Board who are not eligible to participate in the Plan (the "Plan Administrators"). Since it is intended that this Plan provide for grants of Options to non-employee directors of the Company, this function will be limited to matters of administrative oversight. Decisions and determinations of the Plan Administrators shall be final and binding upon all persons having an interest in the Plan. The Plan Administrators will have no discretion with respect to the selection of optionees or the determination of the exercise price, the timing of grants or the number of shares covered by the Options granted hereunder. The Plan Administrators will receive no additional compensation for their services in connection with the administration of the Plan.

4. **Eligibility.** Each member of the Board who is not a full or part-time employee of the Company or of any subsidiary or affiliate of the Company ("Director") shall be entitled to participate in the Plan.

5. **Grants under the Plan.** All Options granted under the Plan shall be non-statutory options, not entitled to special tax treatment under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). The number of Common Shares available for grants under the Plan shall not exceed 600,000 shares, subject to adjustment as provided in Section 7. The shares with respect to which a particular Option has been granted are hereinafter referred to as "Optioned Shares." The written agreement evidencing each Option granted under the Plan (the "Agreement") shall be dated as of the applicable date of grant. Each Director accepting an Option grant shall execute and return a copy of the Agreement to the Company. If any outstanding Option shall terminate for any reason without having been exercised in full, the shares applicable to the unexercised portion of such Option shall again become available under the Plan.

## 6. Share Options.

(a) Initial Grants. On the Adoption Date (which shall be the date of grant for purposes of paragraphs 6(c), (d) and (e)) of the Plan, each Director shall be granted an Option to purchase that number of Common Shares equal to 10,000 minus the number of Common Shares with respect to which options have been previously granted to such Director (without regard to the status of such Director at the time of any such prior grant, whether any such prior grant was made pursuant to another plan of the company or any other circumstances of any such prior grant), subject to the approval of the Plan by the Company's shareholders at the 1992 Annual Meeting. Each person who becomes a Director for the first time after the Effective Date (as defined below) through calendar year 1997 shall be granted an Option on the six-month anniversary of the date such person becomes a Director to purchase that number of Common Shares equal to 10,000 minus the number of Common Shares with respect to which options have been previously granted to such Director (without regard to the status of such Director at the time of any such prior grant, whether any such prior grant was made pursuant to another plan of the Company or any other circumstances of any such prior grant). Each person who becomes a Director for the first time beginning calendar year 1998 through calendar year 2003 shall be granted an Option on the six-month anniversary of the date such person becomes a Director to purchase that number of Common Shares equal to 15,000 minus the number of Common Shares with respect to which options have been previously granted to such Director (without regard to the status of such Director at the time of any such prior grant, whether any such prior grant was made pursuant to another plan of the Company or any other circumstances of any such prior grant). Each person who becomes a Director for the first time beginning calendar year 2004 shall be granted an Option on the date such person becomes a Director to purchase that number of Common Shares equal to 20,000 minus the number of Common Shares with respect to which options have been previously granted to such Director (without regard to the status of such Director at the time of any such prior grant, whether any such prior grant was made pursuant to another plan of the Company or any other circumstances of any such prior grant).

(b) Regular Annual Grants. On each date that the Company holds its annual meeting of shareholders commencing with the 1993 and ending with the 1997 calendar years, immediately after the annual election of directors, each Director then in office (other than those Directors first elected at such meeting) will receive a grant of an Option to purchase 1,000 shares, provided that no Director will receive under this Plan Options to purchase a total of more than 25,000 shares. On each date that the Company holds its annual meeting of shareholders commencing with the 1998 and ending with the 2003 calendar years, immediately after the annual election of directors, each Director then in office (other than those Directors first elected at such meeting) will receive a grant of an Option to purchase 7,500 shares, provided that no Director will receive under this Plan Options to purchase a total of more than 75,000 shares. On each date that the Company holds its annual meeting of shareholders commencing with the 2004 calendar year, immediately after the annual election of directors, each Director then in office (other than those Directors first elected at such meeting) will receive a grant of an Option to purchase 10,000 shares.

---

(c) Option Exercise Price. The per share price to be paid by the Director at the time an Option is exercised shall be 100% of the fair market value of the Common Shares on the date of grant. "Fair market value" shall be determined as follows:

(i) If the Common Shares are not at the time listed or admitted to trading on any stock exchange but is traded in the over-the-counter market, the fair market value shall be the closing selling price per Common Share on the date in question, as such price is reported by the National Association of Securities Dealers through its Nasdaq National Market System or any successor system. If there is no reported closing selling price for Common Shares on the date in question, then the closing selling price on the last preceding date for which such quotation exists shall be determinative of fair market value.

(ii) If the Common Shares are at the time listed or admitted to trading on any stock exchange, then the fair market value shall be the closing selling price per Common Share on the date in question on the stock exchange which is the primary market for the Common Shares, as such price is officially quoted on such exchange. If there is no reported sale of Common Shares on such exchange on the date in question, then the fair market value shall be the closing selling price on the exchange on the last preceding date for which such quotation exists.

(d) Maximum Term of Option. Each Option shall have a maximum term of ten (10) years from the date of grant.

(e) Date of Exercise. Provided that an optionee hereunder (an "Optionee") remains a Director, and except as otherwise provided in paragraph 8(a),

(i) the Options granted in Section 6(a) hereof commencing with the 1992 and ending with the 2003 calendar years shall become exercisable in accordance with the following schedule:

- (A) With respect to Options granted pursuant to the first sentence of Section 6(a) hereof, each such Option shall become exercisable with respect to 20% of the Optioned Shares on the date of grant;
- (B) Each Option shall become exercisable with respect to 20% (or, in the case of Options referred to in clause (A) above, an additional 20%) of the Optional Shares after the expiration of one year from the date of grant;
- (C) Each Option shall become exercisable with respect to an additional 20% of the Optional Shares after the expiration of two years from the date of grant;
- (D) Each Option shall become exercisable with respect to an additional 20% of the Optioned Shares after the expiration of three years from the date of grant;



(E) Each Option shall become exercisable with respect to an additional 20% (or, in the case of Options referred to in clause (A) above, the remaining 20%) of the Optional Shares after the expiration of four years from the date of grant;

(F) With respect to Options other than those referred to in clause (A) above, each such Option shall become exercisable with respect to the remaining 20% of the Optioned Shares after the expiration of five years from the date of grant; and

(ii) the Options granted in Section 6(a) hereof commencing with the 2004 calendar years shall become exercisable after the expiration of one year from the date of grant; and

(iii) the Options granted in Section 6(b) hereof shall become exercisable on the date of grant.

Exercisable installments may be exercised in whole or in part and, to the extent not exercised, shall accumulate and be exercisable at any time on or before the Expiration Date or sooner termination of the Option term.

(f) Accelerated Termination of Option Term. The option term with respect to a particular Option granted hereunder shall terminate (and such Option shall cease to be exercisable) prior to the specified expiration date thereof (the "Expiration Date") should one of the following provisions become applicable:

(i) Except as otherwise provided in subparagraphs (ii), (iii) and (iv) below, should Optionee cease to be a Director at any time during the option term, then Optionee shall have up to a three (3) month period commencing with the date of such cessation of Director status in which to exercise this Option, but in no event shall this Option be exercisable at any time after the Expiration Date. During such limited period of exercisability, the Option may not be exercised for more than the number of Optioned Shares (if any) for which it is exercisable at the date of Optionee's cessation of Director status. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, the Option shall terminate and cease to be outstanding.

(ii) Should Optionee die while such Option is outstanding, then the personal representative of Optionee's estate or the person or persons to whom the Option is transferred shall have the right to exercise this Option, but only with respect to that number of Optioned shares (if any) for which Option is exercisable on the date of Optionee's death. Such right shall lapse and the Option shall cease to be exercisable upon the earlier of (A) the expiration of the one (1) year period measured from the date of Optionee's death or (B) the specified Expiration Date of the Option term.

(iii) Should Optionee become permanently disabled and cease by reason thereof to be a Director at any time during the Option term, then Optionee shall have a period of twelve (12) months (commencing with the date of such cessation of Director status) during which to exercise such Option; provided, however, that in no event shall the Option be exercisable at any time after

---

the Expiration Date. During such limited period of exercisability, the Option may not be exercised for more than the number of Optioned Shares (if any) for which this Option is exercisable at the date of Optionee's cessation of Director status. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, the Option shall terminate and cease to be outstanding. Optionee shall be deemed to be permanently disabled if Optionee is, by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of not less than 12 consecutive months or more, unable to perform his/her usual duties as a director of the Company.

(iv) Should Optionee's status as a Director be terminated on account of any act of (A) fraud or intentional misrepresentation, or (B) embezzlement, misappropriation or conversion of assets or opportunities of the Company, or any unauthorized disclosure of confidential information or trade secrets of the Company, such Option shall terminate and cease to be exercisable immediately upon the date of such termination of Director status.

(g) Method of Exercise. An Option may be exercised with respect to all or any part of the shares of Common Shares for which such Option is at the time exercisable. Each notice of exercise shall be accompanied by the full purchase price of the shares being purchased, with such payment to be made in cash or by check.

(h) Transferability. Options are transferable and assignable to the spouse of the Optionee or a descendent of the Optionee (any such spouse or descendent, an "Immediate Family Member") or a corporation, partnership, limited liability company or trust so long as all of the shareholders, partners, members or beneficiaries thereof, as the case may be, are either the Optionee or an Immediate Family Member of the Optionee, provided that (i) there may be no consideration for any such transfer and (ii) subsequent transfers or transferred options will be prohibited other than by will, by the laws of descent and distribution or pursuant to a "qualified domestic relations order" as such term is defined by the Code or the Employee Retirement Income Security Act of 1974 ("ERISA"). Following transfer, any such options will continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that for purposes of the option agreement the term "Optionee" will refer to the transferee.

#### **7. Adjustment Upon Changes in Capitalization.**

(a) If the number of shares of the Company as a whole are increased, decreased or changed into, or exchanged for, a different number or kind of shares or securities of the Company, whether through reclassification, share dividend, share split, combination of shares, exchange of shares, change in corporate structure or the like, an appropriate and proportionate adjustment shall be made in the number and kind of shares subject to the Plan, and in the number, kind and per share exercise price of shares subject to unexercised Options or portions thereof granted prior to any such change. Any such adjustment in an outstanding Option, however, shall be made without a change in the total price applicable to the unexercised portion of the Option but with a corresponding adjustment in the price for each share covered by the Option.

(b) If the Company is the surviving or continuing entity in any merger, amalgamation or other business combination, then an Option shall be appropriately adjusted to apply and pertain to the number and class of securities which the holder of the number of Common Shares subject to an Option immediately prior to such merger, amalgamation or other business combination would have been entitled to receive in the consummation of such merger, amalgamation or other business combination, and appropriate adjustment shall be made to the option price payable per share, provided the aggregate option price shall remain the same.

**8. Corporate Transaction.**

(a) In the event of one or more of the following transactions (“Corporate Transaction”):

(i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company’s incorporation,

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company, or

(iii) any other business combination in which fifty percent (50%) or more of the Company’s outstanding voting shares are transferred to different holders in a single transaction or a series of related transactions,

then the exercisability of an Option shall automatically be accelerated so that such Option may be exercised for any or all of the Common Shares subject to such Option. No such acceleration of exercise dates shall occur, however, if and to the extent the terms of any agreement relating to such Corporate Transaction provide as a prerequisite to the consummation of such Corporate Transaction that outstanding options purchase Common Shares (including an Option issued pursuant to this Plan) are to be assumed by the successor corporation or parent thereof or are to be replaced with options to purchase capital shares of the successor corporation or parent thereof. In any such case, an appropriate adjustment as to the number and kind of shares and the per share exercise prices shall be made. No fractional shares shall be issued under the Plan on account of any adjustment specified above. Upon the consummation of the Corporate Transaction, an Option shall, to the extent not previously exercised or assumed by the successor corporation or its parent company, terminate and cease to be exercisable.

(b) This Plan shall not in any way affect the right of the company to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, amalgamate, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

**9. Amendment and Termination of Plan.** The Board may make such amendments to the Plan and to any Agreements hereunder as it shall deem advisable; provided, however, that the Board may not, without further approval by the affirmative votes of the holders of a majority of the securities of the Company present, or represented, and entitled to vote at a shareholders meeting duly held in accordance with applicable laws, increase the number of shares as to which

---

Options may be granted under this Plan (except as otherwise permitted in paragraph 8(a) hereof), materially increase the benefits accruing to participants under this Plan or materially modify the requirements as to eligibility for participation under this Plan. In addition, the Board may not amend the Plan or Agreement hereunder more than once every six months, other than to comport with changes in the Code or the rules thereunder. The Board may terminate the Plan at any time within its absolute discretion. No such termination, other than that provided in Section 8(a) hereof, shall in any way affect any Option then outstanding.

10. **Miscellaneous Provisions.** Neither the Plan nor any action taken hereunder shall be construed as giving any Director any right to be nominated for re-election to the Board. The Plan shall be governed by the laws of the State of California.

11. **Effective Date.** The Plan was initially adopted by the Board on February 20, 1992 and approved by the Company shareholders at the 1992 Annual Meeting, to be effective as of February 20, 1992 (the "Effective Date"). Amendments to the Plan regarding transfer provisions were adopted by the Board on October 30, 1996 and approved by the shareholders at the 1997 Annual Meeting. Further amendments to the amended and restated Plan to increase the number of shares issuable under the Plan were adopted by the Board on February 25, 1998 and approved by the shareholders at the 1998 Annual Meeting. The Plan was further amended to reflect the Company's change of domicile from Delaware to Bermuda and the new restatement of the Plan, effective December 31, 1998, was adopted by the Board in February of 1999. An amendment and restatement of the Plan was adopted by the Board on February 25, 2004 and approved by the shareholders at the 2004 Annual Meeting.

## Share Option Agreement

## Under the XOMA Ltd.

## 1992 Directors Share Option Plan

(A) **Optionee:**(B) **Grant Date:**(C) **Shares:**

[ ] shares

(D) **Share Installments:**

All shares vest on [one year from date of grant]

(E) **Expiration Date:**(F) **Exercise Price:**

[\$ ] per share

(G) **Option Type:**

Non-Qualified Share Option

Subject to the terms of the XOMA Ltd. 1992 Directors Share Option Plan, as amended and restated through May 19, 2004 (the "Plan") and to the terms and conditions set forth in this agreement (the "Agreement"), XOMA Ltd. (the "Company") has granted you, as of the Grant Date shown in item (B) above, a non-qualified share option (not entitled to special tax treatment under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code")) to purchase the number of Common Shares of the Company shown in item (C) above (the "Optioned Shares") at the Exercise Price shown in item (F) above.

The details of your option are as follows:

**1. Term.** This option has a maximum term of ten years measured from the Grant Date and will, unless sooner terminated in accordance with Section 4 or Subsection 6(a) hereof, expire on the Expiration Date shown in item (E) above. Upon the Expiration Date or upon the sooner termination of this option under Section 4 or Subsection 6(a), this option will cease to be exercisable and have no further force or effect whatsoever.

**2. Transferability.** This option is transferable and assignable by you to your spouse or descendent (any such spouse or descendent, an "Immediate Family Member") or a corporation, partnership, limited liability company or trust so long as all of the shareholders, partners, members or beneficiaries thereof, as the case may be, are either you or an Immediate Family Member, provided that there may be no consideration for any such transfer, and, following transfer, (i) subsequent transfers of this option will be prohibited other than by will or the laws of descent and distribution, and (ii) this option will continue to be subject to the same terms and conditions

---

as were applicable immediately prior to transfer, provided that for purposes of this Agreement any references to “you” will refer to the transferee.

**3. Exercise Schedule.** The option granted herein is exercisable with respect to 100% of the Optioned Shares beginning on the first anniversary of the Grant Date and exercisable shares may be exercised in whole or in part, and to the extent not exercised, will be exercisable at any time on or before the Expiration Date or sooner termination of the option term.

**4. Accelerated Termination of Option Term.** The option term specified in Section 1 will terminate (and this option will cease to be exercisable) prior to the Expiration Date should one of the following provisions become applicable:

(a) Except as otherwise provided in Subsections (b), (c) and (d) below, if you cease to be a member of the Board of Directors of the Company who is not a full or part-time employee of the Company or of any subsidiary or affiliate of the Company (a “Director”) at any time during the option term, then you will have up to three months commencing with the date of such cessation of Director status in which to exercise this option, but in no event will this option be exercisable at any time after the Expiration Date. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding.

(b) If you die while this option is outstanding, then the personal representative of your estate or the person or persons to whom the option is transferred pursuant to your will or in accordance with the laws of descent and distribution will have the right to exercise this option. Such right will lapse and this option will cease to be exercisable upon the earlier of (i) the expiration of the one-year period measured from the date of your death or (ii) the Expiration Date.

(c) If you become permanently disabled and cease by reason thereof to be a Director at any time during the option term, then you will have a period of twelve months (commencing with the date of such cessation of Director status) during which to exercise this option; provided, however, that in no event will this option be exercisable at any time after the Expiration Date. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. You will be deemed to be permanently disabled if you are, by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of not less than twelve consecutive months or more, unable to perform your usual duties as a Director of the Company.

(d) If your status as a Director is terminated on account of any act of (i) fraud or intentional misrepresentation or (ii) embezzlement, misappropriation or conversion of assets or opportunities of the Company, or any unauthorized disclosure of confidential information or trade secrets of the Company, this option will terminate and cease to be exercisable immediately upon the date of such termination of Director status.

**5. Adjustment Upon Changes in Capitalization.**

---

(a) If the number of shares of the Company as a whole is increased, decreased or changed into, or exchanged for, a different number or kind of shares or securities of the Company, whether through reclassification, share dividend, share split, combination of shares, exchange of shares, change in corporate structure or the like, an appropriate and proportionate adjustment will be made in the number, kind, and per share exercise price of shares subject to unexercised options or portions thereof granted prior to any such change. Any such adjustment in an outstanding portion, however, will be made without a change in the total price applicable to the unexercised portion of the option, but with a corresponding adjustment in the price of each share covered by the option.

(b) If the Company is the surviving or continuing entity in any merger, amalgamation or other business combination, then this option will be appropriately adjusted to apply and pertain to the number and class of securities which the holder of the number of Common Shares of the Company subject to this option immediately prior to such merger, amalgamation or other business combination would have been entitled to receive in the consummation of such merger, amalgamation or other business combination, and an appropriate adjustment will be made to the Exercise Price payable per share, provided the aggregate Exercise Price will remain the same.

#### **6. Corporate Transaction.**

(a) In the event of one or more of the following transactions ("Corporate Transaction"):

(i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company's incorporation,

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company, or

(iii) any other business combination in which fifty percent (50%) or more of the Company's outstanding voting shares is transferred to different holders in a single transaction or a series of related transactions,

then the exercisability of this option will automatically be accelerated so that such option may be exercised simultaneously with consummation of such Corporate Transaction for any or all of the Common Shares of the Company subject to this option. No such acceleration of exercise dates will occur, however, if and to the extent the terms of any agreement relating to such Corporate Transaction provide as a prerequisite to the consummation of such Corporate Transaction that outstanding options to purchase the Company's Common Shares (including this option) are to be assumed by the successor corporation or parent thereof or are to be replaced with options to purchase shares of capital stock of the successor corporation or parent thereof. In any such case, an appropriate adjustment as to the number and kind of shares and the per share exercise prices will be made. No fractional shares will be issued on account of any adjustment specified above. Immediately following the consummation of the Corporate Transaction, this option will, to the ex-

---

tent not previously exercised or assumed by the successor corporation or its parent company, terminate and cease to be exercisable.

(b) This Agreement will not in any way affect the right of the Company to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, amalgamate, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

**7. Privilege of Share Ownership.** You will not have any rights of a shareholder of the Company with respect to the Optioned Shares until you have exercised the option, paid the Exercise Price and been issued the purchased shares.

**8. Manner of Exercising Option.**

(a) In order to exercise this option with respect to all or any part of the Optioned Shares for which this option is at the time exercisable, you (or in the case of exercise after your death, your executor, administrator, heir or legatee, as the case may be) must take the following actions:

(i) Provide the Secretary of the Company with written notice of such exercise, specifying the number of Optioned Shares with respect to which the option is being exercised.

(ii) Pay the Exercise Price in full, in cash or by check payable to the Company's order, for the Optioned Shares being purchased.

(iii) Furnish to the Company appropriate documentation that the person or persons exercising the option, if other than you, have the right to exercise this option.

(b) In no event may this option be exercised for any fractional shares.

**9. Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of Optioned Shares upon such exercise will be subject to compliance by the Company and by you with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange on which Common Shares of the Company may be listed at the time of such exercise and issuance.

(b) In connection with the exercise of this option, you will execute and deliver to the Company such representations in writing as may be requested by the Company in order for it to comply with the applicable requirements of Federal and State securities law.

**10. Restrictive Legends.** If and to the extent any Optioned Shares acquired under this option are not registered under the Securities Act of 1933, the share certificates for such Optioned Shares will be endorsed with restrictive legends, including (without limitation) the following:



---

“The Shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a ‘no action’ letter of the Securities and Exchange Commission with respect to such sale or offer, or (c) an opinion of counsel to the Company that registration under such Act is not required with respect to such sale or offer.”

**11. Successors and Assigns.** Except to the extent otherwise provided in Section 2 and Subsection 6(a), the provisions of this Agreement will inure to the benefit of, and be binding upon, your successors, administrators, heirs, legal representatives and assigns and the successors and assigns of the Company.

**12. Liability of the Company.**

(a) If the Optioned Shares covered by this Agreement exceed, as of the Grant Date, the number of Common Shares of the Company which may without shareholder approval be issued under the Plan, then this option will be void with respect to such excess shares unless shareholder approval of an amendment sufficiently increasing the number of Common Shares of the Company issuable under the Plan is obtained in accordance with the provisions of the Plan.

(b) The inability of the Company to obtain approval from any regulatory body having authority deemed by the Company to be necessary to the lawful issuance and sale of any Common Shares pursuant to this option will relieve the Company of any liability in respect of the non-issuance or sale of such shares as to which such approval will not have been obtained.

**13. No Right to Nomination.** Neither this Agreement nor any action taken hereunder will be construed as giving you any right to be nominated for re-election to the Board of Directors of the Company.

**14. Notices.** Any notice required to be given or delivered to the Company under the terms of this Agreement will be in writing and addressed to the Company in care of its Secretary at its corporate offices. Any notice required to be given or delivered to you will be in writing and addressed to you at the address indicated below your signature line herein. All notices will be deemed to be given or delivered upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

**15. Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the express terms and provisions of the Plan. Any dispute regarding the interpretation of this Agreement will be submitted to the Plan Administrator (as that term is defined in the Plan) for resolution. The decision of the Plan Administrator will be final, binding and conclusive. Questions regarding this option or the Plan should be referred to the Legal Department of the Company.

---

**16. Governing Law.** The interpretation, performance, and enforcement of this Agreement will be governed by the laws of the State of California.

---

XOMA LTD.

By: \_\_\_\_\_  
Steven B.Engle  
Chairman of the Board  
Chief Executive Officer and President

Dated: \_\_\_\_\_

I hereby agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

If the optionee resides in California or another community property jurisdiction, I, as the optionee's spouse, also agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

**Share Option Agreement**  
**Under the XOMA Ltd.**  
**1992 Directors Share Option Plan**

(A) **Optionee:**

(B) **Grant Date:**

(C) **Shares:**

(D) **Share Installments:**

Option is fully exercisable

(E) **Expiration Date:**

(F) **Exercise Price:**

(G) **Option Type:**

Non-Qualified Share Option

Subject to the terms of the XOMA Ltd. 1992 Directors Share Option Plan, as amended and restated through May 19, 2004 (the "Plan") and to the terms and conditions set forth in this agreement (the "Agreement"), XOMA Ltd. (the "Company") has granted you, as of the Grant Date shown in item (B) above, a non-qualified share option (not entitled to special tax treatment under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code")) to purchase the number of Common Shares of the Company shown in item (C) above (the "Optioned Shares") at the Exercise Price shown in item (F) above.

The details of your option are as follows:

**1. Term.** This option has a maximum term of ten years measured from the Grant Date and will, unless sooner terminated in accordance with Section 4 or Subsection 6(a) hereof, expire on the Expiration Date shown in item (E) above. Upon the Expiration Date or upon the sooner termination of this option under Section 4 or Subsection 6(a), this option will cease to be exercisable and have no further force or effect whatsoever.

**2. Transferability.** This option is transferable and assignable by you to your spouse or descendent (any such spouse or descendent, an "Immediate Family Member") or a corporation, partnership, limited liability company or trust so long as all of the shareholders, partners, members or beneficiaries thereof, as the case may be, are either you or an Immediate Family Member, provided that there may be no consideration for any such transfer, and, following transfer, (i) subsequent transfers of this option will be prohibited other than by will or the laws of descent and distribution, and (ii) this option will continue to be subject to the same terms and conditions

---

as were applicable immediately prior to transfer, provided that for purposes of this Agreement any references to “you” will refer to the transferee.

**3. Exercise Schedule.** The option granted herein is exercisable with respect to 100% of the Optioned Shares beginning on the Grant Date and may be exercised in whole or in part, and to the extent not exercised, will be exercisable at any time on or before the Expiration Date or sooner termination of the option term.

**4. Accelerated Termination of Option Term.** The option term specified in Section 1 will terminate (and this option will cease to be exercisable) prior to the Expiration Date should one of the following provisions become applicable:

(a) Except as otherwise provided in Subsections (b), (c) and (d) below, if you cease to be a member of the Board of Directors of the Company who is not a full or part-time employee of the Company or of any subsidiary or affiliate of the Company (a “Director”) at any time during the option term, then you will have up to three months commencing with the date of such cessation of Director status in which to exercise this option, but in no event will this option be exercisable at any time after the Expiration Date. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding.

(b) If you die while this option is outstanding, then the personal representative of your estate or the person or persons to whom the option is transferred pursuant to your will or in accordance with the laws of descent and distribution will have the right to exercise this option. Such right will lapse and this option will cease to be exercisable upon the earlier of (i) the expiration of the one-year period measured from the date of your death or (ii) the Expiration Date.

(c) If you become permanently disabled and cease by reason thereof to be a Director at any time during the option term, then you will have a period of twelve months (commencing with the date of such cessation of Director status) during which to exercise this option; provided, however, that in no event will this option be exercisable at any time after the Expiration Date. Upon the expiration of such limited period of exercisability or (if earlier) upon the Expiration Date, this option will terminate and cease to be outstanding. You will be deemed to be permanently disabled if you are, by reason of any medically determinable physical or mental impairment expected to result in death or to be of continuous duration of not less than twelve consecutive months or more, unable to perform your usual duties as a Director of the Company.

(d) If your status as a Director is terminated on account of any act of (i) fraud or intentional misrepresentation or (ii) embezzlement, misappropriation or conversion of assets or opportunities of the Company, or any unauthorized disclosure of confidential information or trade secrets of the Company, this option will terminate and cease to be exercisable immediately upon the date of such termination of Director status.

**5. Adjustment Upon Changes in Capitalization.**

---

(a) If the number of shares of the Company as a whole is increased, decreased or changed into, or exchanged for, a different number or kind of shares or securities of the Company, whether through reclassification, share dividend, share split, combination of shares, exchange of shares, change in corporate structure or the like, an appropriate and proportionate adjustment will be made in the number, kind, and per share exercise price of shares subject to unexercised options or portions thereof granted prior to any such change. Any such adjustment in an outstanding portion, however, will be made without a change in the total price applicable to the unexercised portion of the option, but with a corresponding adjustment in the price of each share covered by the option.

(b) If the Company is the surviving or continuing entity in any merger, amalgamation or other business combination, then this option will be appropriately adjusted to apply and pertain to the number and class of securities which the holder of the number of Common Shares of the Company subject to this option immediately prior to such merger, amalgamation or other business combination would have been entitled to receive in the consummation of such merger, amalgamation or other business combination, and an appropriate adjustment will be made to the Exercise Price payable per share, provided the aggregate Exercise Price will remain the same.

#### **6. Corporate Transaction.**

(a) In the event of one or more of the following transactions ("Corporate Transaction"):

(i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company's incorporation,

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company, or

(iii) any other business combination in which fifty percent (50%) or more of the Company's outstanding voting shares is transferred to different holders in a single transaction or a series of related transactions,

then the exercisability of this option will automatically be accelerated so that such option may be exercised simultaneously with consummation of such Corporate Transaction for any or all of the Common Shares of the Company subject to this option. No such acceleration of exercise dates will occur, however, if and to the extent the terms of any agreement relating to such Corporate Transaction provide as a prerequisite to the consummation of such Corporate Transaction that outstanding options to purchase the Company's Common Shares (including this option) are to be assumed by the successor corporation or parent thereof or are to be replaced with options to purchase shares of capital stock of the successor corporation or parent thereof. In any such case, an appropriate adjustment as to the number and kind of shares and the per share exercise prices will be made. No fractional shares will be issued on account of any adjustment specified above. Immediately following the consummation of the Corporate Transaction, this option will, to the ex-

---

tent not previously exercised or assumed by the successor corporation or its parent company, terminate and cease to be exercisable.

(b) This Agreement will not in any way affect the right of the Company to adjust, reclassify, reorganize or otherwise make changes in its capital or business structure or to merge, amalgamate, consolidate, dissolve, liquidate or sell or transfer all or any part of its business or assets.

**7. Privilege of Share Ownership.** You will not have any rights of a shareholder of the Company with respect to the Optioned Shares until you have exercised the option, paid the Exercise Price and been issued the purchased shares.

**8. Manner of Exercising Option.**

(a) In order to exercise this option with respect to all or any part of the Optioned Shares for which this option is at the time exercisable, you (or in the case of exercise after your death, your executor, administrator, heir or legatee, as the case may be) must take the following actions:

(i) Provide the Secretary of the Company with written notice of such exercise, specifying the number of Optioned Shares with respect to which the option is being exercised.

(ii) Pay the Exercise Price in full, in cash or by check payable to the Company's order, for the Optioned Shares being purchased.

(iii) Furnish to the Company appropriate documentation that the person or persons exercising the option, if other than you, have the right to exercise this option.

(b) In no event may this option be exercised for any fractional shares.

**9. Compliance with Laws and Regulations.**

(a) The exercise of this option and the issuance of Optioned Shares upon such exercise will be subject to compliance by the Company and by you with all applicable requirements of law relating thereto and with all applicable regulations of any stock exchange on which Common Shares of the Company may be listed at the time of such exercise and issuance.

(b) In connection with the exercise of this option, you will execute and deliver to the Company such representations in writing as may be requested by the Company in order for it to comply with the applicable requirements of Federal and State securities law.

**10. Restrictive Legends.** If and to the extent any Optioned Shares acquired under this option are not registered under the Securities Act of 1933, the share certificates for such Optioned Shares will be endorsed with restrictive legends, including (without limitation) the following:

---

“The Shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold or offered for sale in the absence of (a) an effective registration statement for the shares under such Act, (b) a ‘no action’ letter of the Securities and Exchange Commission with respect to such sale or offer, or (c) an opinion of counsel to the Company that registration under such Act is not required with respect to such sale or offer.”

**11. Successors and Assigns.** Except to the extent otherwise provided in Section 2 and Subsection 6(a), the provisions of this Agreement will inure to the benefit of, and be binding upon, your successors, administrators, heirs, legal representatives and assigns and the successors and assigns of the Company.

**12. Liability of the Company.**

(a) If the Optioned Shares covered by this Agreement exceed, as of the Grant Date, the number of Common Shares of the Company which may without shareholder approval be issued under the Plan, then this option will be void with respect to such excess shares unless shareholder approval of an amendment sufficiently increasing the number of Common Shares of the Company issuable under the Plan is obtained in accordance with the provisions of the Plan.

(b) The inability of the Company to obtain approval from any regulatory body having authority deemed by the Company to be necessary to the lawful issuance and sale of any Common Shares pursuant to this option will relieve the Company of any liability in respect of the non-issuance or sale of such shares as to which such approval will not have been obtained.

**13. No Right to Nomination.** Neither this Agreement nor any action taken hereunder will be construed as giving you any right to be nominated for re-election to the Board of Directors of the Company.

**14. Notices.** Any notice required to be given or delivered to the Company under the terms of this Agreement will be in writing and addressed to the Company in care of its Secretary at its corporate offices. Any notice required to be given or delivered to you will be in writing and addressed to you at the address indicated below your signature line herein. All notices will be deemed to be given or delivered upon personal delivery or upon deposit in the U.S. mail, postage prepaid and properly addressed to the party to be notified.

**15. Construction.** This Agreement and the option evidenced hereby are made and granted pursuant to the Plan and are in all respects limited by and subject to the express terms and provisions of the Plan. Any dispute regarding the interpretation of this Agreement will be submitted to the Plan Administrator (as that term is defined in the Plan) for resolution. The decision of the Plan Administrator will be final, binding and conclusive. Questions regarding this option or the Plan should be referred to the Legal Department of the Company.



---

**16. Governing Law.** The interpretation, performance, and enforcement of this Agreement will be governed by the laws of the State of California.

---

XOMA LTD.

By: \_\_\_\_\_  
Steven B.Engle  
Chairman of the Board  
Chief Executive Officer and President

Dated: \_\_\_\_\_

I hereby agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

If the optionee resides in California or another community property jurisdiction, I, as the optionee's spouse, also agree to be bound by the terms and conditions of this Agreement and the Plan.

By: \_\_\_\_\_

Dated: \_\_\_\_\_

## XOMA Ltd.

## CEO Incentive Compensation Plan

**I. Introduction and Summary.**

This document describes the XOMA Ltd. ("XOMA") CEO Incentive Compensation Plan (the "Plan"), as approved by the Board of Directors of XOMA (the "Board"). The Plan becomes effective on January 1, 2004, subject to shareholder approval. Subject to the ability of the Board to terminate the Plan at any time, the Plan applies to fiscal years ending December 31, 2004 and each December 31 thereafter.

Only the Chief Executive Officer of XOMA (the "CEO") is eligible to participate in this Plan and, depending on his or her performance and that of XOMA, earn incentive compensation ("Incentive Compensation"). (Article III contains the definitions of certain terms not otherwise defined in the places such terms first appear in this Plan.) A new CEO who becomes an employee of XOMA during a Plan Period and thereby meets the eligibility criteria for participation in the Plan will be considered for participation in the Plan on a pro-rata basis by the Compensation Committee ("Compensation Committee") of the Board for recommendation to the Board for approval in its discretion.

After the conclusion of each applicable Plan Period, the Board will make a determination on the recommendation of the Compensation Committee as to the performance of XOMA and the CEO in meeting Company Objectives as well as individual performance objectives. The target award opportunity of the CEO is 50% of the CEO's Base Salary ("Target Award Opportunity"). Awards to the CEO will vary depending on (1) the achievement of Company Objectives; (2) the CEO's Base Salary; and (3) the CEO's performance during the applicable Plan Period and expected ongoing contribution to XOMA. Awards may exceed or be lower than the Target Award Opportunity on the basis of the calculation of the extent to which XOMA's Company Objectives have been met as set forth in Article IV.

Awards will be granted in cash and common shares of XOMA based on the average market value of the common shares for the ten trading days prior to the date of the award. Awards will be immediately vested on the distribution date set by the Board and expected to be in February or March of the year succeeding the Plan Period. The award to be paid on the distribution date will be comprised of 50% cash and 50% in common shares of XOMA based on the market value formula set forth above. The distribution date of awards under the Plan for each Plan Period is expected to be set no later than ninety days after the end of each Plan Period.

In all instances, the written provisions of the Plan and other determinations of the Board shall govern and be final.

---

**II. Purposes.**

To actively engage the CEO in driving and achieving company performance goals by providing a variable reward opportunity based on business performance. The Plan is in alignment with XOMA's growth objectives and commitment to retain and competitively compensate company leaders.

**III. Definitions.**

For the purpose of this Plan, the following definitions will apply:

- A. Base Salary. The term "Base Salary" means total base salary before any deferred tax reductions, excluding moving allowances, participation in clinical studies, incentive or bonus payments, imputed income due to fringe benefits such as group insurance plans or other insurance, payments in lieu of earned vacation or personal holiday, payments for financial services or taxes, and other compensatory items of this type.
- B. Company Objectives. The term "Company Objectives" means that list of company objectives approved from time to time by the Board in its sole discretion for each Plan Period. The objectives may be based on financial goals, scientific or commercial progress, profits, return on investments or any other criteria established by the Board. The current Company Objectives, the milestones within each Company Objective and their respective relative percentage contribution to the overall Company Objectives shall be maintained by the Human Resources Department and are the same as under the Management Incentive Compensation Plan. The Required Minimum Company Objective Percentage is set forth in Article IV.
- C. Plan Period. Subject to Article VI, the term "Plan Period" means each fiscal year ending December 31.
- D. Plan Term. Subject to Article VI, the term "Plan Term" means the period commencing on January 1, 2004 and continuing until the termination of this Plan by the Board.

**IV. Plan Mechanics.**

- A. Eligibility. The CEO is eligible for participation in the Plan. An individual who becomes the CEO after the beginning of a Plan Period, or is promoted after the beginning of a Plan Period to the position of CEO, will be considered for participation in the Plan by the Compensation Committee for recommendation to the Board for approval in its discretion and, if approved by the Board to participate, the CEO will have his/her award pro-rated as of the date of eligibility determined by the Board.
- B. Length of Plan. Subject to Article VI, the Plan will be effective for the Plan Term.

C. Incentive Plan.

1. Determination of Amounts Available for Incentive Compensation

a. The Target Award Opportunity for the CEO is set at 50% of the CEO's Base Salary.

b. As soon as practicable after the end of each Plan Period, the Compensation Committee will recommend to the Board, and the Board will determine, whether and to what extent the Company Objectives have been met. If a determination is made that XOMA has not met the Company Objectives to the extent required, the Compensation Committee may decline to recommend, and the Board may decline to award, any Incentive Compensation.

c. For each year during the Plan Term, unless 70% of the Company Objectives (the "Required Minimum Company Objective Percentage") have been met, no Incentive Compensation will be awarded.

d. The final award opportunity ("Final Award Opportunity") will be determined by utilizing the method of calculation of the extent to which XOMA's Company Objectives have been met for the applicable Plan Period as set forth in Article IV.

2. Calculation of Individual Incentive Awards

a. It is the intention of the Board that awards to the CEO shall vary depending on: (1) the extent of achievement of Company Objectives; (2) the CEO's Base Salary; and (3) the CEO's achievement of certain individual performance objectives to be determined from time to time by the Board in its sole discretion.

b. Company and individual performance goals for the CEO are to be weighted as follows:

| <u>Company Objectives</u> | <u>Discretionary Objectives</u> |
|---------------------------|---------------------------------|
| 70%                       | 30%                             |

c. The award opportunity range for the CEO expressed as a percentage of the CEO's Base Salary is as follows:

| <u>Minimum</u> | <u>Target</u> | <u>Maximum</u> |
|----------------|---------------|----------------|
| 25%            | 50%           | 75%            |

d. Each of the individual Company Objectives shall be assigned a percentage reflecting its relative importance (the "Target Contribution Percentage") to the achievement of the overall Company Objectives as well as

target results and results reflecting best and worst case scenarios (denominated maximum or minimum for purposes hereof). If the target results are achieved, the Target Contribution Percentage is awarded. If results between the target and the best case scenario are achieved, the Target Contribution Percentage is increased proportionately up to a maximum of 150% of the Target Contribution Percentage (the "Best Case Percentage Limitation"). No percentage contribution in excess of the Best Case Percentage Limitation will be awarded. Alternatively, if target results are not met but results greater than the worst case scenario are achieved, the Target Contribution Percentage will be decreased proportionately to a minimum of 50% of the Target Contribution Percentage. Achievements below the worst case scenario will result in a 0% contribution from the applicable Company Objective.

e. The performance of the CEO will be rated as soon as practicable following the conclusion of the applicable Plan Period in the exercise of the sole discretion of the Board based on the recommendation of the Compensation Committee. If the CEO's performance for the Plan Period is unsatisfactory, he or she will not be eligible for participation in the Plan for that Plan Period and no Incentive Compensation will be awarded for below minimum performance.

3. Awards to CEO.

a. Approval. All awards will be approved following the end of a Plan Period by the Board acting on the advice of the Compensation Committee.

b. Distribution of Incentive Awards. The distribution dates for awards will be established by the Board. It is expected that distributions will normally be made in February or March of the succeeding year of the applicable Plan Period.

c. Taxes and Withholding. The CEO will bear any Federal, state, and local taxes accruing with respect to any award under the Plan. As required by law, XOMA will withhold in cash from any distributions amounts required for Federal and state withholding tax purposes. With respect to the portion of any award to be made in common shares, XOMA may withhold in cash the required amount from the cash portion of the same award, in addition to the amount required to be withheld with respect to such cash portion.

d. Termination of participation.

i. Subject to other provisions hereof, if the CEO's employment is terminated for any reason, or for no reason, on or before December 31 of any Plan Period or at any time in any subsequent year prior to the distribution date on which awards with respect to any Plan Period are expected to be made, the CEO shall forfeit all rights to Incentive Compensation as yet unpaid pursuant to the Plan, unless the Board, based on the recommendation of the

---

Compensation Committee, determines in its sole discretion that the CEO should continue to participate in whole or in part.

ii. The CEO may elect to withdraw, without prejudice, from the Plan at any time.

e. Eligibility for Distribution. Subject to other provisions hereof, the CEO must be the CEO of the Company continuously from the conclusion of any Plan Period up to and including the date of distribution of the award to be eligible to receive such distribution.

f. Change in Control Exception. Notwithstanding any other provision hereof, if within one year after a “change in control” (as defined below) either (x) the CEO’s employment with XOMA is involuntarily terminated after the end of a Plan Year but before the distribution date of the award hereunder for such Plan Year, other than for cause, or (y) the CEO shall voluntarily terminate his or her employment with XOMA after the end of a Plan Year but before the distribution date of the award hereunder for such Plan Year, because the nature of such participant’s duties or compensation do not continue to be substantially equivalent to what they were at the time of such change in control, then the provisions hereof shall continue to apply to the former CEO with respect to such Plan Year and the Compensation Committee and the Board shall in good faith make such recommendations and determinations hereunder with respect to the former CEO as if the former CEO continued to be employed by XOMA as CEO on the date of any recommendation or determination hereunder, and on the date of distribution of the award hereunder, with respect to such Plan Year.

For the purposes of this subsection, a “change in control” shall have occurred if any person (as defined in Section 13 of the Securities Exchange Act of 1934, as amended) acquires shares of voting capital shares, (other than directly from XOMA) and thereby becomes the owner of more than 20% of XOMA’s outstanding shares of voting capital shares (on a fully diluted basis) or XOMA enters into a merger, amalgamation or other consolidation (other than one in connection with a voluntary change of corporate domicile or similar reorganization or recapitalization transaction) in which the shareholders of XOMA (as determined immediately prior to the merger, amalgamation or other consolidation) do not own at least 50% of the outstanding shares of voting capital shares of the surviving or continuing entity after the merger, amalgamation or other consolidation. Solely for the purposes of the foregoing, a termination shall be deemed to have been made for “cause” in the event the CEO is terminated for any of the following reasons:

iii. the CEO’s continued failure to substantially perform his or her duties with XOMA, or

iv. gross misconduct by the CEO which is materially and demonstrably injurious to XOMA or its employees.

---

g. Death of CEO. In the event of the death of the CEO while CEO after the completion of any Plan Period but prior to the distribution, the award will be made as soon as practicable to the deceased CEO's beneficiary as indicated on the CEO's group insurance enrollment card.

**V. No Right to Employment**

Nothing in this Plan shall give the CEO the right to continued employment by XOMA.

**VI. Plan Modification**

This Plan may be modified or terminated by the Board at any time.

**VII. Miscellaneous**

- A. Nontransferability. Awards shall not be transferable by a participant except by will or the laws of descent and distribution. The CEO's rights under the Plan may not be pledged, mortgaged, hypothecated, or otherwise encumbered, and shall not be subject to claims of the CEO's creditors.
- B. Unfunded Status of Awards. The Plan is intended to constitute an "unfunded" plan of incentive compensation. With respect to any payments not yet made to the CEO pursuant to an award, nothing contained in the Plan or any award shall give the CEO any rights that are greater than those of a general unsecured creditor of XOMA.



## XOMA Ltd.

## Bonus Compensation Plan

**I. Introduction and Summary.**

This document describes the XOMA Ltd. (“XOMA” or the “Company”) Bonus Compensation Plan (the “Plan”), as approved by the Company’s Board of Directors (the “Board of Directors” or the “Board”). The Plan became effective on January 1, 2007, subject to Board and shareholder approval, [both of which took place on May 22, 2007]. Subject to the ability of the Board of Directors to terminate the Plan at any time, the Plan applies to fiscal years ending December 31, 2007 and each December 31 thereafter.

All employees having the status of “Employee” on January 1 of a particular Plan Period and who are not eligible to participate in XOMA’s Management Incentive Compensation Plan (the “MICP”) or CEO Incentive Compensation Plan are eligible to participate in the Plan for that Plan Period and, depending on the performance of the Company, earn incentive compensation (“Incentive Compensation”). (Article III contains the definitions of certain terms not otherwise defined in the places where such terms first appear in the Plan.) The CEO shall designate those eligible employees who will participate in the Plan. New employees joining XOMA during a Plan Period, who thereby meet the eligibility criteria for participation in the Plan, will be considered at the discretion of the CEO for participation in the Plan on a pro rata basis. The CEO will not participate in the Plan.

After the conclusion of each applicable Plan Period, the Board of Directors and the Compensation Committee of the Board of Directors (the “Compensation Committee”) will make a determination as to the performance of XOMA and Plan participants in meeting Company Objectives. Prior to the commencement of each Plan Period, the Board of Directors acting on the advice of the Compensation Committee, will establish a target Incentive Compensation pool (“Target Incentive Compensation Pool”). The Target Incentive Compensation Pool will be expressed as a percentage of the aggregate annual Base Salaries of all participants in the Plan for the applicable Plan Period. Awards to individual participants will vary depending on (1) the achievement of Company Objectives; (2) the size of the Target Incentive Compensation Pool; and (3) the individual’s Base Salary. Awards may be lower than the Target Incentive Compensation Pool on the basis of the calculation of the extent to which XOMA’s Company Objectives have been met. Awards to individuals who are subject to, but fail to meet, a Company-initiated performance improvement plan may also be reduced or eliminated.

Individual awards will be granted in cash and common shares of XOMA based on the average market value of the common shares for the ten trading days prior to the date of the award. Each award will be comprised of 50% cash and 50% in fully-vested common shares of XOMA based on the market value formula set forth above. The distribution date of awards under the Plan for each Plan Period will be the same for all participants and is expected to be set

---

no later than the March 15 immediately following the end of such Plan Period.

Questions concerning the Plan should be forwarded to the Vice President of Human Resources. In all instances, the written provisions of the Plan and other determinations of the Compensation Committee and the Board of Directors shall govern and be final.

**II. Purposes.**

To build a company team that will achieve XOMA's goals and objectives, to recognize individual efforts, to attract and retain highly motivated individuals and to encourage outstanding performance and contributions to XOMA.

**III. Definitions.**

For the purpose of the Plan, the following definitions will apply:

- A. Base Salary. The term "Base Salary" means an individual's total base salary in each Plan Period before any deferred tax reductions, including overtime and shift differential pay, but excluding moving allowances, participation in clinical studies, incentive or bonus payments, imputed income due to fringe benefits such as group insurance plans, and other compensatory items of this type.
- B. Company Objectives. The term "Company Objectives" means that list of company objectives approved from time to time by the Board of Directors in its sole discretion for each Plan Period. The objectives may be based on financial goals, scientific or commercial progress, profits, return on investments or any other criteria established by the Board of Directors.
- C. Employee. The term "Employee" means any individual on the XOMA payroll rendering services for XOMA whose normal work week is 30 hours or more (excluding consultants, advisors, and other similar individuals providing services to XOMA).
- D. Plan Period. Subject to Article VI, the term "Plan Period" means the fiscal period from January 1 to December 31, 2007 and, thereafter, each fiscal year ending December 31.
- E. Plan Term. Subject to Article VI, the term "Plan Term" means the period commencing on January 1, 2007 and continuing until the termination of the Plan by the Board of Directors.

---

**IV. Plan Mechanics.**

- A. Eligibility. All Employees having status as such on January 1 of a particular Plan Period and who are not eligible to participate in the MICP or XOMA's CEO Incentive Compensation Plan are eligible for participation in the Plan for such Plan Period. The CEO shall designate in writing the employees who will participate in the Plan. An individual who becomes an Employee who meets the eligibility criteria for participation in the Plan after the beginning of a Plan Period will be considered by the Compensation Committee or the CEO, as the case may be, for participation in the Plan and, if designated in writing to participate, such Employee will have her/his award pro rated as of the date of eligibility determined by the Compensation Committee or the CEO, as the case may be. An Employee participating in the Plan who becomes eligible to participate in the MICP during a Plan Period will remain eligible to receive an award under the Plan for that portion of such Plan Period preceding the date such Employee first became eligible to participate in the MICP.
- B. Length of Plan. Subject to Article VI, the Plan will be effective for the Plan Term.
- C. Incentive Plan.
1. Determination of Amounts Available for Incentive Compensation.
    - a. Prior to the commencement of each Plan Period (or, with respect to the 2007 Plan Period, prior to or upon receipt of Board and shareholder approval of the Plan), the Compensation Committee acting on behalf of the Board of Directors in its sole discretion will determine the Target Incentive Compensation Pool. As soon as practicable after the end of each Plan Period, the Compensation Committee will determine whether and to what extent the Company Objectives have been met. If a determination is made that XOMA has not met the Company Objectives to the extent required, the Compensation Committee may decline to award any Incentive Compensation.
    - b. Each year during the Plan Term, the Required Minimum Company Objective Percentage will be 70%.
    - c. The Target Incentive Compensation Pool is expressed as a percentage of the aggregate annual Base Salaries of the participants in the Plan. The final Incentive Compensation pool ("Final Incentive Compensation Pool") will be determined by utilizing the method of calculation of the extent to which XOMA's Company Objectives have been met for the applicable Plan Period as set forth in this Article IV.
  2. Calculation of Individual Incentive Awards
    - a. It is the intention of the Compensation Committee and the Board of Directors that awards to participants shall vary depending on: (1) the extent of collective achievement of Company Objectives; and (2) each participant's Base Salary.

b. The bonus opportunity range for participants in the Plan expressed as a percentage of Base Salaries at the beginning of a Plan Period is as follows:

| <u>Minimum</u> | <u>Target</u> | <u>Maximum</u> |
|----------------|---------------|----------------|
| 2.5%           | 5%            | 7.5%           |

c. If the Company's target results are achieved, the Target Contribution Percentage is awarded. If results between the target and the upper limit scenario are achieved, the Target Contribution Percentage is increased proportionately up to a maximum of 150% of the Target Contribution Percentage (the "Maximum Percentage Limitation"). No percentage contribution in excess of the Maximum Percentage Limitation will be awarded. Alternatively, if target results are not met but results greater than the lower limit scenario are achieved, the Target Contribution Percentage will be decreased proportionately to a minimum of 50% of the Target Contribution Percentage. Achievements below the lower limit scenario will result in a 0% contribution from the applicable Company Objective.

d. The Company's performance will be rated as soon as practicable following the conclusion of the applicable Plan Period in the exercise of the sole discretion of the individual or group indicated below. The payout percentages are based solely on the Company's performance and outstanding performance by an individual will not result in an above target payout.

e. Individual awards to any Employee who (i) at any time during the applicable Plan Period is subject to a Company-initiated performance improvement plan, and (ii) fails to achieve the objectives set forth in such performance improvement plan within the time period prescribed therein may be reduced or eliminated in management's discretion. Determination of awards for any Employee who continues to be subject to such a performance improvement plan after the end of the applicable Plan Period will be deferred until after the time period prescribed in such plan for achievement of its objectives.

f. The total value of all awards made for the applicable Plan Period will not exceed the amount of the Final Incentive Compensation Pool determined for that Plan Period.

3. Awards to Participants

a. Approval. All awards will be approved following the end of a Plan Period by the Compensation Committee acting on the advice of the Board of Directors and the CEO.

b. Distribution of Incentive Awards. The distribution dates for awards will be established by the Board of Directors acting on the advice of the Compensation Committee. It is expected that distributions will normally be made in March of the succeeding year of the applicable Plan Period.

c. Taxes and Withholding. Each participant will bear any Federal, state, and local taxes accruing with respect to any award under the Plan. As required by law, XOMA will withhold in cash from any distributions amounts required for Federal and state withholding tax purposes. With respect to awards in common shares, arrangements for the payment of withholding tax in cash satisfactory to XOMA must be made prior to the date of any distribution.

d. Termination of Participation.

- i. Subject to other provisions hereof, if a participant's employment is terminated for any reason, or for no reason, on or before December 31 of any Plan Period, such participant shall forfeit all rights to Incentive Compensation as yet unpaid pursuant to the Plan.
- ii. If an Employee changes employment status from full-time to part-time (less than 30 hours per week), any such change will terminate participation in the Plan and all rights to payments awarded for any Plan Period but payable in subsequent years, unless the CEO determines in her/his sole discretion, that such Employee should continue to participate.
- iii. A participant may elect to withdraw, without prejudice, from the Plan at any time.

e. Eligibility for Distribution. Subject to other provisions hereof, a participant must also be an Employee of the Company continuously from the conclusion of any Plan Period up to and including the date of distribution of the award to be eligible to receive such distribution.

f. Change in Control Exception. Notwithstanding any other provision hereof, if within one year after a "change in control" (as defined below), a participant's employment with XOMA is involuntarily terminated other than for cause, then all awards authorized but not yet distributed to such participant shall be distributed to such participant.

For the purposes of this subsection, a "change in control" shall have occurred if any person (as defined in Section 13 of the Securities Exchange Act of 1934, as amended) acquires shares of voting capital shares, (other than directly from XOMA) and thereby becomes the owner of more than 20% of XOMA's outstanding shares of voting capital shares (on a fully diluted basis) or XOMA enters into a merger, amalgamation or other consolidation (other than one in connection with a voluntary change of corporate domicile or similar reorganization or recapitalization transaction) in which the shareholders of XOMA (as determined immediately prior to the merger, amalgamation or other consolidation) do not own at least 50% of the outstanding shares of voting capital shares of the surviving or continuing entity after the merger, amalgamation or other consolidation. Solely for the purposes of the foregoing, a termination shall be deemed to have been made for "cause" in the event a participant is terminated for any of the

---

following reasons:

- i. the participant's continued failure to substantially perform her or his duties with XOMA, or
- ii. gross misconduct.

g. Death of a Participant. In the event of the death of a participant while an Employee after the completion of any Plan Period but prior to the distribution, the award will be made as soon as practicable to the deceased participant's beneficiary as indicated on the participant's group insurance enrollment card.

**V. No Right to Employment.**

Nothing in the Plan shall give any participant the right to continued employment by XOMA. Furthermore, under XOMA policy, employment at XOMA is "at will" and can be terminated at any time by either party, with or without cause and with or without notice.

**VI. Plan Modification.**

The Plan may be modified or terminated by the Board of Directors at any time.

**VII. Miscellaneous.**

- A. Nontransferability. Awards shall not be transferable by a participant except by will or the laws of descent and distribution and shall be exercisable during the lifetime of a participant only by such participant or his or her guardian or legal representative. A participant's rights under the Plan may not be pledged, mortgaged, hypothecated, or otherwise encumbered, and shall not be subject to claims of the participant's creditors.
- B. Unfunded Status of Awards. The Plan is intended to constitute an "unfunded" plan of incentive compensation. With respect to any payments not yet made to a participant pursuant to an award, nothing contained in the Plan or any Award shall give any such participant any rights that are greater than those of a general unsecured creditor of XOMA.

Subsidiaries of the Company

XOMA (Bermuda) Ltd.  
XOMA Ireland Limited  
XOMA Technology Ltd.  
XOMA (US) LLC  
XOMA Limited

Jurisdiction of Organization

Bermuda  
Ireland  
Bermuda  
Delaware  
United Kingdom

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-108306, 333-66171, and 333-39155) pertaining to the XOMA Ltd. 1981 Share Option Plan, the XOMA Ltd. Restricted Share Plan, the XOMA Ltd. Management Incentive Compensation Plan, the XOMA Ltd. 1992 Directors Share Option Plan, the XOMA Ltd. 2002 Director Share Option Plan, and the XOMA Ltd. 1998 Employee Share Purchase Plan, and in the Registration Statements on Form S-3 (Nos. 333-112161, 333-107929, 333-60503, 333-148342) and the related Prospectuses of XOMA Ltd., of our reports dated March 10, 2008, with respect to the consolidated financial statements of XOMA Ltd., and the effectiveness of internal control over financial reporting of XOMA Ltd. included in this Annual Report (Form 10-K) for the year ended December 31, 2007.

/s/ ERNST & YOUNG LLP

Palo Alto, California

March 10, 2008



**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, Steven B. Engle, certify that:

1. I have reviewed this quarterly report on Form 10-K 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) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f))) 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - c) 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
  - d) 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: March 11, 2008

/s/ STEVEN B. ENGLE

\_\_\_\_\_  
Steven B. Engle  
Chairman, Chief Executive Officer and President

**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, J. David Boyle II, certify that:

1. I have reviewed this quarterly report on Form 10-K 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) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f))) for the registrant and we have:
  - e) 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;
  - f) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - g) 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
  - h) 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):
  - c) 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
  - d) 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: March 11, 2008

/s/ J. DAVID BOYLE II

J. David Boyle II

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 Annual Report of the Company on Form 10-K for the year ended December 31, 2006, 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: March 11, 2008

/s/ STEVEN B. ENGLE

\_\_\_\_\_  
Steven B. Engle  
Chairman, Chief Executive Officer and President

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 Annual Report of the Company on Form 10-K for the year ended December 31, 2006, 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: March 11, 2008

/s/ J. DAVID BOYLE II

\_\_\_\_\_  
J. David Boyle II

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.

**XOMA Reports 2007 Results**

BERKELEY, Calif., Mar 11, 2008 — XOMA Ltd. (Nasdaq:XOMA), a leader in the discovery and development of antibody therapeutics, today announced its results for the year ended December 31, 2007.

“In 2007, our revenues more than doubled as a result of the Company’s success in establishing a vibrant business consisting of technology licensing, antibody collaborations, biodefense contracts and marketed product royalties. As a sign of the increasing value of our antibody discovery technology, we earned our largest technology license payment yet with the world’s largest pharmaceutical company, Pfizer. With clear progress in all of our businesses and as part of our new strategy, we advanced XOMA 052, a broad anti-inflammatory product candidate targeting the IL-1 pathway, into the first disease indication with the initiation of two Phase 1 clinical trials for Type 2 diabetes,” said Steven Engle, Chairman of the Board, Chief Executive Officer and President of XOMA. “Our strong revenue growth and effective execution have set the stage for a dynamic 2008 as we look forward to the continued progress of XOMA 052, including clinical data in Type 2 diabetes and initiation of clinical studies in up to three additional indications.”

Total revenues in 2007 were \$84.3 million, compared with \$29.5 million in 2006. The increase was primarily due to an up-front cash payment of \$30 million by Pfizer Inc. for a license providing non-exclusive access to our bacterial cell expression technology, and increases in royalty revenues from sales of RAPTIVA® and LUCENTIS® by Genentech, Inc. and its marketing partners.

Operating expenses in 2007 totaled \$86.8 million compared with \$70.2 million in 2006. The increase was principally due to an increase in research and development spending, primarily in support of the clinical development of XOMA 052, our collaborations with Schering-Plough Research Institute and Takeda Pharmaceutical Company Limited (Takeda), and our contract development and manufacturing activities. General and administrative spending increased primarily as a result of increased employee-related costs.

XOMA’s net loss was \$12.3 million, or \$0.10 per share, for the year ended December 31, 2007, compared with net loss of \$51.8 million, or \$0.54 per share, for 2006.

Cash, cash equivalents and short-term investments at December 31, 2007, totaled \$38.6 million, compared with \$46.4 million at December 31, 2006. Restricted cash as of December 31, 2007 and 2006 was \$6.0 million and \$4.3 million, respectively. During 2007, XOMA eliminated its remaining outstanding convertible notes.

A more detailed discussion of XOMA’s financial results appears below and in the Company’s Form 10-K filing.

**2007 and early 2008 Key Events**

**Technology license with Pfizer** - XOMA licensed to Pfizer the non-exclusive worldwide rights to XOMA’s patented bacterial cell expression technology, a key enabling technology for antibody drug discovery and manufacturing. XOMA received an upfront cash payment of \$30 million, and will receive milestone, royalty and other fees on future sales of all products subject to the license, including products in clinical development. XOMA has signed more than 50 licensees for the bacterial cell expression technology.

---

**Proof of concept of IL-1 blockade in Type 2 diabetes** – An important study was published in the New England Journal of Medicine in April 2007 demonstrating that the administration of an IL-1 receptor blocker or antagonist to Type 2 diabetes patients resulted in statistically significant improvement in the control of blood glucose, improvement in beta-cell secretory function and reduction of systemic inflammation. The study supports the rationale for clinical trials of XOMA 052, an antibody designed to block the same IL-1 inflammatory pathway by binding the IL-1 beta ligand.

**Start of two Phase 1 studies of XOMA 052 in Type 2 diabetes** -XOMA started two Phase 1 studies of XOMA 052 in Type 2 diabetes patients, one in the U.S and one in Europe. The two randomized, placebo-controlled, double-blind studies are designed to assess the safety and pharmacokinetics of XOMA 052, and evaluate standard medical measures of diabetes like Hemoglobin A1c and of inflammation like C-reactive protein. Results of the European study and part one of the U.S. study are expected in the third quarter of 2008.

**Expanded collaborations with Schering Plough and Takeda** -Schering Plough Research Institute and Takeda each added new discovery and development programs to our existing collaborations. XOMA was paid an initial milestone and is being paid for research activities for each project. Total payments before royalties from Schering Plough Research Institute and Takeda could reach more than \$75 million and \$230 million, respectively.

**Progress of XOMA-enabled, royalty-bearing products** -LUCENTIS® was approved for sale in the European Union. Genentech released positive statistically significant safety and efficacy results of a 12-week Phase 4 study of RAPTIVA® in psoriasis of the hands and feet. In 2007, worldwide sales of LUCENTIS® were \$1.2 billion and worldwide sales of RAPTIVA® were \$213 million.

CIMZIA® was approved in Switzerland for the treatment of Crohn's disease and subsequently launched in January of 2008. Also in January of 2008, the U.S. FDA accepted for filing and review a biologics license application for CIMZIA® submitted by UCB for the treatment of adult patients with active rheumatoid arthritis. The review is expected to be completed by the end of 2008. XOMA receives a royalty on worldwide sales of CIMZIA®, which is manufactured using XOMA's bacterial cell expression technology.

**Elimination of all outstanding convertible notes** – During 2007, XOMA eliminated all \$44.5 million of its remaining outstanding convertible notes through a combination of voluntary conversions by holders and automatic conversion by the Company pursuant to the terms of the notes.

**Executive leadership transition** - XOMA elected Steven Engle as Chairman of the Board, Chief Executive Officer and President. After 15 years of service, Jack Castello retired from these positions.

**New product-focused strategy** –XOMA realigned its strategy to expand and accelerate the development of proprietary products like XOMA 052 and to advance its leadership in antibody discovery and development.

**Board of Directors changes** – In addition to naming Mr. Engle as Chairman of the Board, XOMA elected Charles J. Fischer, M.D. of Cardiome Pharma Corporation as Director and appointed existing board member, W. Denman Van Ness, Lead Independent Director.

#### **2008 Anticipated Milestones**

**Proprietary products** - XOMA expects to have initial data from the two Phase 1 clinical studies of XOMA 052 in Type 2 diabetes patients in the third quarter of 2008. Based on the outcome of

---

the two Phase 1 studies in Type 2 diabetes, XOMA plans to start clinical studies of XOMA 052 in three additional indications – gout, systemic juvenile idiopathic arthritis (sJIA), and rheumatoid arthritis in 2008.

XOMA anticipates completing Phase 1 studies of an antimicrobial drug candidate, XOMA 629, in surface skin infections, including impetigo, staphylococcus aureus and methicillin-resistant staphylococcus aureus (MRSA). The product is designed to be applied topically as a gel.

**Technology Licensing** - XOMA will pursue additional revenue and product opportunities through agreements with pharmaceutical and biotechnology companies for access to XOMA's patented bacterial cell expression and Human Engineering™ antibody optimization technologies.

**XOMA's Royalties** - XOMA expects that royalty revenues from RAPTIVA® and LUCENTIS® will continue to support the Company's activities in 2008. Upon the potential marketing approval of CIMZIA®, XOMA would begin receiving royalties on sales of the product.

**Collaborations business** - XOMA will continue to advance antibody discovery and development programs with Takeda and Schering Plough Research Institute, enabling XOMA to generate revenue and participate in the pipeline expansion of its collaborators. In addition, XOMA will pursue additional collaboration opportunities.

**Biodefense** – XOMA will pursue additional biodefense opportunities in the U.S. and key international markets including the development of additional anti-botulinum neurotoxin monoclonal antibodies and other monoclonal antibody-based biodefense products.

#### **Financial Discussion**

**Revenues** - Total revenues for 2007 were \$84.3 million, compared with \$29.5 million in 2006. License and collaborative fee revenues were \$36.5 million in 2007, compared with \$2.8 million in 2006. The increase resulted primarily from the Company's license agreement with Pfizer with its \$30 million up-front cash payment.

Contract and other revenues were \$31.1 million in 2007, compared with \$16.3 million in 2006. The increase resulted primarily from the Company's service arrangements with National Institute of Allergy and Infectious Diseases (NIAID), Schering Plough Research Institute, AVEO Pharmaceuticals, Inc. (AVEO), and Takeda.

Royalties in 2007 totaled \$16.7 million, compared with \$10.3 million in 2006, reflecting the growth in RAPTIVA® and LUCENTIS® sales.

**Expenses** - In 2007, research and development expenses were \$66.2 million, compared with \$52.1 million in 2006. The \$14.1 million increase in 2007 compared with 2006 primarily reflects increased spending on development of XOMA 052, including Phase 1 clinical trials, and our contracts with NIAID, Schering Plough Research Institute/AVEO and Takeda, partially offset by a decrease in our spending on Taligen.

In 2007, general and administrative expenses were \$20.6 million compared with \$18.1 million in 2006. The \$2.5 million increase for 2007 resulted primarily from increased employee-related costs.

**Interest Expense** - Interest expense was \$11.6 million in 2007 compared with \$12.9 million in 2006. Interest expense for 2007 primarily consisted of \$6.1 million from the revaluation of the embedded derivative on the Company's convertible debt, \$3.4 million in interest expense on the Company's loan from Goldman Sachs and \$1.3 million of interest payable on the Company's loan from Novartis AG (Novartis). Interest expense for 2006 primarily consisted of interest on convertible debt and the Company's loan from Novartis.

**Long-Term Debt** - At December 31, 2007, XOMA had \$30.3 million of long-term debt under a \$35 million 5-year term loan facility with Goldman Sachs and \$20.6 million of long-term debt under a \$50.0 million loan facility with Novartis established to facilitate XOMA's participation in its collaboration with Novartis.

**Liquidity and Capital Resources** - As of December 31, 2007, cash, cash equivalents and short-term investments were \$38.6 million compared with \$46.4 million at December 31, 2006. This \$7.8 million decrease in 2007 reflects cash provided by operations of \$4.5 million offset by cash used in the purchase of fixed assets of \$9.5 million primarily for research and development capabilities and cash transferred to restricted cash of \$1.7 million. Net cash used in operating activities was \$33.3 million in 2006.

**Guidance** - XOMA is providing the following guidance for 2008 and plans to update this guidance on a quarterly basis.

We expect revenue for 2008 will be between 90 percent and 105 percent of the \$84.3 million record level in 2007. Due to the timing of anticipated business activities, we also expect that revenues will be greater in the second half of 2008 than in the first half of 2008. We expect research and development expense in 2008 to increase between 25 percent and 40 percent from the \$66.2 million spent in 2007 primarily to fund proprietary product research and expansion of projects with our collaborators. We expect general and administrative expense for 2008 will increase between 15 percent and 25 percent from the \$20.6 million spent in 2007.

We expect to use \$15 million to \$20 million in cash in 2008 operating activities and to spend \$12 million to \$13 million for capital items. Based on current spending levels, anticipated revenues, collaborator funding and other sources of funding expected to be available, the Company estimates it has sufficient cash resources to meet anticipated net cash needs through at least the next 12 months.

#### **Pipeline Highlights**

**XOMA 052** - XOMA 052 is a potent, Human Engineered™ monoclonal antibody with the potential to impact numerous inflammatory conditions. XOMA 052 has a very high binding affinity for interleukin-1 beta, a pro-inflammatory cytokine that is involved in rheumatoid arthritis, diabetes and gout. The antibody targets the IL-1 beta ligand and halts the signaling events that underlie multiple inflammatory conditions. Because of its high binding affinity, specificity and half-life, XOMA 052 is likely to provide more convenient dosing of once per one or two months. XOMA 052 is currently being developed for acute, chronic and orphan indications, including its evaluation in two Phase 1 clinical studies in Type 2 diabetes where its development may represent a novel therapeutic modality by impacting inflammation as an underlying cause of the disease.

The two randomized, placebo-controlled, double-blind studies in Type 2 diabetes are designed to assess the safety and pharmacokinetics of XOMA 052, and include measures of Hemoglobin A1c and systemic inflammation. The European study will enroll up to 36 patients in six cohorts, and



---

involves single-dose intravenous administration and dose-escalation by cohort. The U.S study will enroll up to 72 patients and is designed in consists of three parts - single-dose intravenous, single-dose subcutaneous and multi-dose intravenous administration.

The European study and part one of the U.S study will each enroll up to 36 patients and investigate six levels of single-dose intravenous drug administration, 0.01, 0.03, 0.1, 0.3, 1.0 and 3.0 mg/kg, in six groups of patients. Both studies have advanced to the third dose group. XOMA expects to have results of the European study and part one of the U.S. study in the third quarter of 2008.

In 2008, XOMA plans to initiate clinical studies of XOMA 052 in rheumatoid arthritis (RA), systemic juvenile idiopathic arthritis (SJIA) and gout, based on data from the studies of Type 2 diabetes.

XOMA developed XOMA 052 using the Company's extensive antibody discovery infrastructure and humanized it using XOMA's Human Engineering™ technology. XOMA 052 is fully owned by XOMA.

**XOMA 629** - XOMA 629 (formerly known as XMP.629) is a synthetic peptide derived from an amino acid sequence found in bactericidal/permeability-increasing protein (BPI), a human host-defense protein that is one of the body's early lines of defense against invading microorganisms. Consistent with XOMA's multi-indication approach to product development, we are currently evaluating XOMA 629 topically for the eradication of *Staphylococcus aureus* (staph), both methicillin-sensitive (MSSA) and methicillin-resistant (MRSA), and superficial skin infections, such as impetigo.

Along with an alarming rise in antibiotic resistance, treatment of topical bacterial infections has become more complex. In preclinical studies, XOMA 629 has been shown to act as a broad-spectrum antimicrobial compound. XOMA 629 has an encouraging safety profile based on clinical experience in approximately 300 patients.

XOMA intends to commence clinical trials in 2008 to evaluate the safety and anti-microbial activity of XOMA 629 for use in superficial infections.

**RAPTIVA® (Efalizumab): Collaboration with Genentech** - RAPTIVA® was developed in the U.S. through collaboration between Genentech and XOMA, and received FDA approval in October of 2003 as the first FDA-approved biologic therapy 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.

Genentech has been marketing RAPTIVA® in the U.S. since November of 2003. Outside the U.S. and Japan, RAPTIVA® is sold by Merck Serono S.A. ("Serono"), which announced in October of 2004 that it had received European Commission Marketing Authorization for RAPTIVA® in patients with moderate-to-severe chronic plaque psoriasis for whom other systemic treatments or phototherapy have been inadequate or inappropriate. By the end of 2006, Merck Serono had launched RAPTIVA® in approximately 50 countries worldwide. In February 2007, Genentech released positive and statistically significant safety and efficacy results of a 12-week Phase 4 study of RAPTIVA® in psoriasis of the hands and feet. Worldwide RAPTIVA® sales totaled \$213 million in 2007. XOMA earns a mid single-digit royalty on worldwide sales of RAPTIVA®.

**LUCENTIS® (ranibizumab injection) by Genentech** - LUCENTIS® is an antibody fragment against Vascular Endothelial Growth Factor for the treatment of neovascular (wet) age-related

---

macular degeneration, which causes vision loss in the elderly. LUCENTIS® was approved by the FDA on June 30, 2006, and in the European Union, where it is distributed by Novartis, in January of 2007. It is the first marketed therapeutic product manufactured under XOMA's license using XOMA's bacterial cell expression technology. XOMA earns royalties on worldwide sales of LUCENTIS®. Worldwide sales totaled \$1.2 billion in 2007. XOMA earns royalties on bacterial cell expression-enabled products, including LUCENTIS®, of 0.5 percent to 3.0 percent of sales.

**HCD122 (formerly CHIR-12.12) with Novartis** - HCD122 is a fully human anti-CD40 antibody designed as an antagonist to CD40 and as a treatment for B-cell mediated diseases, including cancer malignancies and autoimmune diseases. This antibody has a dual mechanism of action blocking tumor cell growth and survival signal as well as recruiting immune effector cells to kill tumor cells. HCD122 is the first product candidate selected under the multi-product antibody development and commercialization agreement for the treatment of cancer announced by Novartis and XOMA in March of 2004. In April of 2005, the Company announced the initiation of a Phase 1 study for patients with advanced chronic lymphocytic leukemia, and in October of 2005, it initiated a second Phase 1 study for patients with multiple myeloma. In December of 2006, the Company reported favorable preliminary results of these Phase 1 trials, as well as favorable pre-clinical results of comparisons of HCD122 with RITUXAN®. Both Phase 1 trials are ongoing. Novartis is leading the project and has said they expect to expand clinical development with one or more additional indications in 2008. In addition, the Company is investigating a number of undisclosed preclinical stage programs with Novartis.

#### **Contract Development and Collaboration Agreements**

**Biodefense: Anti-Botulinum Neurotoxin Program** - In July of 2006, XOMA was awarded a \$16.3 million contract to produce monoclonal antibodies for the treatment of botulism to protect U.S. citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. The contract work is being performed on a cost plus fixed fee basis over a three year period.

In March of 2005, XOMA was awarded a \$15.0 million contract from NIAID to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics. The contract work was performed over an 18-month period and was completed in October of 2006.

In November of 2006, XOMA was named as a subcontractor under a prime contract between SRI International and NIAID. Once the final terms are negotiated, we can manufacture a variety of monoclonal antibody therapeutic agents of importance to NIAID in the areas of biodefense and infectious diseases.

We are continuing to seek other opportunities for government and biodefense contracts.

**Collaboration with Schering-Plough** - In May of 2006, XOMA entered into a collaboration agreement with Schering-Plough for therapeutic monoclonal antibody discovery and development. During the collaboration, XOMA will discover therapeutic antibodies against one or more targets selected by Schering-Plough, use its phage display libraries to generate fully human antibodies and the Company's proprietary HE(tm) technology to humanize antibody candidates generated by hybridoma techniques, perform pre-clinical studies to support regulatory filings, cell line and process development and produce antibodies for initial clinical trials. In January of 2007, XOMA announced that this collaboration had been expanded to include additional disease targets. XOMA estimates that it could receive more than \$75 million before royalties over the life of the agreement in aggregate upfront, R&D funding, milestone and other payments.

**Collaboration with Takeda** - In November of 2006, the Company entered into a collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development. During the collaboration, XOMA will discover therapeutic antibodies against multiple targets selected by Takeda. In February of 2007, XOMA announced that this collaboration had been expanded to include additional disease targets in oncology. XOMA estimates that it could receive more than \$230 million, before royalties, over the life of the agreement in aggregate upfront, R&D funding, milestone and other payments.

#### **Investor Conference Call**

XOMA will host a conference call and webcast to discuss its 2007 results today, March 11, 2008, at 4:30 p.m. Eastern. The webcast can be accessed via XOMA's website at [www.xoma.com](http://www.xoma.com) and will be available for replay until close of business on April 31, 2008. Telephone numbers for the live audiocast are 877-407-9205 (U.S. and Canada) and 201-689-8054 (International). No conference ID is necessary. A telephonic replay will be available beginning approximately two hours after the conclusion of the call until close of business on March 25, 2008. Telephone numbers for the replay are 877-660-6853 (U.S./Canada) and 201-612-7415 (International). Two access numbers are required for the replay: account number 286 and conference ID # 273120.

#### **About XOMA**

XOMA is a leader in the discovery, development and manufacture of therapeutic antibodies. The Company's expanding pipeline includes XOMA 052, a broad anti-inflammatory antibody drug candidate that targets the IL-1 pathway, and XOMA 629, an anti-microbial drug candidate that is a synthetic peptide compound derived from bactericidal/permeability-increasing protein (BPI). BPI is a human host-defense protein that is one of the body's early lines of defense against invading microorganisms.

XOMA has multiple revenue streams from the licensing of its antibody technologies, product royalties, development collaborations, and biodefense contracts. XOMA's technologies and experienced team have contributed to the success of marketed antibody products, including RAPTIVA® (efalizumab) for chronic moderate to severe plaque psoriasis and LUCENTIS® (ranibizumab injection) for wet age-related macular degeneration.

The Company has a premier antibody discovery and development platform that incorporates leading antibody phage display libraries and XOMA's proprietary Human Engineering and bacterial cell expression technologies. Bacterial cell expression is a key breakthrough biotechnology for the discovery and manufacturing of antibodies and other proteins. As a result, more than 50 pharmaceutical and biotechnology companies have signed bacterial cell expression licenses.

In addition to developing its own products, XOMA develops products for premier pharmaceutical companies including Novartis AG, Schering-Plough Research Institute and Takeda Pharmaceutical Company Limited. XOMA has a fully integrated product development infrastructure, extending from pre-clinical science to product launch, and a team of 300 employees at its Berkeley location. For more information, please visit <http://www.xoma.com>.

Certain statements contained herein relating to the sufficiency of our cash resources, anticipated levels of revenues, expenses and cash utilization, sales of approved products, expected payments under existing agreements and/or product development and shareholder value, 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 sufficiency of our cash and anticipated levels of revenues, expenses and cash utilization may be other than as expected due to unanticipated changes in XOMA's research and development programs, unavailability of additional arrangements, lower than anticipated sales of approved products or failure of products to receive approval; the sales efforts for approved products may not be successful if the parties responsible for marketing and sales fail to meet their commercialization goals, due to the strength of competition, if physicians do not adopt the products as treatments for their patients or if remaining regulatory approvals are not obtained or maintained; and XOMA will not receive the estimated total amounts of funds if it cannot successfully carry out its obligations under its existing contracts.

---

These and other risks, including those related to the results of discovery research and preclinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the 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 and licensing relationships; the ability of collaborators, licensees and other third parties to meet their obligations; XOMA's ability to meet the demands of the United States government agency with which it has entered into its government contracts; competition; market demand for products; scale up and marketing capabilities; availability of additional licensing or collaboration opportunities; 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 XOMA's most recent annual report on Form 10-K and in other SEC filings. Consider such risks carefully in considering XOMA's prospects.

**\*\* Tables Follow \*\***

**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share amounts)

|   | December 31,     |                  |
|---|------------------|------------------|
|   | 2007             | 2006             |
| <b>ASSETS</b>   |                  |                  |
| Current assets:   |                  |                  |
| Cash and cash equivalents   | \$ 22,500        | \$ 28,002        |
| Short-term investments  | 16,067           | 18,381           |
| Restricted cash   | 6,019            | 4,330            |
| Receivables   | 12,135           | 12,045           |
| Prepaid expenses  | 1,113            | 1,061            |
| Debt issuance costs   | 254              | 668              |
| Total current assets  | <u>58,088</u>    | <u>64,487</u>    |
| Property and equipment, net   | 25,603           | 22,434           |
| Debt issuance costs – long-term   | 722              | 2,661            |
| Other assets  | 402              | 495              |
| Total assets  | <u>\$ 84,815</u> | <u>\$ 90,077</u> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY<br/>(NET CAPITAL DEFICIENCY)</b>  |                  |                  |
| Current liabilities:  |                  |                  |
| Accounts payable  | \$ 6,995         | \$ 4,186         |
| Accrued liabilities   | 7,710            | 7,086            |
| Accrued interest  | 878              | 1,794            |
| Deferred revenue  | 8,017            | 8,200            |
| Total current liabilities   | <u>23,600</u>    | <u>21,266</u>    |
| Deferred revenue – long-term  | 10,047           | 8,768            |
| Convertible debt – long-term  | —                | 46,823           |
| Interest bearing obligation – long-term   | 50,850           | 51,393           |
| Total liabilities   | <u>84,497</u>    | <u>128,250</u>   |
| Commitments and contingencies (Note 6)  |                  |                  |
| Shareholders' equity (net capital deficiency):  |                  |                  |
| Preference shares, \$.05 par value, 1,000,000 shares authorized   |                  |                  |
| Series A, 210,000 designated, no shares issued and outstanding at December 31, 2007 and 2006  | —                | —                |
| Series B, 8,000 designated, 2,959 shares issued and outstanding at December 31, 2007 and 2006; aggregate liquidation preference of \$29.6 million           | 1                | 1                |
| Common shares, \$.0005 par value, 210,000,000 shares authorized, 131,957,774 and 105,454,389 shares outstanding at December 31, 2007 and 2006, respectively | 66               | 53               |
| Additional paid-in capital  | 740,119          | 689,315          |
| Accumulated comprehensive loss  | (9)              | (9)              |
| Accumulated deficit   | <u>(739,859)</u> | <u>(727,533)</u> |
| Total shareholders' equity (net capital deficiency)   | <u>318</u>       | <u>(38,173)</u>  |
| Total liabilities and shareholders' equity (net capital deficiency)   | <u>\$ 84,815</u> | <u>\$ 90,077</u> |

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

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except share and per share amounts)

|   | Year Ended December 31, |                    |                 |
|---|-------------------------|--------------------|-----------------|
|   | 2007                    | 2006               | 2005            |
| <b>Revenues:</b>  |                         |                    |                 |
| License and collaborative fees  | \$ 36,460               | \$ 2,846           | \$ 5,061        |
| Contract and other revenue  | 31,057                  | 16,329             | 7,392           |
| Royalties   | 16,735                  | 10,323             | 6,216           |
| Total revenues  | <u>84,252</u>           | <u>29,498</u>      | <u>18,669</u>   |
| <b>Operating costs and expenses:</b>  |                         |                    |                 |
| Research and development (including contract related of \$17,032, \$10,909, and \$5,536, respectively, for the years ended December 31, 2007, 2006, and 2005) | 66,215                  | 52,094             | 39,896          |
| General and administrative  | 20,581                  | 18,088             | 14,798          |
| Total operating costs and expenses  | <u>86,796</u>           | <u>70,182</u>      | <u>54,694</u>   |
| Loss from operations  | (2,544)                 | (40,684)           | (36,025)        |
| <b>Other income (expense):</b>  |                         |                    |                 |
| Investment and interest income  | 1,866                   | 1,675              | 1,882           |
| Interest expense  | (11,585)                | (12,932)           | (4,254)         |
| Gain on extinguishment of debt  | —                       | —                  | 40,935          |
| Other income (expense)  | (63)                    | 100                | 244             |
| Net income (loss) before taxes  | (12,326)                | (51,841)           | 2,782           |
| Income tax expense  | —                       | —                  | 3               |
| Net income (loss)   | <u>\$ (12,326)</u>      | <u>\$ (51,841)</u> | <u>\$ 2,779</u> |
| Basic net income (loss) per common share  | <u>\$ (0.10)</u>        | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  |
| Diluted net income (loss) per common share  | <u>\$ (0.10)</u>        | <u>\$ (0.54)</u>   | <u>\$ 0.03</u>  |
| Shares used in computing basic net income (loss) per common share   | <u>127,946</u>          | <u>95,961</u>      | <u>86,141</u>   |
| Shares used in computing diluted net income (loss) per common share   | <u>127,946</u>          | <u>95,961</u>      | <u>90,063</u>   |

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

Company Contact:  
Greg Mann  
XOMA  
510-204-7270  
[mann@xoma.com](mailto:mann@xoma.com)

Media & Investors Contact:  
Rachel Lipsitz  
Porter Novelli Life Sciences  
619-849-5378  
[rlipsitz@pnlifesciences.com](mailto:rlipsitz@pnlifesciences.com)