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

# FORM 10-Q

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

For the quarterly period ended March 31, 2005

Commission File No. 0-14710

# XOMA Ltd.
**(Exact name of registrant as specified in its charter)**

| **Bermuda** | **52-2154066** |
|---|---|
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |

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

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

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

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

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

| **Class** | **Outstanding at May 3, 2005** |
|---|---|
| **Common shares US$.0005 par value** | **86,252,640** |

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**FORM 10-Q**

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**XOMA Ltd.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(in thousands)**

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| | (unaudited) | (note 1) |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 61,679 | $ 23,808 |
| Short-term investments | — | 511 |
| Receivables | 1,375 | 707 |
| Related party receivables | 165 | 167 |
| Prepaid expenses | 1,957 | 1,414 |
| Total current assets | 65,176 | 26,607 |
| Property and equipment, net | 18,496 | 19,306 |
| Related party receivables – long-term | 171 | 188 |
| Deposits and other | 3,272 | 159 |
| Total assets | $ 87,115 | $ 46,260 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,331 | $ 1,919 |
| Accrued liabilities | 11,203 | 19,331 |
| Notes payable | — | 116 |
| Capital lease obligations | 156 | 237 |
| Deferred revenue | 2,000 | 2,000 |
| Total current liabilities | 14,690 | 23,603 |
| Deferred revenue – long-term | 5,883 | 6,333 |
| Convertible debt – long-term | 60,000 | — |
| Interest bearing obligation – long-term | — | 40,934 |
| Total liabilities | 80,573 | 70,870 |
| Commitments and contingencies | | |
| Shareholders' equity (net capital deficiency): | | |
| Preference shares, $.05 par value, 1,000,000 shares authorized | | |
| Series A, 135,000 designated, no shares issued and outstanding | — | — |
| Series B, 8,000 designated, 2,959 shares issued and outstanding; aggregate liquidation preference of $29.6 million | 1 | 1 |
| Common shares, $.0005 par value, 135,000,000 shares authorized, 86,252,640 and 85,587,174 shares outstanding at March 31, 2005 and December 31, 2004, respectively | 43 | 43 |
| Additional paid-in capital | 654,889 | 653,537 |
| Accumulated comprehensive income | — | 280 |
| Accumulated deficit | (648,391) | (678,471) |
| Total shareholders' equity (net capital deficiency) | 6,542 | (24,610) |
| Total liabilities and shareholders' equity (net capital deficiency) | $ 87,115 | $ 46,260 |

*See accompanying notes to condensed consolidated financial statements.*

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Revenues: | | |
| License and collaborative fees | $ 525 | $ 155 |
| Contract revenue | 1,259 | — |
| Royalties | 1,209 | 15 |
| Total revenues | 2,993 | 170 |
| Operating costs and expenses: | | |
| Research and development (including contract related of $810 and $0, respectively) | 10,002 | 13,015 |
| General and administrative | 3,751 | 3,935 |
| Collaboration arrangement | — | 3,238 |
| Total operating costs and expenses | 13,753 | 20,188 |
| Loss from operations | (10,760) | (20,018) |
| Other income (expense): | | |
| Investment and interest income | 569 | 194 |
| Interest expense | (661) | (340) |
| Other income (expense) | 40,932 | (4) |
| Net income (loss) | $ 30,080 | $(20,168) |
| Basic net income (loss) per common share | $ 0.35 | $ (0.24) |
| Diluted net income (loss) per common share | $ 0.28 | $ (0.24) |
| Shares used in computing basic net income (loss) per common share | 85,745 | 84,171 |
| Shares used in computing diluted net income (loss) per common share | 108,461 | 84,171 |

*See accompanying notes to condensed consolidated financial statements.*

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Cash flows from operating activities: | | |
| Net income (loss) | $ 30,080 | $(20,168) |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: | | |
| Depreciation and amortization | 1,105 | 1,083 |
| Common shares contribution to 401(k) and management incentive plans | 1,291 | 906 |
| Accrued interest on convertible notes and other interest bearing obligations | 574 | 305 |
| Amortization of debt issuance costs | 80 | — |
| Gain on extinguishment of long-term debt | (40,935) | — |
| Loss on disposal of property and equipment | 1 | 2 |
| Gain on sale of investments | (271) | — |
| Changes in assets and liabilities: | | |
| Receivables and related party receivables | (649) | 10,521 |
| Prepaid expenses | (60) | 135 |
| Deposits and other | (297) | (1) |
| Accounts payable | (588) | (2,798) |
| Accrued liabilities | (8,702) | 2,268 |
| Deferred revenue | (450) | 4,970 |
| Net cash used in operating activities | (18,821) | (2,777) |
| Cash flows from investing activities: | | |
| Proceeds from sale of short-term investments | 502 | — |
| Purchase of property and equipment | (296) | (729) |
| Net cash provided by (used in) investing activities | 206 | (729) |
| Cash flows from financing activities: | | |
| Principal payments of short-term loan | (115) | (3,014) |
| Payments under capital lease obligations | (81) | (153) |
| Proceeds from issuance of convertible notes | 56,621 | — |
| Proceeds from issuance of common shares | 61 | 399 |
| Net cash provided by (used in) financing activities | 56,486 | (2,768) |
| Net increase (decrease) in cash and cash equivalents | 37,871 | (6,274) |
| Cash and cash equivalents at the beginning of the period | 23,808 | 84,812 |
| Cash and cash equivalents at the end of the period | $ 61,679 | $ 78,538 |

*See accompanying notes to condensed consolidated financial statements.*

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

## 1. OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Business

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

### Basis of Presentation

The condensed consolidated financial statements include the accounts of XOMA and its subsidiaries. All significant intercompany accounts and transactions were eliminated during consolidation. The unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q. These financial statements and related disclosures have been prepared with the assumption that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year. Accordingly, these statements should be read in conjunction with the audited Consolidated Financial Statements and related Notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 15, 2005.

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, which are necessary to present fairly the Company's consolidated financial position as of March 31, 2005, the consolidated results of the Company's operations for the three months ended March 31, 2005 and 2004, and the Company's cash flows for the three months then ended. The condensed consolidated balance sheet amounts at December 31, 2004, have been derived from audited consolidated financial statements. The interim results of operations are not necessarily indicative of the results that may occur for the full fiscal year or future periods.

### Critical Accounting Policies

The Company believes that there have been no significant changes in its critical accounting policies during the three months ended March 31, 2005, as compared with those previously disclosed in its Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 15, 2005.

### Estimates

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

### Concentration of Risk

Cash, cash equivalents, short-term investments and accounts receivable are financial instruments, which potentially subject the Company to concentrations of credit risk. The Company maintains money market funds and short-term investments that bear minimal risk. The Company has not experienced any significant credit losses and does not generally require collateral on receivables. For the three months ended March 31, 2005, three customers represented 66%, 17% and 15% of total revenues and, as of March 31, 2005, one of these customers had outstanding receivables of $0.5 million. For the three months ended March 31, 2004, three customers represented 59%, 18% and 15% of total revenues and, as of March 31, 2004, there were no billed or unbilled receivables outstanding from these customers.

### Share-Based Compensation

In accordance with the provisions of the Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by Financial Accounting Standards No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of SFAS No. 123," the Company has elected to continue to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations and to adopt the

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

"disclosure only" alternative described in SFAS 123. Under APB 25, if the exercise price of the Company's employee share options equals or exceeds the fair market value on the date of the grant or the fair value of the underlying shares on the date of the grant as determined by the Company's Board of Directors, no compensation expense is recognized. Accordingly, the financial statements reflect amortization of compensation resulting from options granted at exercise prices which were below market price at the grant date. Had compensation cost for the Company's share-based compensation plans been based on the fair value method at the grant dates for awards under these plans consistent with the provisions of SFAS 123, the Company's net income (loss) and net income (loss) per share would have been decreased (increased) to the pro forma amounts indicated below for the three months ended March 31, 2005 and 2004 (in thousands, except per share amounts):

| | Three months ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Net income (loss) – as reported | $30,080 | $(20,168) |
| Deduct: | | |
| Total share-based employee compensation expense determined under fair value method | (438) | (811) |
| Pro forma net income (loss) | $29,642 | $(20,979) |
| Income (loss) per share: | | |
| Basic – as reported | $ 0.35 | $ (0.24) |
| Basic – pro forma | $ 0.35 | $ (0.25) |
| Diluted – as reported | $ 0.28 | $ (0.24) |
| Diluted – pro forma | $ 0.28 | $ (0.25) |

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

| | Three months ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Dividend yield | 0% | 0% |
| Expected volatility | 84% | 79% |
| Risk-free interest rate | 4.15% | 1.17% |
| Expected life | 4.3 years | 4.0 years |

**Comprehensive Income (Loss)**

Unrealized gains or losses on the Company's available-for-sale securities are included in other comprehensive income (loss). Comprehensive income (loss) and its components for the three months ended March 31, 2005 and 2004, are as follows (in thousands):

| | Three months ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Net income (loss) | $30,080 | $(20,168) |
| Unrealized gain (loss) on securities available-for-sale | (280) | 32 |
| Comprehensive income (loss) | $29,800 | $(20,136) |

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

Basic net income (loss) per common share is based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is based on the weighted average number of common shares and other dilutive securities outstanding during the period, provided that including these dilutive securities does not increase (decrease) the net income (loss) per share.

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**(unaudited)**

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

| | March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Options for common shares | 5,718 | 6,269 |
| Warrants for common shares | 125 | 525 |
| Convertible preference shares, notes, debentures and related interest, as if converted | 38,827 | 4,865 |

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

| | March 31, | |
|---|---|---|
| | 2005 | 2004 |
| **Numerator** | | |
| Net income (loss) | $ 30,080 | $(20,168) |
| Interest on convertible long-term debt | 654 | — |
| Net income used for diluted net income (loss) per share | $ 30,734 | $(20,168) |
| **Denominator** | | |
| Weighted average shares outstanding used for basic net income (loss) per share | 85,745 | 84,171 |
| Effect of dilutive stock options | 48 | — |
| Effect of convertible preference shares | 3,818 | — |
| Effect of convertible long-term debt | 18,850 | — |
| Weighted-average shares outstanding and dilutive securities used for diluted net income (loss) per share | 108,461 | 84,171 |

**Accrued Liabilities**

Accrued liabilities consist of the following (in thousands):

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| Accrued collaboration arrangement | $ 3,302 | $ 9,144 |
| Accrued payroll costs | 2,574 | 4,804 |
| Accrued co-development, net | 2,890 | 3,361 |
| Accrued legal fees | 1,028 | 1,176 |
| Accrued interest | 574 | — |
| Accrued clinical trial costs | 192 | 214 |
| Other | 643 | 632 |
| Total | $ 11,203 | $ 19,331 |

**Recent Accounting Pronouncements**

In December of 2004, the FASB issued SFAS No. 123 (revised 2004), “Share-Based Payment”, which replaces SFAS No. 123, “Accounting for Stock-Based Compensation,” and supercedes APB Opinion No. 25, “Accounting for Stock Issued to Employees.” SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. XOMA is required to adopt SFAS 123R in the year beginning January 1, 2006. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated.

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**(unaudited)**

The Company is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R may have a material impact on its consolidated results of operations and earnings per share. The Company has not yet determined the method of adoption or the effect of adopting SFAS 123R, and has not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

The Company's Board of Directors approved the acceleration of the vesting of all outstanding employee share options with an exercise price greater than $3.00 per share, effective April 15, 2005.

## 2. COLLABORATIVE AND OTHER ARRANGEMENTS

In January of 2005, the Company announced a restructuring of its arrangement with Genentech on RAPTIVA®. Under the restructured arrangement, effective January 1, 2005, XOMA will be entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA®. 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. Genentech may elect and XOMA may agree to provide further clinical trial or other development services at Genentech's expense. In addition, XOMA's obligation to pay its outstanding balance to Genentech of $40.9 million under a development loan was extinguished. In 2004, XOMA recorded collaboration arrangement expense of $16.4 million, incurred an additional $3.9 million of RAPTIVA® costs included in its research and development expenses, and recorded $1.0 million in interest expense related to the development loan. In the first quarter of 2005, the Company recorded a one-time credit to other income of $40.9 million related to the extinguishment of the loan obligation.

In March of 2005, the Company was awarded a $15.0 million contract from the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health (NIH), to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics. The contract work will be performed over an eighteen month period and will be 100% funded with Federal funds from NIAID under Contract No. HHSN266200500004C. The Company is recognizing revenue over the life of the contract as the services are performed and, as per the terms of the contract, a 10% retention on all revenue is being deferred until completion of the contract.

## 3. CONVERTIBLE DEBT

In February of 2005, XOMA issued $60.0 million of 6.5% convertible senior notes due February 1, 2012. The notes are initially convertible into approximately 32 million common shares at a conversion rate of 533.4756 of XOMA common shares per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $1.87 per common share. Before February 6, 2008, the Company may not redeem the notes. On or after February 6, 2008, the Company may redeem any or all of the notes at 100% of the principal amount, plus accrued and unpaid interest, if its common shares trade at 150% of the conversion price then in effect for 20 trading days in a 30 consecutive trading day period. Holders of the notes may require XOMA to repurchase some or all of the notes for cash at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest following a fundamental change as defined in the indenture governing the notes. In addition, following certain fundamental changes, the Company will increase the conversion rate up to 50 common shares per $1,000 principal amount of notes which would increase the number of shares into which the notes are convertible by up to 3 million common shares or, in lieu thereof, it may, in certain circumstances, elect to adjust the conversion rate and related conversion obligation so that the notes are convertible into shares of the acquiring, continuing or surviving company.

The notes were issued, to the initial purchasers, for net proceeds of $56.6 million. The issuance costs of approximately $3.4 million are being amortized on a straight-line basis over the 84 month life of the notes.

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**(unaudited)**

## 4. RESTRUCTURING CHARGES

During the quarter ended March 31, 2005, the Company restructured its clinical organization to a level needed to support its current clinical activity. As a result of the restructuring, the Company recorded charges of $461,000 for severance and related benefits of which $330,000 remained outstanding at March 31, 2005. These charges are included in research and development expenses.

| (in thousands) | Severance and Related Benefits |
|---|---|
| Total restructuring charges | $ 461 |
| Amount paid | (131) |
| Accrued restructuring liabilities at March 31, 2005 | $ 330 |

## 5. LEGAL PROCEEDINGS

In November of 2004, a complaint was filed in the United States District Court, Northern District of California, in a lawsuit captioned Physicians Executive Business Corp. v. XOMA Ltd., et al., No. C 04 4878, by an investor in XOMA's common shares. The complaint asserts claims for alleged fraud and negligent misrepresentation relating to events preceding the announcement of Phase II trial results for XMP.629 in August of 2004. The complaint seeks unspecified compensatory damages. XOMA filed a motion to dismiss the complaint and that motion was granted with leave to amend on April 27, 2005. Plaintiff has until May 20, 2005, to file an amended complaint. The Company intends to continue to vigorously defend against this lawsuit.

In April of 2005, a complaint was filed in the Circuit Court of Cook County, Illinois, in a lawsuit captioned Hanna v. Genentech, Inc. and XOMA (US) LLC, No. 2005L00438B, by an alleged participant in one of the clinical trials of RAPTIVA®. The complaint asserts claims for alleged strict product liability and negligence against Genentech and XOMA based on injuries alleged to have occurred as a result of plaintiff's treatment in the clinical trial. The complaint seeks unspecified compensatory damages alleged to be in excess of $100,000. Given that this lawsuit was filed only recently, the Company has not yet fully assessed its merits; however, it intends to vigorously investigate and pursue available defenses.

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

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

**Results of Operations**

***Revenues***

Revenues for the three months ended March 31, 2005, were $3.0 million compared with $0.2 million for the three months ended March 31, 2004.

License and collaborative fees revenues were $0.5 million for the three months ended March 31, 2005, compared with $0.2 million for the three months ended March 31, 2004. These revenues include upfront and milestone payments related to the outlicensing of our products and technologies and other collaborative arrangements. The increase of $0.3 million resulted primarily from amortization of the $10.0 million in upfront payments received from our oncology collaboration with Chiron Corporation ("Chiron"), which is being recognized as revenue over the five year expected term of the agreement. The amortization of this payment began in the second quarter of 2004.

Contract revenues were $1.3 million for the three months ended March 31, 2005, compared with zero for the three months ended March 31, 2004. The increase resulted primarily from clinical trial services performed on behalf of Genentech, Inc. ("Genentech") and contract manufacturing services performed under the National Institute of Allergy and Infectious Diseases ("NIAID") contract entered into in March of 2005, to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics. The contract work will be performed over an eighteen month period and will be 100% funded with Federal funds from NIAID under Contract No. HHSN266200500004C. We are recognizing revenue over the life of the contract as the services are performed and, as per the terms of the contract, a 10% retention on all revenue is being deferred until completion of the contract.

Royalties were $1.2 million for the three months ended March 31, 2005, compared with zero for the three months ended March 31, 2004. The increase resulted primarily from RAPTIVA® royalties earned under our restructured arrangement with Genentech. Beginning on January 1, 2005, we are earning a mid-single digit royalty on worldwide sales of RAPTIVA®.

Research and development expenses consist of direct and research-related allocated overhead costs such as salaries and related personnel costs, facilities costs, patent costs and material and supply costs in addition to costs related to clinical trials to validate our testing processes and procedures and related overhead expenses. Research and development expenses consist of independent research and development and costs associated with collaborative research and development arrangements as well as contract research and development arrangements. Research and development expenses for the three months ended March 31, 2005, were $10.0 million compared with $13.0 million for the same period of 2004, a decrease of 23%. This decrease reflected increased spending on our Chiron oncology collaboration and our anti-gastrin antibody collaboration with Aphton Corporation ("Aphton"), which was more than offset by decreases in spending on MLN2222, XMP.629, RAPTIVA®, TPO mimetic and new product research. Additionally, during the quarter ended March 31, 2005, research and development expenses included $0.5 million in costs for severance and benefits related to the restructuring of our clinical organization. This area was restructured to a level needed to support our current clinical activity.

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):

| | Three Months Ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Earlier stage programs | $ 8,632 | $ 6,703 |
| Later stage programs | 1,370 | 6,312 |
| Total | $10,002 | $13,015 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2005 | 2004 |
| Internal projects | $ 6,293 | $ 8,621 |
| External projects | 3,709 | 4,394 |
| Total | $10,002 | $13,015 |

For the three months ended March 31, 2005, one development program (Chiron) accounted for more than 20% but less than 30% and no development program accounted for more than 30% of our total research and development expenses. For the three months ended March 31, 2004, three development programs (MLN2222, XMP.629 and RAPTIVA®) 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.

General and administrative expenses include salaries and related personnel costs, facilities costs and professional fees. General and administrative expenses for the three months ended March 31, 2005, were $3.8 million compared with $3.9 million for the three months ended March 31, 2004.

Collaborative arrangement expenses, which related exclusively to RAPTIVA® were zero and $3.2 million for the three months ended March 31, 2005 and 2004, respectively. The 2004 amount reflects our 25% share of commercialization costs for RAPTIVA® in excess of Genentech's revenues less cost of goods sold and research and development cost sharing adjustments. Because of the restructuring of our arrangement with Genentech, which was effective January 1, 2005, we are no longer responsible for a share of operating costs or R&D expenses, but rather we are entitled to receive royalties on worldwide sales. Genentech will be responsible for all development costs and, to the extent that we provide further clinical trial support or other development services for RAPTIVA®, we will be compensated by Genentech.

| (in thousands) | Three Months Ended March 31, 2004 |
|---|---|
| Net collaborative loss before R&D expense | $ (3,825) |
| R&D co-development benefit (charge) | 587 |
| Total collaboration arrangement expense | $ (3,238) |

Investment and interest income for the three months ended March 31, 2005, was $0.6 million compared with $0.2 million for the same period of 2004. The $0.4 million increase resulted primarily from the gain on the sale of our remaining short-term investments and increased interest rates.

Interest expense for the three months ended March 31, 2005, was $0.7 million compared with $0.3 million for the same period of 2004. The $0.4 million increase in 2005 compared with 2004 resulted primarily from the interest incurred on our $60.0 million in convertible notes issued in February of 2005 partially offset by a reduction in interest as a result of the repayment of our Genentech and Millennium Pharmaceuticals, Inc. ("Millennium") convertible notes which were outstanding in 2004.

Other income for the three months ended March 31, 2005, was $40.9 million compared with zero for the three months ended March 31, 2004. The 2005 amount reflects the one-time credit related to the extinguishment of the Genentech development loan that was outstanding at December 31, 2004, as a result of the restructuring of the Genentech agreement, which was announced in January of 2005.

**Liquidity and Capital Resources**

Cash, cash equivalents and short-term investments at March 31, 2005, was $61.7 million compared with $24.3 million at December 31, 2004. This $37.4 million increase primarily reflects cash from our February financing of $56.6 million partially offset by cash used in operation of $18.8 million.

Net cash used in operating activities was $18.8 million for the three months ended March 31, 2005, compared with $2.8 million for the three months ended March 31, 2004. Net cash used in operating activities for the three months ended March 31, 2005, resulted primarily from a net income of $30.1 million, depreciation and amortization of $1.1 million, common shares issued under employee 401(k) and management incentive plans of $1.3 million and accrued interest on convertible notes of $0.6 million more than offset by the gain on extinguishment of long-term debt of $40.9 million, the gain on sale of investments of $0.3 million and a net decrease in assets and liabilities of $10.7 million. Net cash used in operating activities for the three months ended March 31, 2004, resulted primarily from a net loss of $20.2 million partially offset by depreciation and amortization of $1.1 million, common shares issued under employee 401(k) and management incentive plans of $0.9 million, accrued interest on convertible notes of $0.3 million and a net increase in assets and liabilities of $15.1 million.

Net cash provided by investing activities for the three months ended March 31, 2005, was $0.2 million compared with cash used in investing activities of $0.7 million for the three months ended March 31, 2004. The $0.9 million increase in 2005 compared with 2004 reflected $0.5 million in proceeds from the sale of our short-term securities and a $0.4 million decrease in purchases of property and equipment.

Net cash provided by financing activities was $56.5 million for the three months ended March 31, 2005, compared with cash used in financing activities of $2.8 million for the three months ended March 31, 2004. Financing activities for the first three months of 2005 consisted of an issuance of convertible senior notes for net proceeds of $56.6 million and $0.1 million in proceeds from the issuance of common shares partially offset with capital lease payments of $0.1 million and payments of short-term loan obligations of $0.1 million. Financing activities for the first three months of 2004 consisted of a $3.0 million payment on our short-term loan obligation and $0.2 million in capital lease payments partially offset by $0.4 million in proceeds from the issuance of common shares.

In February of 2005, we issued $60.0 million of 6.5% convertible senior notes due February 1, 2012. The notes are initially convertible into approximately 32 million common shares at a conversion rate of 533.4756 of XOMA common shares per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $1.87 per common share. Before February 6, 2008, we may not redeem the notes. On or after February 6, 2008, we may redeem any or all of the notes at 100% of the principal amount, plus accrued and unpaid interest, if our common shares trade at 150% of the conversion price then in effect for 20 trading days in a 30 consecutive trading day period. Holders of the notes may require us to repurchase some or all of the notes for cash at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest following a fundamental change as defined in the indenture governing the notes. In addition, following certain fundamental changes, we will increase the conversion rate up to 50 common shares per $1,000 principal amount of notes which would increase the number of shares into which the notes are convertible by up to 3 million common shares or, in lieu thereof, it may, in certain circumstances, elect to adjust the conversion rate and related conversion obligation so that the notes are convertible into shares of the acquiring, continuing or surviving company.

The notes were issued, to the initial purchasers, for net proceeds of $56.6 million. The issuance costs of approximately $3.4 million are being amortized on a straight-line basis over the 84 month life of the notes.

Our cash, cash equivalents and short-term investments are expected to decrease through 2005 with the use of cash to fund ongoing operations.

Based on current spending levels, anticipated revenues, partner funding, remaining net proceeds received from our last underwritten public offering, and proceeds from our convertible senior notes issued in February of 2005, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least 2008. Any significant revenue shortfalls or increases in planned spending on development programs or more rapid progress of development programs could shorten this period. Additional licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms.

**Critical Accounting Policies**

Critical accounting policies are those that require significant judgment and/or estimates by management at the time that the financial statements are prepared such that materially different results might have been reported if other assumptions had been made. We consider certain accounting policies related to revenue recognition and recognition of research and development expenses to be critical policies. We believe there have been no significant changes to our critical accounting policies since we filed our 2004 Annual

Report on Form 10-K with the Securities and Exchange Commission on March 15, 2005. For a description of our critical accounting policies, please refer to our 2004 Annual Report on Form 10-K.

**Recent Accounting Pronouncements**

In December of 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation," ("SFAS 123") and supercedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. We are required to adopt SFAS 123R beginning January 1, 2005. Under SFAS 123R, we must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS 123R, while the retroactive method would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated.

We are evaluating the requirements of SFAS 123R and expect that the adoption of SFAS 123R may have a material impact on our consolidated results of operations and earnings per share. We have not yet determined the method of adoption or the effect of adopting SFAS 123R, and have not determined whether the adoption will result in amounts that are similar to the current pro forma disclosures under SFAS 123.

Our Board of Directors approved the acceleration of the vesting of all outstanding employee share options with an exercise price greater than $3.00 per share, effective April 15, 2005.

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

Certain statements contained herein related to our potential for profitability, future sales of RAPTIVA®, the sufficiency of our cash resources, 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, our ability to achieve profitability will depend on the success of the sales efforts for RAPTIVA®, revenues related to development services we provide, our ability to effectively anticipate and manage our expenditures and the availability of capital market and other financing; the sales efforts for RAPTIVA® may not be successful if Genentech or its partner, Serono, S.A. ("Serono"), fails to meet its commercialization goals, due to the strength of the competition, if physicians do not adopt the product as treatment for their patients or if remaining regulatory approvals are not obtained; and 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, or if funds are not otherwise available on acceptable terms. These and other risks, including those related to the results of pre-clinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; competition; market demand for products; scale-up and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in the remainder of this section.

**The Marketing And Sales Effort In Support Of The Only Product In Which We Have An Interest That Has Received Regulatory Approval May Not Be Successful.**

RAPTIVA®, the only product in which we have an interest that has received regulatory approval, was approved by the FDA on October 27, 2003, for the treatment of chronic moderate-to-severe plaque psoriasis in adults who are candidates for systemic therapy or phototherapy. Genentech and Serono, Genentech's international marketing partner for RAPTIVA®, are responsible for the marketing and sales effort in support of this product, and Genentech has only commenced the full intended scope of this effort in the United States within the past year. In September of 2004, 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. We have no role in marketing and sales efforts. Under our current arrangement with Genentech, we are entitled to receive royalties on worldwide sales of RAPTIVA®. Successful commercialization of this product is subject to a number of risks, including Genentech's and Serono's 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, physicians' and patients' acceptance of RAPTIVA® as a treatment for psoriasis, Genentech's ability to provide manufacturing capacity to meet demand for the product, and pricing and reimbursement issues. Certain of these risks are discussed in more detail below.

**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, partner funding, remaining net proceeds received from our last underwritten public offering, and proceeds from our convertible senior notes issued in February of 2005, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least 2008. Any significant revenue shortfalls or increases in planned spending on development programs or more rapid progress of development programs could shorten this period. Additional

licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. As a result, we do not know 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.

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.

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

Our products cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. Only one of our therapeutic products, RAPTIVA®, has received regulatory approval. The United States government and governments of other countries extensively regulate many aspects of our products, including:

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

In the United States, the FDA regulates pharmaceutical products under the Federal Food, Drug, and Cosmetic Act and other laws, including, in the case of biologics, the Public Health Service Act. At the present time, we believe that most of our products will be regulated by the FDA as biologics. The review of therapeutic biologic products has been transferred within the FDA from the Center for Biologics Evaluation and Research to the Center for Drug Evaluation and Research, the body that reviews drug products. Because implementation of this plan may not be complete, we do not know when or how this change will affect us. 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®, 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.

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

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

**Because All Of Our Products Are Still Being Developed, We Have Sustained Losses In The Past And We Expect To Sustain Losses In The Future.**

We have experienced significant losses and, as of March 31, 2005, we had an accumulated deficit of $648.4 million.

For the three months ended March 31, 2005, as a result of the restructuring of our Genentech arrangement and subsequent extinguishment of our obligation to pay $40.9 million under a development loan and related one-time credit to other income, we had a net income of approximately $30.1 million or $0.35 per common share (basic) and $0.28 per common share (diluted). For the year ended December 31, 2004, we had a net loss of approximately $78.9 million, or $0.93 per common share (basic and diluted). We expect to incur additional losses in the future.

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 all of 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, 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 U.S. 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.
- In March of 2004, we announced we had agreed to collaborate with Chiron for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will jointly research, develop, and commercialize multiple antibody product candidates. In April of 2005, we announced the initiation of clinical testing of the first product candidate out of the collaboration, CHIR-12.12, an anti-CD40 antibody.
- In September of 2004, we entered into a collaboration with Aphton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies.
- In October of 2004, we announced the licensing of our ING-1 product to Triton BioSystems, Inc. ("Triton") for use with their TNT™ System.
- In November of 2004, we announced the licensing of our BPI product platform, including our NEUPREX® product, to Zephyr Sciences, Inc. ("Zephyr").
- In March of 2005, we entered into a contract with the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health, to produce three botulinum neurotoxin monoclonal antibodies designed to protect U.S. citizens against the harmful effects of biological agents used in bioterrorism.

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. If these collaborators and licensees do not successfully develop and market our products, we may not be able to do so on our own. We do not know whether Genentech, Millennium, Chiron, Aphton, Triton or Zephyr 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 Chiron provides for funding by it in the form of periodic loans, and we cannot be certain that Chiron will have the necessary funds available when these loans are to be made. Furthermore, our contract with NIAID contains 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 that this contract is our first with NIAID or any other governmental agency, we are uncertain as to the extent of NIAID's demands and the flexibility that will be granted to us in meeting those demands.

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

- In January of 2000, we licensed the worldwide rights to all pharmaceutical compositions containing a particular human protein for treatment of meningococcemia and additional potential future human clinical indications to Baxter. In July of 2003, this arrangement was terminated, and the rights returned to us.
- In January of 2001, we entered into a strategic process development and manufacturing alliance with Onyx Pharmaceuticals, Inc. ("Onyx") to scale-up production to commercial volume of one of Onyx's cancer products. In June of 2003, Onyx notified us that it was discontinuing development of the product and terminating the agreement so that it could focus on another of its anticancer compounds.
- 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 to terminate their collaboration.

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

**Certain Of Our Technologies Are Relatively New And Are In-Licensed From Third Parties, So Our Capabilities Using Them Are Unproven And Subject To Additional Risks.**

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

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

As a biopharmaceutical company, we have experienced significant volatility in our common shares. Fluctuations in our operating results and general market conditions for biotechnology stocks could have a significant impact on the volatility of our common share price. From January 1, 2004 through May 3, 2005, our share price has ranged from a high of $7.71 to a low of $0.98. On May 3, 2005, the closing price of the common shares as reported on the Nasdaq National Market was $1.22 per share. Factors contributing to such volatility include, but are not limited to:

- sales and estimated or forecasted sales of products,
- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of our products,
- developments regarding regulatory filings,
- announcements of new collaborations,
- failure to enter into collaborations,
- developments in existing collaborations,
- our funding requirements and the terms of our financing arrangements,
- announcements of technological innovations or new indications for our therapeutic products,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares outstanding,
- the number of shares trading on an average trading day,
- announcements regarding other participants in the biotechnology and pharmaceutical industries, and
- market speculation regarding any of the foregoing.

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

Genentech is responsible for manufacturing or arranging for the manufacturing of commercial quantities of RAPTIVA®. Should Genentech have difficulty in providing manufacturing capacity to produce RAPTIVA® in sufficient quantities, we do not know whether they will be able to meet market demand. If any of our other products are approved, because we have never commercially introduced any pharmaceutical products, we do not know whether the capacity of our existing manufacturing facilities can be increased to produce sufficient quantities of our products to meet market demand. Also, if we or our third party collaborators 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 A Viable Market For RAPTIVA® Or Our Other Products.**

Even though Genentech and we received FDA approval in October of 2003 to market RAPTIVA® and even if we receive regulatory approval for our other products, our products may not be accepted in the marketplace. For example, physicians and/or patients may not accept a product for a particular indication because it has been biologically derived (and not discovered and developed by more traditional means) or if no biologically derived products are currently in widespread use in that indication. Similarly, physicians may not accept RAPTIVA® if they believe other products to be more effective or are more comfortable prescribing other products. Consequently, we do not know if physicians or patients will adopt or use our products for their approved indications.

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

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

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

These factors may enable others to develop products and processes competitive with or superior to our own or those of our collaborators. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements.

Furthermore, positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product's failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

Without limiting the foregoing, we are aware that:

- In April of 2004, Amgen Inc. 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;

- Biogen Idec Inc. has been marketing Amevive® in the U.S. to treat the same psoriasis indication as RAPTIVA® and announced in October of 2004 that it had received approval in Canada;
- Biogen Idec Inc. and Fumapharm AG have taken their psoriasis-treating pill, BG-12, through a Phase III trial in Germany in which, according to the companies, the product significantly reduced psoriasis symptoms in patients.
- Centocor, Inc., a unit of Johnson & Johnson, has announced that it has tested its rheumatoid arthritis and Crohn's disease drug, Remicade®, in psoriasis, showing clinical benefits, and that the European Commission has granted approval of Remicade®, in combination with methotrexate, to treat psoriatic arthritis, in the European Union;
- Abbott Laboratories has presented data from a Phase II psoriasis trial showing clinical benefits of its rheumatoid arthritis drug Humira™;
- Isotechnika, Inc. has begun a Canadian Phase III trial of ISA247, a trans-isomer of a cyclosporine analog, in 400 patients with moderate to severe psoriasis; and
- other companies are developing monoclonal antibody or other products for treatment of inflammatory skin disorders.

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

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

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

In collaboration with Chiron, we are co-developing the monoclonal antibody target CD40, and, at the current time, there are several CD40-related programs under development, mostly focused on the development of CD40 ligand products. For example, SGN-40 is a humanized monoclonal antibody under development by Seattle Genetics, Inc. which is targeting CD40 antigen. SGN-40 is currently in Phase I studies in multiple myeloma and non-Hodgkin's lymphoma, with an additional Phase I study in chronic lymphocytic leukemia to begin in 2005. Another example is 5d12, an anti-CD40 antibody under development by Tanox, Inc. for Crohn's disease. Chiron licensed the antibody to Tanox, Inc. in 1995 and retains some commercialization and technology rights.

**Even If We Or Our Third Party Collaborators 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 health care through various means. In the United States, there have been and will continue to be a number of federal and state proposals to implement government controls on pricing. In addition, the emphasis on managed care in the United States has increased and will continue to increase the pressure on the pricing of pharmaceutical products. We cannot predict whether any legislative or regulatory proposals will be adopted or the effect these proposals or managed care efforts may have on our business.

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

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

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

The Patent Office has issued approximately 76 patents to us related to our products based on human bactericidal/permeability-increasing protein, which we call BPI, including novel compositions, their manufacture, formulation, assay and use. In addition, we are the exclusive licensee of BPI-related patents and applications owned by NYU and Incyte. These patents and licenses are now licensed and sublicensed to Zephyr. The Patent Office has also issued nine patents to us related to our bacterial expression technology.

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

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

**Protecting Our Intellectual Property Can Be Costly And Expose Us To Risks Of Counterclaims Against Us.**

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

**The Financial Terms Of 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 purchases 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 arrangement could result in dilution in the value of our shares.

**Because Many Of The Companies We Do Business With Are Also In The Biotechnology Sector, The Volatility Of That Sector Can Affect Us Indirectly As Well As Directly.**

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

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

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

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

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

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

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. There is intense competition for such personnel. Our research, product development and business efforts could be adversely affected by the loss of one or more key members of our scientific or management staff, particularly our executive officers: John L. Castello, our Chairman of the Board, President and Chief Executive Officer; Patrick J. Scannon, M.D., Ph.D., our Senior Vice President and Chief Scientific and Medical Officer; Peter B. Davis, our Vice President, Finance and Chief Financial Officer; and Christopher J. Margolin, our Vice President, General Counsel and Secretary. We have employment agreements with each of these executive officers. We currently have no key person insurance on any of our employees.

**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. We believe that we currently have adequate levels of insurance for our development and manufacturing activities; however, in the event of one or more large, unforeseen awards, such levels 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.

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

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

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

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

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

We are a Bermuda company. All or a substantial portion of our assets, 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 XOMA or our directors and officers that are predicated upon the civil liability provisions of the U.S. securities laws or entertain original actions brought in Bermuda against XOMA or such persons predicated upon the U.S. securities laws. There is no treaty in effect between the United States and Bermuda providing for such enforcement, and there are grounds upon which Bermuda courts may not enforce judgments of United States courts. Certain remedies available under the United States federal securities laws may not be allowed in Bermuda courts as contrary to that nation's policy.

**Our Shareholder Rights Agreement Or Bye-laws May Prevent Transactions That Could Be Beneficial To Our Shareholders And May Insulate Our Management From Removal.**

In February of 2003, we adopted a new shareholder rights agreement (to replace the shareholder rights agreement that had expired), which could make it considerably more difficult or costly for a person or group to acquire control of XOMA in a transaction that our board of directors opposes.

Our bye-laws:

- require certain procedures to be followed and time periods to be met for any shareholder to propose matters to be considered at annual meetings of shareholders, including nominating directors for election at those meetings;
- authorize our board of directors to issue up to 1,000,000 preference shares without shareholder approval and to set the rights, preferences and other designations, including voting rights, of those shares as the board of directors may determine; and
- contain provisions, similar to those contained in the Delaware General Corporation Law that may make business combinations with interested shareholders more difficult.

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

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

***Interest Rate Risk***

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

In February of 2005, we issued $60.0 million of 6.5% convertible senior notes due in 2012.

The table below presents the amounts and related weighted interest rates of our cash equivalents in overnight funds and commercial paper at March 31, 2005 and December 31, 2004:

| | Maturity | Fair Value (in thousands) | Average Interest Rate |
|---|---|---|---|
| March 31, 2005 | Daily | $ 61,679 | 2.38% |
| December 31, 2004 | Daily | $ 23,808 | 2.06% |

## ITEM 4. CONTROLS AND PROCEDURES

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

In April of 2003, we implemented a new financial reporting system which represents a significant change in our internal controls. During our evaluation of internal controls conducted for the second quarter of 2003, special procedures were performed regarding the system conversion and implementation. We concluded that the system conversion and implementation was properly controlled to ensure accurate financial reporting. We are further enhancing internal financial controls and staffing consistent with the requirements of the Sarbanes-Oxley Act of 2002. Apart from this, there were no changes in our internal controls over financial reporting during 2005 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial accounting.

***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. 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 generally accepted accounting principles.

Management assessed the effectiveness of our internal control over financial reporting as of March 31, 2005. 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 March 31, 2005, our internal control over financial reporting is effective based on those criteria.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

In November of 2004, a complaint was filed in the United States District Court, Northern District of California, in a lawsuit captioned Physicians Executive Business Corp. v. XOMA Ltd., et al., No. C 04 4878, by an investor in our common shares. The complaint asserts claims for alleged fraud and negligent misrepresentation relating to events preceding the announcement of Phase II trial results for XMP.629 in August of 2004. The complaint seeks unspecified compensatory damages. We filed a motion to dismiss the complaint and that motion was granted with leave to amend on April 27, 2005. Plaintiff has until May 20, 2005, to file an amended complaint. We intend to continue to vigorously defend against this lawsuit.

In April of 2005, a complaint was filed in the Circuit Court of Cook County, Illinois, in a lawsuit captioned Hanna v. Genentech, Inc. and XOMA (US) LLC, No. 2005L00438B, by an alleged participant in one of the clinical trials of RAPTIVA®. The complaint asserts claims for alleged strict product liability and negligence against Genentech and us based on injuries alleged to have occurred as a result of plaintiff's treatment in the clinical trial. The complaint seeks unspecified compensatory damages alleged to be in excess of $100,000. Given that this lawsuit was filed only recently, we have not yet fully assessed its merits; However, we intent to vigorously investigate and pursue available defenses.

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

*Sale of $60.0 million principal amount of 6.5% Convertible Senior Notes*

On February 7, 2005, we issued $60.0 million of 6.5% convertible senior notes due February 1, 2012 in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The notes are 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. Before February 6, 2008, we may not redeem the notes. On or after February 6, 2008, we may redeem any or all of the notes at 100% of the principal amount, plus accrued and unpaid interest, if our common shares trade at 150% of the conversion price then in effect for 20 trading days in a 30 consecutive trading day period. Holders of the notes may require us to repurchase some or all of the notes for cash at a repurchase price equal to 100% of the principal amount of the notes plus accrued and unpaid interest following a fundamental change as defined in the indenture governing the notes. In addition, following certain fundamental changes, we will increase the conversion rate up to 50 common shares per $1,000 principal amount of notes which would increase the number of shares into which the notes are convertible by up to 3 million common shares or, in lieu thereof, we may, in certain circumstances, elect to adjust the conversion rate and related conversion obligation so that the notes are convertible into shares of the acquiring, continuing or surviving company.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

(a) Exhibits:

| | |
|---|---|
| 10.11 | Employment Agreement dated March 26, 2005, between XOMA (US) LLC and Patrick J. Scannon, M.D., Ph.D. |
| 31.1 | Certification of John L. Castello, Principal Executive Officer, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Peter D. Davis, Principal Financial Officer, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |

| | |
|---|---|
| 32.1 | Certification of John L. Castello, Chief Executive Officer, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Peter D. Davis, Chief Financial Officer, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99.1 | Press Release dated May 9, 2005, furnished herewith. |

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**XOMA Ltd.**

**SIGNATURES**

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

XOMA Ltd.

Date: May 9, 2005

By: /s/ JOHN L. CASTELLO
John L. Castello
Chairman of the Board, President and
Chief Executive Officer

Date: May 9, 2005

By: /s/ PETER D. DAVIS
Peter D. Davis
Vice President, Finance and
Chief Financial Officer

**Exhibit 10.11**

**EMPLOYMENT AGREEMENT**

This Employment Agreement ("Agreement"), made and effective this 26th day of March, 2005, by and between XOMA (US) LLC ("XOMA" or the "Company"), a Delaware limited liability company with its principal office at 2910 Seventh Street, Berkeley, California, and Patrick J. Scannon, M.D., Ph.D., ("Executive"), an individual residing at 176 Edgewood, San Francisco, California.

WHEREAS, the Company wishes to enter into this Agreement to assure the Company of the continued services of Executive; and

WHEREAS, Executive is willing to enter into this Agreement and to continue to serve in the employ of the Company upon the terms and conditions hereinafter provided;

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Employment. The Company agrees to continue to employ Executive, and Executive agrees to continue to be employed by the Company, for the period referred to in Section 3 hereof and upon the other terms and conditions herein provided.

2. Position and Responsibilities. The Company agrees to employ Executive in the position of Senior Vice President and Chief Scientific and Medical Officer, and Executive agrees to serve as Senior Vice President and Chief Scientific and Medical Officer, for the term and on the conditions hereinafter set forth. Executive agrees to perform such services not inconsistent with his position as shall from time to time be assigned to him by the Chairman of the Board, President and Chief Executive Officer of the Company (the "Chairman").

3. Term and Duties.

(a) Term of Employment. This Agreement shall become effective and the term of employment pursuant to this Agreement shall commence on March 26, 2005 and will continue until March 25, 2006, when it will terminate unless it is extended by mutual written consent of Executive and the Company or unless Executive's employment is terminated by the Company or he resigns from the Company's employ as described herein.

(b) Duties. During the period of his employment hereunder Executive shall serve the Company as its Senior Vice President and Chief Scientific and Medical Officer, and except for illnesses, vacation periods and reasonable leaves of absence, Executive shall devote all of his business time, attention, skill and efforts to the faithful performance of his duties hereunder.

So long as Executive is Senior Vice President and Chief Scientific and Medical Officer of the Company, he will discharge all duties incidental to such office and such further duties as may be reasonably assigned to him from time to time by the Chairman.

4. Compensation and Reimbursement of Expenses.

(a) Compensation. For all services rendered by Executive as Senior Vice President and Chief Scientific and Medical Officer during his employment under this Agreement, the Company shall pay Executive as compensation a salary at a rate of not less than $350,000 per annum. All taxes and governmentally required withholding shall be deducted in conformity with applicable laws.

(b) Reimbursement of Expenses. The Company shall pay or reimburse Executive for all reasonable travel and other expenses incurred by Executive in performing his obligations under this Agreement in a manner consistent with past Company practice. The Company further agrees to furnish Executive with such assistance and accommodations as shall be suitable to the character of Executive's position with the Company, adequate for the performance of his duties and consistent with past Company practice.

5. Participation in Benefit Plans. The payments provided in Section 4 hereof are in addition to benefits Executive is entitled to under any group hospitalization, health, dental care, disability insurance, surety bond, death benefit plan, travel and/or accident insurance, other allowance and/or executive compensation plan, including, without limitation, any senior staff incentive plan, capital accumulation and termination pay programs, restricted or non-restricted share purchase plan, share option plan, retirement income or pension plan or other present or future group employee benefit plan or program of the Company for which key executives are or shall become eligible, and Executive shall be eligible to receive during the period of his employment under this Agreement, and during any subsequent period(s) for which he shall be entitled to receive payment from the Company under paragraph 6(b) below, all benefits and emoluments for which key executives are eligible under every such plan or program to the extent permissible under the general terms and provisions of such plans or programs and in accordance with the provisions thereof.

6. Payments to Executive Upon Termination of Employment.

(a) Termination. Upon the occurrence of an event of termination (as hereinafter defined) during the period of Executive's employment under this Agreement, the provisions of this paragraph 6(a) and paragraph 6(b) shall apply. As used in this Agreement, an "event of termination" shall mean and include any one or more of the following:

(i) The termination by the Company of Executive's employment hereunder for any reason other than pursuant to paragraph 6(c); or

(ii) Executive's resignation from the Company's employ, upon not less than thirty (30) days' prior written notice.

(b) Continuation of Salary and Other Benefits. Upon the occurrence of an event of termination under paragraph 6(a), the Company (i) shall, subject to the provisions of Section 7 below, pay Executive, or in the event of his subsequent death, his beneficiary or beneficiaries of his estate, as the case may be, as severance pay or liquidated damages, or both,

semi-monthly for a period of twelve (12) months following the event of termination (the "Severance Payment Period"), a sum equal to his current salary in effect at the time of the event of termination, but in no case less than $350,000 per annum, (ii) shall continue to provide the other benefits referred to in Section 5 hereof until the end of the Severance Payment Period or until Executive becomes employed elsewhere, whichever is earlier, and (iii) shall continue to provide the benefits provided for in paragraph 4(c) to the extent of expenses incurred but not reimbursed prior to the event of termination. Such payments shall commence on the last day of the next regular pay period following the date of the event of termination, or, at the election of the Company, may be paid in one lump sum or in such other installments as may be mutually agreed between the Company and Executive or, in the event of his subsequent death, his beneficiary or beneficiaries or legal representative, as the case may be.

(c) Other Termination of Employment. Notwithstanding paragraphs 6(a) and (b) or any other provision of this Agreement to the contrary, if on or after the date of this Agreement and prior to the end of the term hereof:

(i) Executive has been convicted of any crime or offense constituting a felony under applicable law, including, without limitation, any act of dishonesty such as embezzlement, theft or larceny;

(ii) Executive shall act or refrain from acting in respect of any of the duties and responsibilities which have been assigned to him in accordance with this Agreement and shall fail to desist from such action or inaction within ten (10) days (or such longer period of time, not exceeding ninety (90) days, as Executive shall in good faith and the exercise of reasonable efforts require to desist from such action or inaction) after Executive's receipt of notice from the Company of such action or inaction and the Board of Directors determines that such action or inaction constituted gross negligence or a willful act of malfeasance or misfeasance of Executive in respect of such duties; or

(iii) Executive shall breach any material term of this Agreement and shall fail to correct such breach within ten (10) days (or such longer period of time, not exceeding ninety (90) days, as Executive shall in good faith and the exercise of reasonable efforts require to cure such breach) after Executive's receipt of notice from the Company of such breach;

then, and in each such case, the Company shall have the right to give notice of termination of Employee's services hereunder as of a date (not earlier than fourteen (14) days from such notice) to be specified in such notice and this Agreement (other than the provisions of Section 7 hereof) shall terminate on such date.

7. Post-Termination Obligations. All payments and benefits to Executive under this Agreement shall be subject to Executive's compliance with the following provisions during the term of his employment and for the Severance Payment Period:

(a) Confidential Information and Competitive Conduct. Executive shall not, to the detriment of the Company, disclose or reveal to any unauthorized person any trade secret or other confidential information relating to the Company or its affiliates or to any businesses

operated by them, and Executive confirms that such information constitutes the exclusive property of the Company. Executive shall not otherwise act or conduct himself to the material detriment of the Company or its affiliates, or in a manner which is inimical or contrary to the interests thereof, and shall not, directly or indirectly, engage in, enter the employ of or render any service to any person, firm or business in direct competition with any part of the business being conducted by the Company; provided, however, that Executive's ownership less than five percent (5%) of the outstanding stock of a corporation shall not be itself be deemed to constitute such competition. Executive recognizes that the possible restrictions on his activities which may occur as a result of his performance of his obligations under this paragraph 7(a) are required for the reasonable protection of the Company and its investments. For purposes hereof, "direct competition" means the pursuit of one or more of the same therapeutic or diagnostic indications utilizing a substantially similar scientific basis.

(b) Failure of Executive to Comply. If, for any reason other than death or disability, Executive shall, without written consent of the Company, fail to comply with the provisions of paragraph 7(a) above, his rights to any future payments or other benefits hereunder shall terminate, and the Company's obligations to make such payments and provide such benefits shall cease.

(c) Remedies. Executive agrees that monetary damages would not be adequate compensation for any loss incurred by the Company by reason of a breach of the provisions of this Section 7 and hereby agrees to waive the defense in any action for specific performance that a remedy at law would be adequate.

8. Effect of Prior Agreements. This Agreement contains the entire understanding between the parties hereto and supersedes any prior employment agreements between the Company and Executive.

9. General Provisions.

(a) Binding Agreement. This Agreement shall be binding upon, and inure to the benefit of, Executive and the Company and their respective permitted successors and assigns.

(b) Legal Expenses. In the event that Executive incurs legal expenses in contesting any provision of this Agreement and such contest results in a determination that the Company has breached any of its obligations hereunder, Executive shall be reimbursed by the Company for such legal expenses.

10. Successors and Assigns.

(a) Assignment by the Company. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Company and, unless clearly inapplicable, reference herein to the Company shall be deemed to include its successors and assigns.

(b) Assignment by Executive. Executive may not assign this Agreement in whole or in part.

11. Modification and Waiver.

(a) Amendment of Agreement. This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

(b) Waiver. No term or condition of this Agreement shall be deemed to have been waived except by written instrument of the party charged with such waiver. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived.

12. Severability. In the event any provision of this Agreement or any part hereof is held invalid, such invalidity shall not affect any remaining part of such provision or any other provision. If any court construes any provision of this Agreement to be illegal, void or unenforceable because of the duration or the area or matter covered thereby, such court shall reduce the duration, area or matter of such provision, and, in its reduced form, such provision shall then be enforceable and shall be enforced.

13. Governing Law. This Agreement has been executed and delivered in the State of California, and its validity interpretation, performance, and enforcement shall be governed by the laws of said State.

IN WITNESS WHEREOF, XOMA has caused this Agreement to be executed by its duly authorized officer, and Executive has signed this Agreement, all as of the day and year first above written.

XOMA (US) LLC

/s/ JOHN L. CASTELLO
John L. Castello
Chairman of the Board, President
and Chief Executive Officer

/s/ PATRICK J. SCANNON, M.D., Ph.D.
Patrick J. Scannon, M.D., Ph.D.

**Exhibit 31.1**

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

I, John L. Castello, certify that:

1. I have reviewed this quarterly report on Form 10-Q of XOMA Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) 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: May 9, 2005

/s/ JOHN L. CASTELLO

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

**Exhibit 31.2**

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

I, Peter B. Davis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of XOMA Ltd.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) 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: May 9, 2005

/s/ PETER B. DAVIS

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

**Exhibit 32.1**

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

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Quarterly Report of the Company on Form 10-Q for the period ended March 31, 2005, 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: May 9, 2005

/s/ JOHN L. CASTELLO

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

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

**Exhibit 32.2**

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

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Quarterly Report of the Company on Form 10-Q for the period ended March 31, 2005, 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: May 9, 2005

/s/ PETER B. DAVIS

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

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

**News Release**

Exhibit 99.1

Ellen M Martin
Kureczka/Martin Associates
Investor Relations
Tel: (510) 832-2044

Deb McManus, APR
Media Relations
Tel: (510) 204-7240

**XOMA Reports First Quarter 2005 Financial Results**

**********

***Records Net Income of $0.28 per share, Sharp Reduction in Operating Loss***

**Berkeley, CA – May 9, 2005** — XOMA Ltd. (Nasdaq: XOMA), a biopharmaceutical company developing antibody and protein-based drugs for cancer, immunological disorders and infectious diseases, today announced its financial results for the quarter ended March 31, 2005.

For the first quarter of 2005, the Company reported net income of $30.1 million or $0.28 per share on a fully diluted basis, compared with the first quarter of 2004 net loss of $20.2 million or ($0.24) per share. The 2005 net income figure includes a non-recurring gain of $40.9 million, recognizing the extinguishment of a long-term loan due to Genentech, Inc. (NYSE: DNA) as part of a restructuring of XOMA's arrangement with Genentech with regard to the RAPTIVA® product. XOMA's loss from operations fell by 46%, from $20.0 million in the prior year quarter to $10.8 million in the first quarter of 2005. The improved results reflected higher revenues, as well as reduced research and development expenses and the elimination of losses from the collaboration agreement with Genentech following its re-structuring.

As of March 31, 2005, XOMA held $61.7 million in cash, cash equivalents and short-term investments, compared with $24.3 million at December 31, 2004. The increase primarily reflects $56.6 million net proceeds from the convertible note offering completed in February of 2005, partially offset by cash used in operating activities of $18.8 million.

A more detailed discussion of XOMA's financial results is provided below and in XOMA's first quarter 2005 10-Q filing.

"The first quarter financial results reflect several actions we've taken to improve XOMA's financial position," said Peter Davis, XOMA's chief financial officer. "Re-structuring our collaboration agreement with Genentech has had an immediate positive effect on both revenues and expenses. We have recorded our first revenue from our NIAID agreement, which began in March and we have taken steps to reduce expenses going forward. For the full year 2005 we expect to have cut our operating losses by at least half and to record a modest profit."

**Key first quarter 2005 events:**

- In January, XOMA restructured its RAPTIVA® agreement with Genentech, replacing a US cost and profit sharing arrangement and an ex-US royalty arrangement with a worldwide royalty arrangement beginning in January 2005. Genentech also discharged XOMA's $40.9 million long-term note obligation, which XOMA recognized as "other income" in the first quarter of 2005 in exchange for reduced royalty obligations to XOMA.
- In February, XOMA completed a $60.0 million convertible senior note financing to qualified institutional buyers. The notes, which mature in 2012, are convertible into XOMA common shares at a price of approximately $1.87 per share.
- In February, investigators presented final results of a three-year study of RAPTIVA® in moderate-to-severe plaque psoriasis patients at the American Academy of Dermatology meeting, providing additional confirmation of the long-term safety and sustained treatment

benefit of the product. In March, Genentech disclosed its intention to initiate Phase II clinical testing of RAPTIVA® in atopic dermatitis patients.

- In March, XOMA was awarded a $15.0 million 18-month contract from the National Institute of Allergy and Infectious Diseases ("NIAID"), a part of the National Institutes of Health (NIH), to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics designed to protect US citizens against the harmful effects of biological agents used in bioterrorism. The contract will be 100% funded with Federal funds from NIAID under Contract No. HHSN266200500004C.
- In April, XOMA and Chiron Corporation (Nasdaq: CHIR) announced the initiation of Phase I clinical testing of CHIR-12.12, a fully human, antagonist antibody that targets the CD40 antigen. Treatment has begun in the first study in subjects with advanced chronic lymphocytic leukemia ("CLL"). CHIR-12.12 is the first drug candidate to enter clinical testing under the collaborative agreement between Chiron and XOMA for the development of antibody products for the treatment of cancer.

"The start of the Phase I program moves CHIR 12.12, our first drug candidate from the Chiron collaboration, into clinical testing in CLL," said John L. Castello, president, chairman and CEO of XOMA. "We also plan to test this antibody in multiple myeloma later this year, and we are already working with Chiron on additional drug candidates. The NIAID agreement is an important first contract to improve utilization of our process development and manufacturing assets. RAPTIVA® sales continue to grow worldwide, and our new arrangement with Genentech has already had a very positive impact on our financial performance."

**Financial Discussion**

***Revenues:***

Revenues for the three months ended March 31, 2005, were $3.0 million, compared with $0.2 million for the three months ended March 31, 2004.

License and collaborative fees revenues increased to $0.5 million for the quarter, compared with $0.2 million for the same period of 2004, reflecting amortization of the $10.0 million in upfront payments received in 2004 from Chiron, which are being recognized as revenue over the five-year expected term of the agreement. The amortization of this payment began in the second quarter of 2004.

Contract revenues increased to $1.3 million for the 2005 quarter, compared with zero in the first quarter of 2004, primarily due to clinical trial services performed on behalf of Genentech and contract manufacturing services performed under the NIAID contract which began in March of this year.

Royalties of $1.2 million were recorded for the three months ended March 31, 2005, compared with zero for the 2004 quarter. This increase resulted primarily from RAPTIVA® royalties earned under the restructured arrangement with Genentech. Beginning on January 1, 2005, XOMA earns a mid-single digit royalty on worldwide sales of RAPTIVA®.

Revenues for the next several years will be largely determined by the timing and extent of royalties generated by worldwide sales of RAPTIVA® and by the establishment and nature of future manufacturing, outlicensing and collaboration arrangements.

***Expenses:***

Research and development expenses for the three months ended March 31, 2005, decreased 23% to $10.0 million from $13.0 million for the same period of 2004. The decrease resulted from reduced spending on MLN2222, XMP.629, RAPTIVA®, TPO mimetic and new product research which was partially offset by increased spending on the Chiron oncology and Aphton anti-gastrin

antibody collaborations. Additionally, during the first quarter of 2005, R&D expenses included $0.5 million in costs related to restructuring our clinical organization to a level more appropriate to support current requirements.

General and administrative expenses for the three months ended March 31, 2005 were $3.8 million compared with $3.9 million for the same period of 2004.

Collaborative arrangement expenses, which related exclusively to RAPTIVA®, were zero and $3.2 million for the three months ended March 31, 2005 and 2004, respectively. The 2004 amount reflects XOMA's 25% share of commercialization costs for RAPTIVA® in excess of Genentech's revenues less cost of goods sold and research and development cost sharing arrangements. Because of the restructured arrangement with Genentech, effective January 1, 2005, XOMA is no longer responsible for a share of operating costs or R&D expenses, but receives royalties on worldwide sales. Genentech will be responsible for all development costs and will compensate XOMA for any development support for RAPTIVA®.

***Long-term Debt***

At December 31, 2004, XOMA's balance sheet reflected a $40.9 million long-term note due to Genentech, which was extinguished under the restructuring of the Genentech agreement that was announced in January 2005. In February of 2005, XOMA issued $60 million of 6.5% convertible senior notes due in 2012, which is shown on the March 31, 2005 balance sheet as convertible long term debt.

***Liquidity and Capital Resources***

Cash, cash equivalents and short-term investments at March 31, 2005, were $61.7 million compared with $24.3 million at December 31, 2004. The $37.4 million increase primarily reflects cash proceeds of $56.6 million from the February 2005 financing partially offset by cash used in operations of $18.8 million.

Based on current spending levels, anticipated revenues, partner funding, remaining net proceeds received from XOMA's last underwritten public offering, and proceeds from the convertible senior notes issued in February of 2005, the Company estimates that it should have sufficient cash resources to meet anticipated net cash needs through at least 2008. Any significant revenue shortfalls or increases in planned spending on development programs or more rapid progress of development programs could shorten this period. Additional licensing arrangements or collaborations or otherwise entering into new equity or other financing arrangements could extend this period. Progress or setbacks by potentially competing products may also affect XOMA's ability to secure new funding on acceptable terms.

**Product Highlights**

***RAPTIVA® (Efalizumab): Collaboration with Genentech, Inc.***

RAPTIVA® was developed through a collaboration between Genentech and XOMA, and received FDA approval in October of 2003 as a treatment 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. US sales of RAPTIVA® in 2004 were approximately $52.4 million.

Outside the United States and Japan, RAPTIVA® is sold by Serono S.A. ("Serono"), which in September of 2004 received European Commission Marketing Authorisation for RAPTIVA® in patients with moderate-to-severe chronic plaque psoriasis for whom other systemic treatments or phototherapy have been inadequate or inappropriate. Serono received additional international approvals in 2004 and international sales of RAPTIVA® in 2004 were $4.9 million. RAPTIVA® is now available in 18 countries worldwide and reimbursed in 12 countries.

In the first quarter of 2005, Genentech reported US RAPTIVA® sales of $16.6 million and Serono reported international sales of $4.5 million.

**News Release**

***Oncology Therapeutic Antibodies Program: Collaboration with Chiron Corporation***

In April of 2005, Chiron and XOMA announced the start of Phase I clinical testing of the first drug candidate to reach clinical development under their collaborative agreement to develop antibody products for the treatment of cancer. The study is expected to enroll up to 40 patients with advanced CLL at three leading cancer centers in the United States and will monitor subject biomarkers in real time using translational medicine. The single-agent, open-label Phase I study of CHIR-12.12 is designed to evaluate the safety, dose tolerability and pharmacokinetic profile of this fully human, antagonist antibody that targets the CD40 antigen. Chiron and XOMA also plan to initiate clinical testing of CHIR-12.12 in patients with multiple myeloma later in 2005.

Under the worldwide, exclusive, multiple product agreement, launched in March of 2004, the companies will jointly research, develop, and commercialize multiple antibody product candidates, sharing development and commercialization expenses, as well as revenues, generally on a 70-30 basis, with XOMA's share being 30%. Chiron has also made available a $50.0 million credit facility under which XOMA can receive financing for up to 75% of its share of development expenses under the collaboration. XOMA has not yet drawn down any financing under this facility.

***TPO Mimetic: Collaboration with Alexion Pharmaceuticals, Inc.***

In December of 2003, XOMA agreed to collaborate with Alexion Pharmaceuticals, Inc. 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, XOMA and Alexion determined that the lead molecule in the 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 to terminate their collaboration.

***NIAID Anti-Bioterrorism Antibody Manufacturing Contract***

In March, XOMA was awarded a $15.0 million contract from the National Institute of Allergy and Infectious Diseases, a part of the National Institutes of Health, to develop three anti-botulinum neurotoxin monoclonal antibody therapeutics designed to protect US citizens against the harmful effects of biological agents used in bioterrorism. Under this 18-month contract, XOMA will use its proprietary antibody expression systems to produce anti-type A-botulinum neurotoxin monoclonal antibodies including a Master Cell Bank (MCB), Manufacturer's Working Cell Bank (MWCB) and other designated deliverables.

**Investor Conference Call**

XOMA has scheduled an investor conference call regarding this announcement to be held tomorrow, May 10, 2005, beginning at 4:00 PM EST (1:00 P.M. PST). Investors are invited to listen to the conference call by phone or via XOMA's website, http://www.xoma.com/. The domestic dial-in number (U.S./Canada) for the live call is 1-877-869-7222 and the conference ID number is 5739895. The international dial-in number is 1-706-679-5933 and uses the same dial-in conference I.D. number. To listen to the call via the Internet, go to XOMA's website a few minutes before the start of the call to register, download, and install any necessary audio software. The audio replay of the call will be available beginning two hours following the conclusion of the webcast through 6:00 p.m. EST (3:00 p.m. PST) on June 10, 2005. Access numbers for the replay are 1-800-642-1687 (U.S./Canada) or 1-706-645-9291 (International); Conference I.D. 5739895.

**News Release**

**About XOMA**

XOMA develops for commercialization antibody and other protein-based biopharmaceuticals to treat cancer, immune disorders and infectious diseases. The Company pipeline includes proprietary products along with collaborative product development programs with Chiron Corporation, Millennium Pharmaceuticals, Inc., and Aphton Corporation. The Company also has a royalty interest in RAPTIVA®, a product marketed worldwide that was developed under a collaboration arrangement with Genentech, Inc. For more information about XOMA's product pipeline and antibody product development capabilities and technologies, please visit XOMA's website at http://www.xoma.com/.

*Certain statements contained herein related to the sufficiency of XOMA's cash resources, the company's potential for profitability, the relative levels of the company's expenses for the balance of 2005, future revenues and future sales and development of RAPTIVA®, as well as other statements related to the progress and timing of product development, present or future licensing, collaborative or financing arrangements or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market.*

*Among other things, the sufficiency of cash resources could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated or if funds are not available on acceptable terms; the Company's ability to achieve profitability will depend on the success of the sales efforts for RAPTIVA®, the Company's ability to effectively anticipate and manage its expenditures and the availability of capital market and other financing; expenses for 2005 may be higher if expenditures are made earlier or in larger amounts than anticipated or are unanticipated; future revenues will be largely determined by the timing and extent of royalties generated by worldwide sales of RAPTIVA® and by the establishment and nature of future manufacturing, outlicensing and collaboration arrangements; the sales efforts for RAPTIVA® may not be successful if Genentech or its partner, Serono SA, fails to meet its commercialization goals, due to the strength of the competition, if physicians do not adopt the product as treatment for their patients or if any important remaining regulatory approvals are not obtained; and future development of RAPTIVA® may not be successful for reasons related to safety or efficacy.*

*These and other risks, including those related to the results of pre-clinical testing, the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data), changes in the status of the existing collaborative relationships, availability of additional licensing or collaboration opportunities, the ability of collaborators and other partners to meet their obligations, market demand for products, scale up and marketing capabilities, competition, international operations, share price volatility, XOMA's financing needs and opportunities, uncertainties regarding the status of biotechnology patents, uncertainties as to the cost of protecting intellectual property and risks associated with XOMA's status as a Bermuda company, are described in more detail in the Company's most recent annual report on Form 10-K, its quarterly report on Form 10-Q and in other SEC filings.*

Condensed Financial Statements Follow

**XOMA Ltd.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(in thousands)**

| | March 31, 2005 | December 31, 2004 |
|---|---|---|
| | (unaudited) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 61,679 | $ 23,808 |
| Short-term investments | — | 511 |
| Receivables | 1,375 | 707 |
| Related party receivables | 165 | 167 |
| Prepaid expenses | 1,957 | 1,414 |
| Total current assets | 65,176 | 26,607 |
| Property and equipment, net | 18,496 | 19,306 |
| Related party receivables – long-term | 171 | 188 |
| Deposits and other | 3,272 | 159 |
| Total assets | $ 87,115 | $ 46,260 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)** | | |
| Current liabilities: | | |
| Accounts payable | $ 1,331 | $ 1,919 |
| Accrued liabilities | 11,203 | 19,331 |
| Notes payable | — | 116 |
| Capital lease obligations | 156 | 237 |
| Deferred revenue | 2,000 | 2,000 |
| Total current liabilities | 14,690 | 23,603 |
| Deferred revenue – long-term | 5,883 | 6,333 |
| Convertible debt – long-term | 60,000 | — |
| Interest bearing obligation – long-term | — | 40,934 |
| Total liabilities | 80,573 | 70,870 |
| Commitments and contingencies | | |
| Shareholders' equity (net capital deficiency): | | |
| Preference shares, $.05 par value, 1,000,000 shares authorized | | |
| Series A, 135,000 designated, no shares issued and outstanding | — | — |
| Series B, 8,000 designated, 2,959 shares issued and outstanding; aggregate liquidation preference of $29.6 million | 1 | 1 |
| Common shares, $.0005 par value, 135,000,000 shares authorized, 86,252,640 and 85,587,174 shares outstanding at March 31, 2005 and December 31, 2004, respectively | 43 | 43 |
| Additional paid-in capital | 654,889 | 653,537 |
| Accumulated comprehensive income | — | 280 |
| Accumulated deficit | (648,391) | (678,471) |
| Total shareholders' equity (net capital deficiency) | 6,542 | (24,610) |
| Total liabilities and shareholders' equity (net capital deficiency) | $ 87,115 | $ 46,260 |

**News Release**

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

| | Three Months Ended March 31, | |
|---|---|---|
| | **2005** | **2004** |
| Revenues: | | |
| License and collaborative fees | $ 525 | $ 155 |
| Contract revenue | 1,259 | — |
| Royalties | 1,209 | 15 |
| Total revenues | 2,993 | 170 |
| Operating costs and expenses: | | |
| Research and development (including contract-related of $810 and $0, respectively) | 10,002 | 13,015 |
| General and administrative | 3,751 | 3,935 |
| Collaboration arrangement | — | 3,238 |
| Total operating costs and expenses | 13,753 | 20,188 |
| Loss from operations | (10,760) | (20,018) |
| Other income (expense): | | |
| Investment and interest income | 569 | 194 |
| Interest expense | (661) | (340) |
| Other income (expense) | 40,932 | (4) |
| Net income (loss) | $ 30,080 | $(20,168) |
| Basic net income (loss) per common share | $ 0.35 | $ (0.24) |
| Diluted net income (loss) per common share | $ 0.28 | $ (0.24) |
| Shares used in computing basic net income (loss) per common share | 85,745 | 84,171 |
| Shares used in computing diluted net income (loss) per common share | 108,461 | 84,171 |