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

FORM 10-Q

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

For the quarterly period ended September 30, 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 by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): 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 October 27, 2005**
Common shares US$.0005 par value	**86,294,010**

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PART I - FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

XOMA Ltd.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2005	December 31, 2004
	(unaudited)	(note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,584	$ 23,808
Short-term investments	31,194	511
Receivables	4,366	707
Related party receivables	96	167
Prepaid expenses	2,022	1,414
Total current assets	52,262	26,607
Property and equipment, net	18,549	19,306
Related party receivables – long-term	130	188
Deposits and other	3,086	159
Total assets	$ 74,027	$ 46,260
LIABILITIES AND SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)		
Current liabilities:		
Accounts payable	$ 2,454	$ 1,919
Accrued liabilities	5,789	19,331
Notes payable	—	116
Capital lease obligations	49	237
Deferred revenue	3,048	2,000
Total current liabilities	11,340	23,603
Deferred revenue – long-term	4,833	6,333
Convertible debt – long-term	60,000	—
Interest bearing obligation – long-term	8,844	40,934
Total liabilities	85,017	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, 210,000,000 shares authorized, 86,294,010 and 85,587,174 shares outstanding at September 30, 2005 and December 31, 2004, respectively	43	43
Additional paid-in capital	654,965	653,537
Accumulated comprehensive (loss) income	(32)	280
Accumulated deficit	(665,967)	(678,471)
Total shareholders' equity (net capital deficiency)	(10,990)	(24,610)
Total liabilities and shareholders' equity (net capital deficiency)	$ 74,027	$ 46,260

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenues:				
License and collaborative fees	$ 856	$ 530	$ 4,036	$ 1,442
Contract revenue	1,858	—	4,050	—
Royalties	1,712	29	4,492	65
Total revenues	4,426	559	12,578	1,507
Operating costs and expenses:				
Research and development (including contract related of $956 and $2,741, respectively, for the three and nine months ended September 30, 2005, and zero for the same periods of 2004)	9,383	12,562	28,932	38,439
General and administrative	3,243	4,015	10,703	11,538
Collaboration arrangement	—	3,857	—	12,286
Total operating costs and expenses	12,626	20,434	39,635	62,263
Loss from operations	(8,200)	(19,875)	(27,057)	(60,756)
Other income (expense):				
Investment and interest income	454	158	1,441	452
Interest expense	(1,236)	(307)	(3,014)	(925)
Other income (expense)	(10)	(119)	41,174	(125)
Income (loss) from operations before income taxes	(8,992)	(20,143)	12,544	(61,354)
Provision for income taxes	2	—	40	—
Net income (loss)	$ (8,994)	$ (20,143)	$ 12,504	$ (61,354)
Basic net income (loss) per common share	$ (0.10)	$ (0.24)	$ 0.15	$ (0.73)
Diluted net income (loss) per common share	$ (0.10)	$ (0.24)	$ 0.13	$ (0.73)
Shares used in computing basic net income (loss) per common share	86,277	85,284	86,091	84,619
Shares used in computing diluted net income (loss) per common share	86,277	85,284	117,666	84,619

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net income (loss)	$ 12,504	$(61,354)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	3,359	3,260
Common shares contribution to 401(k) and management incentive plans	1,304	906
Accrued interest on convertible notes and other interest bearing obligations	789	285
Amortization of debt issuance costs	328	—
Amortization of premiums and discounts	22	—
Gain on extinguishment of long-term debt	(40,935)	—
Loss on disposal of property and equipment	10	123
Gain on sale of investments	(286)	—
Changes in assets and liabilities:		
Receivables and related party receivables	(3,530)	10,268
Prepaid expenses	(114)	(68)
Deposits and other	(298)	—
Accounts payable	535	(2,269)
Accrued liabilities	(14,331)	7,045
Deferred revenue	(452)	8,743
Net cash used in operating activities	(41,095)	(33,061)
Cash flows from investing activities:		
Purchase of short-term investments	(37,780)	—
Proceeds from sales or maturities of short-term investments	7,049	—
Purchase of property and equipment	(2,612)	(2,521)
Net cash used in investing activities	(33,343)	(2,521)
Cash flows from financing activities:		
Proceeds from short-term loan	—	508
Principal payments of short-term loan	(115)	(13,400)
Payments under capital lease obligations	(188)	(439)
Proceeds from issuance of long-term notes	8,844	—
Net proceeds from issuance of convertible notes	56,549	—
Principal payments of convertible notes	—	(5,000)
Proceeds from issuance of common shares	124	5,031
Net cash provided by (used in) financing activities	65,214	(13,300)
Net decrease in cash and cash equivalents	(9,224)	(48,882)
Cash and cash equivalents at the beginning of the period	23,808	84,812
Cash and cash equivalents at the end of the period	$ 14,584	$ 35,930

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 discovers and develops antibody and other protein-based biopharmaceuticals, with a therapeutic focus on cancer, immune disorders and infectious diseases. The Company's products are presently in various stages of development and are subject to regulatory approval before they can be introduced commercially. The Company has a royalty 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 an agreement with Genentech, Inc. ("Genentech"). The Company's pipeline includes both proprietary products and collaborative programs at various stages of preclinical and clinical development. In addition, XOMA's fully integrated infrastructure allows the Company to offer process development and manufacturing services on a fee-for-service basis.

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 September 30, 2005, the consolidated results of the Company's operations for the three months and nine months ended September 30, 2005 and 2004, and the Company's cash flows for the nine 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 nine months ended September 30, 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 receivables 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 nine months ended September 30, 2005, four customers represented 44%, 22%, 16% and 12% of total revenues and, as of September 30, 2005, two of these customers had outstanding receivables of $2.0 million and $1.9 million. For the nine months ended September 30, 2004, one customer represented 77% of total revenues and, as of September 30, 2004, there were no billed or unbilled receivables outstanding from this customer.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Reclassifications

Certain items previously reported in specific financial statement captions have been reclassified to conform to the fiscal 2005 presentation. Such reclassifications have not impacted previously reported total revenues, operating loss or net loss.

Share-Based Compensation

In accordance with the provisions of the Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by Financial Accounting Standards No. 148 "Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of SFAS No. 123," the Company has elected to continue to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related interpretations and to adopt the "disclosure only" alternative described in SFAS 123. Under APB 25, if the exercise price of the Company's employee share options equals or exceeds the fair market value on the date of the grant or the fair value of the underlying shares on the date of the grant as determined by the Company's Board of Directors, no compensation expense is recognized. Accordingly, the financial statements reflect amortization of compensation resulting from options granted at exercise prices which were below market price at the grant date. Had compensation cost for the Company's share-based compensation plans been based on the fair value method at the grant dates for awards under these plans consistent with the provisions of SFAS 123, the Company's net income (loss) and net income (loss) per share would have been decreased (increased) to the pro forma amounts indicated below for the three and nine months ended September 30, 2005 and 2004 (in thousands, except per share amounts):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Net income (loss) – as reported	$ (8,994)	$ (20,143)	$ 12,504	$ (61,354)
Deduct:				
Total share-based employee compensation expense determined under fair value method	(142)	(759)	(3,305)	(2,640)
Pro forma net income (loss)	$ (9,136)	$ (20,902)	$ 9,199	$ (63,994)
Income (loss) per share:				
Basic – as reported	$ (0.10)	$ (0.24)	$ 0.15	$ (0.73)
Basic – pro forma	$ (0.11)	$ (0.25)	$ 0.11	$ (0.76)
Diluted – as reported	$ (0.10)	$ (0.24)	$ 0.13	$ (0.73)
Diluted – pro forma	$ (0.11)	$ (0.25)	$ 0.10	$ (0.76)

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

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Dividend yield	0%	0%	0%	0%
Expected volatility	.81%	1.02%	.83%	.82%
Risk-free interest rate	4.01%	3.29%	4.09%	1.45%
Expected life	4.0 years	4.5 years	4.3 years	6.3 years

On April 15, 2005, with the approval of the Company's Board of Directors, the Company accelerated the vesting of all outstanding employee share options with an exercise price greater than $3.00 per share. Because the exercise price of all the accelerated options exceeded the market price per share of the common shares as of the new measurement date, the acceleration had no impact on the Company's earnings for the three and nine months ended September 30, 2005. The Company's modification to its outstanding employee share options will allow expense recognized in future financial statements to better reflect the Company's compensation strategies under SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, and supercedes APB 25.

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Comprehensive Income (Loss)

Unrealized gains or losses on the Company's available-for-sale securities are included in other comprehensive income (loss). Comprehensive income (loss) and its components for the three and nine months ended September 30, 2005 and 2004, are as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Net income (loss)	$ (8,994)	$ (20,143)	$ 12,504	$ (61,354)
Unrealized (loss) gain on securities available-for-sale	(32)	14	(312)	31
Comprehensive income (loss)	$ (9,026)	$ (20,129)	$ 12,192	$ (61,323)

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.

The following 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):

	September 30,	
	2005	2004
Options for common shares	5,392	5,959
Warrants for common shares	125	525
Convertible preference shares, notes, debentures and related interest, as if converted	38,827	3,818

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

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Numerator				
Net income (loss)	$ (8,994)	$ (20,143)	$ 12,504	$ (61,354)
Interest on convertible long-term debt	—	—	2,863	—
Net income used for diluted net income (loss) per share	$ (8,994)	$ (20,143)	$ 15,367	$ (61,354)
Denominator				
Weighted average shares outstanding used for basic net income (loss) per share	86,277	85,284	86,091	84,619
Effect of dilutive stock options	—	—	86	—
Effect of convertible preference shares	—	—	3,818	—
Effect of convertible long-term debt	—	—	27,671	—
Weighted-average shares outstanding and dilutive securities used for diluted net income (loss) per share	86,277	85,284	117,666	84,619

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Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2005	December 31, 2004
Accrued payroll costs	$ 3,431	$ 4,804
Accrued interest	789	—
Accrued collaboration arrangement	198	9,144
Accrued accounting fees	588	—
Accrued co-development, net	—	3,361
Accrued legal fees	496	1,176
Accrued clinical trial costs	15	214
Other	272	632
Total	$ 5,789	$ 19,331

Recent Accounting Pronouncements

In December of 2004, the FASB issued SFAS No. 123R, which replaces SFAS No. 123 and supercedes APB 25. 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.

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.

In May 2005, FASB issued Statement No. 154, “Accounting Changes and Error Corrections” (“SFAS 154”). SFAS 154 requires retrospective application to prior periods’ financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. The statement will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the adoption of SFAS 154 to have a material effect on the Company’s consolidated financial position or results of operations.

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 gain 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

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(unaudited)

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 and classified as a receivable until completion of the contract. For the three and nine months ended September 30, 2005, the Company recorded revenues of $1.8 and $2.8 million respectively.

In June of 2005, the Company announced that it granted Merck & Co., Inc. ("Merck") a non-exclusive, worldwide license related to XOMA's bacterial cell expression technology. XOMA received and recognized in full an undisclosed access fee, and will receive milestones in the aggregate amount of $850,000 and royalties on future sales of any products subject to this license. The agreement also provides an option for Merck to use XOMA's bacterial cell expression technology to manufacture antibodies. Should Merck exercise this option, XOMA will receive an option fee, additional milestones in the aggregate amount of $850,000 and royalties.

In June of 2005, the Company announced the formation of a collaboration with Lexicon Genetics Inc. ("Lexicon") to jointly develop and commercialize novel antibodies for certain targets discovered by Lexicon and will share the responsibility and costs for research, preclinical, clinical, and commercialization activities, which along with any profits, will be allocated 65% to Lexicon and 35% to XOMA. XOMA will have principal responsibility for manufacturing antibodies for use in clinical trials and commercial sales.

In July of 2005, the Company announced its decision to terminate its exclusive worldwide license agreement with Zephyr Sciences, Inc. ("Zephyr") for the research, development and commercialization of products related to bactericidal/permeability-increasing protein (BPI), including its NEUPREX® product. The Company has no further rights or obligations under the terms of the original agreement with Zephyr nor will there be any additional costs related to the termination of the agreement.

In September of 2005, the Company announced that it had signed a letter agreement with Cubist Pharmaceuticals, Inc. ("Cubist") to develop production processes and to manufacture a novel two-antibody biologic in quantities sufficient to conduct Phase III clinical trials.

3. SECURED NOTE AGREEMENT

In May of 2005, the Company executed a secured note agreement with Chiron Corporation ("Chiron"). Under the note agreement, Chiron agreed to make semi-annual loans to the Company, to fund up to 75% of the Company's research and development and commercialization costs under the collaboration arrangement, not to exceed $50.0 million in an aggregate principal amount. Any unpaid principal amount together with accrued and unpaid interest shall be due and payable in full on June 21, 2015, the tenth anniversary date of the advance date on which the first loan was made. Interest on the unpaid balance of the principal amount of each loan shall accrue at a floating rate per annum which was equal to 5.64% at September 30, 2005, and is payable semi-annually in June and December of each year. At the Company's election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed $50.0 million. Loans under the note agreement are secured by the Company's interest in its collaboration with Chiron, including its share of any profits arising therefrom. At September 30, 2005, the outstanding principal balance under this note agreement totaled $8.8 million.

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(unaudited)

4. 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, and are disclosed as part of deposits and other assets on the financial statement.

5. 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. During the quarter ended June 30, 2005, $22,000 of these charges were released. None of these charges remained outstanding at September 30, 2005. These charges are included in research and development expenses.

6. LEGAL PROCEEDINGS

In April of 2005, a complaint was filed in the Circuit Court of Cook County, Illinois, in a lawsuit captionedHanna v. Genentech, Inc. and XOMA (US) LLC, No. 2005004386, by a participant in one of the clinical studies for RAPTIVA®. The lawsuit was thereafter removed to the United States District Court, Northern District of Illinois, No. 05C 3251. 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 trials. The complaint seeks unspecified compensatory damages alleged to be in excess of $100,000. Although the Company has not yet fully assessed the merits of this lawsuit, it intends to vigorously investigate and pursue available defenses. The Company does not believe that this matter, or the resolution of this matter, will have a material impact upon the Company's future consolidated financial position or results of operations.

ITE M 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 and nine months ended September 30, 2005, were $4.4 million and $12.6 million, respectively, compared with $0.6 million and $1.5 million for the same periods of 2004 .

License and collaborative fees revenues were $0.9 million and $4.0 million for the three and nine months ended September 30, 2005, compared with $0.5 million and $1.4 million for the three and nine months ended September 30, 2004 respectively. These revenues include amortization of upfront payments, milestone revenues and licensing revenues related to the outlicensing of our products and technologies and other collaborative arrangements. The increases of $0.4 million and $2.6 million resulted from various outlicensing agreements including Merck in the second quarter of 2005.

Contract revenues were $1.9 million and $4.1 million for the three and nine months ended September 30, 2005, respectively, compared with zero for the same periods of 2004. The increases resulted primarily from clinical trial services performed on behalf of Genentech and contract manufacturing services performed under the 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 and classified as a long-term receivable until completion of the contract.

Royalties were $1.7 million and $4.5 million for the three and nine months ended September 30, 2005, compared with $29,000 and $65,000 for the three and nine months ended September 30, 2004, respectively. The increases 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, patents, materials and supplies in addition to costs related to clinical trials to validate our testing processes and procedures and related overhead expenses. Research and development expenses include independent research and development and costs associated with collaborative research and development as well as contract research and development arrangements. Research and development expenses for the three and nine months ended September 30, 2005, were $9.4 million and $28.9 million, respectively, compared with $12.6 million and $38.4 million for the same periods of 2004, a decrease of 25% and 25%, respectively. This decrease reflected decreases in spending on MLN2222, XMP.629, RAPTIVA®, TPO mimetic and new product research partially offset by increased spending on our oncology collaboration with Chiron, our NIAID contract, our anti-gastrin antibody collaboration with Aphton Corporation ("Aphton") and our antibody collaboration with Lexicon. Additionally, research and development expenses included $0.4 million in costs for severance and benefits related to the first quarter 2005 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 September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Earlier stage programs	$ 7,647	$ 8,306	$ 21,680	$ 23,307
Later stage programs	1,736	4,256	7,252	15,132
Total	$ 9,383	$ 12,562	$ 28,932	$ 38,439

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 September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Internal projects	$ 5,496	$ 7,659	$ 17,625	$ 23,765
External projects	3,887	4,903	11,307	14,674
Total	$ 9,383	$ 12,562	$ 28,932	$ 38,439

For the three months ended September 30, 2005, one development program (Chiron) accounted for more than 40% but less than 50% and no development program accounted for more than 50% of our total research and development expenses. For the nine months ended September 30, 2005, one development program (Chiron) accounted for more than 30% but less than 40% and no development program accounted for more than 40% of our total research and development expenses. For the three and nine months ended September 30, 2004, two development programs (MLN2222 and XMP.629) 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 and nine months ended September 30, 2005, were $3.2 million and $10.7 million compared with $4.0 million and $11.5 million for the three and nine months ended September 30, 2004, respectively.

Collaborative arrangement expenses, which related exclusively to RAPTIVA®, were zero for the three and nine months ended September 30, 2005, compared with $3.9 and $12.3 million for the same periods in 2004, respectively. The 2004 amounts reflect 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 research and development 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. The prior year collaborative arrangement expenses are as follow (in thousands):

	Three Months Ended September 30, 2004	Nine months Ended September 30, 2004
Net collaborative loss before R&D expense	$ (3,404)	$ (11,851)
R&D co-development benefit (charge)	(504)	(486)
Royalties from international sales	51	51
Total collaboration arrangement expense	$ (3,857)	$ (12,286)

Investment and interest income for the three and nine months ended September 30, 2005, was $0.5 million and $1.4 million, respectively, compared with $0.2 million and $0.5 million for the same periods of 2004. The increases of $0.3 million and $0.9 million resulted primarily from increased interest rates and a higher cash, cash equivalents and investment balances. Additionally, the increase for the nine months ended September 30, 2005, includes a gain on the sale of our remaining short-term investments during the first quarter of 2005.

Interest expense for the three and nine months ended September 30, 2005 was $1.2 million and $3.0 million, respectively, compared with $0.3 million and $0.9 million for the same periods of 2004. The increases of $0.9 million and $2.1 million in 2005 compared with 2004 resulted primarily from the interest incurred on our $60.0 million aggregate principal amount of convertible senior notes issued in February of 2005, as well as the $8.8 million drawdown on our Chiron loan facility in June 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 (expense) for the three and nine months ended September 30, 2005, was zero and $41.2 million, respectively, compared with $(0.1) million for the three and nine months ended September 30, 2004. The increase for the nine months ending September 30, 2005, reflects a one-time gain 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, and proceeds of $250,000 from the sale of our issued patents and patent applications related to gelonin and gelonin fusion technology to Research Development Foundation ("RDF") in June of 2005.

Provision for income taxes for the three and nine months ended September 30, 2005 was $2,000 and $40,000, respectively, compared with zero for the comparable periods in 2004. The provision is related to activities of our foreign operations.

Liquidity and Capital Resources

Cash, cash equivalents and short-term investments at September 30, 2005, was $45.8 million compared with $24.3 million at December 31, 2004. This $21.5 million increase primarily reflects cash from our February financing of $56.6 million and the June drawdown on our Chiron loan facility of $8.8 million offset by cash used in operations of $41.1 million and investing cash used in investing activities of $33.3 million.

Net cash used in operating activities was $41.1 million for the nine months ended September 30, 2005, compared with $33.1 million for the nine months ended September 30, 2004. Net cash used in operating activities for the nine months ended September 30, 2005, resulted primarily from net income of $12.5 million, depreciation and amortization of $3.4 million, common shares issued under employee 401(k) and management incentive plans of $1.3 million and accrued interest on convertible notes and other interest bearing obligations of $0.8 million, and amortization of debt issuance costs of $0.3 million more than offset by the gain on extinguishment of long-term debt of $40.9 million, a decrease in accrued liabilities of $14.3 million, an increase in receivables of $3.5 million, the gain on sale of investments of $0.3 million and a net increase in other assets and liabilities of $0.3 million. Net cash used in operating activities for the nine months ended September 30, 2004, resulted primarily from a net loss of $61.4 million that was offset by the $10.0 million received in January of 2004 from Baxter Healthcare Corporation related to the termination of agreements, and the $8.8 million in deferred revenue remaining from the $10.0 million received from Chiron, in 2004, related to the initiation of an exclusive collaboration agreement in oncology in February of 2004.

Net cash used in investing activities for the nine months ended September 30, 2005, was $33.3 million compared with $2.5 million for the nine months ended September 30, 2004. The $30.8 million increase in 2005 compared with 2004 reflects purchases of $37.8 million in short-term investments and purchases of $2.6 million in fixed assets of offset by $7.0 million in proceeds from sales or maturities of short-term investments, compared to only $2.5 million in fixed asset purchases for the nine months ended September 30, 2004.

Net cash provided by financing activities was $65.2 million for the nine months ended September 30, 2005, compared with cash used in financing activities of $13.3 million for the nine months ended September 30, 2004. Financing activities for the first nine months of 2005 consisted of an issuance of convertible senior notes for net proceeds of $56.6 million, a drawdown on our Chiron loan facility of $8.8 million and $0.1 million in proceeds from the issuance of common shares partially offset by capital lease payments of $0.2 million and payments of short-term loan obligations of $0.1 million. Financing activities in the first nine months of 2004 consisted principally of a $13.2 million payment to retire our short-term loan obligation to Genentech, a $5.0 million payment of our convertible debt to Millennium, $0.4 million for principal payments on capital lease obligations and $0.2 million for principal payments on a short-term loan partially offset by $1.4 million in proceeds from the sale of common shares through share option exercises and the employee share purchase plan, $0.5 million proceeds from a short-term note and $3.7 million in proceeds from 0.9 million common shares sold under our investment agreement with Millennium.

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.

In May of 2005, we executed a secured note agreement with Chiron. Under the note agreement, Chiron agreed to make semi-annual loans to us, to fund up to 75% of the our research and development and commercialization costs under the collaboration arrangement, not to exceed $50.0 million in an aggregate principal amount. Any unpaid principal amount together with accrued and

unpaid interest shall be due and payable in full on June 21, 2015, the tenth anniversary date of the advance date on which the first loan was made. Interest on the unpaid balance of the principal amount of each loan shall accrue at a floating rate per annum which was 5.64% at September 30, 2005, and is payable semi-annually in June and December of each year. At our election, we may add the semi-annual interest payments to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed $50.0 million. Loans under the note agreement are secured by our interest in our collaboration with Chiron, including our share of any profits arising therefrom. At September 30, 2005, the outstanding principal balance under this note agreement totaled $8.8 million.

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, collaborator funding, proceeds from our convertible senior note offering in February of 2005 and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least 2008. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. Additional licensing arrangements or collaborations or our otherwise entering into new equity or currently unanticipated 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 FASB issued SFAS No. 123R. 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.

On April 15, 2005, with the approval of the Board of Directors, we accelerated the vesting of all outstanding employee share options with an exercise price greater than $3.00 per share. Because the exercise price of all the accelerated options exceeded the market price per share of the common shares as of the new measurement date, the acceleration had no impact on the our earnings for the three and nine months ended September 30, 2005. The modification to our outstanding employee share options will allow expense recognized in future financial statements to better reflect our compensation strategies under SFAS 123R, which we will adopt as of January 1, 2006.

In May 2005, FASB issued SFAS 154 which requires retrospective application to prior periods' financial statements of changes in accounting principle. It also requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. The statement will be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We do not expect the adoption of SFAS 154 to have a material effect on our consolidated financial position or results of operations.

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

Certain statements contained herein related to the sufficiency of our cash resources, future sales of RAPTIVA®, as well as other statements related to current plans for product development and existing and potential collaborative and licensing relationships, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things, the 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; and 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. 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 Food and Drug Administration ("FDA"), European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; our ability to meet the demand of the United States government agency with which we have entered our first government contract; competition; market demands for products; scale-up and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in 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 a royalty 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. 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, the occurrence of adverse events which may give rise to safety concerns, 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. According to Genentech, U.S. sales of RAPTIVA® for the third quarter of 2005 were $20.9 million, compared to $21.3 million for the second quarter of 2005. According to Serono, ex-U.S. sales of RAPTIVA® for the third quarter of 2005 were $10.0 million, compared to $7.4 million for the second quarter of 2005.

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

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

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

Based on current spending levels, anticipated revenues, collaborator funding, proceeds from our convertible senior note offering in February of 2005 and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least 2008. Any significant revenue shortfalls, increases in planned spending on

development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. Additional licensing arrangements or collaborations or our otherwise entering into new equity or currently unanticipated 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.

Our Level Of Leverage And Debt Service Obligations Could Adversely Affect Our Financial Condition.

As of September 30, 2005, we (including our subsidiaries) would have had approximately $68.8 million of indebtedness outstanding. We may not be able to generate cash sufficient to pay the principal of, interest on and other amounts due in respect of our indebtedness when due. We and our subsidiaries may also incur additional debt that may be secured. In connection with our collaboration with Chiron, Chiron has extended a line of credit to us (through our U.S. subsidiary) for $50 million to fund up to 75% of our expenses thereunder, of which $8.8 million is currently drawn. This line of credit is secured by a pledge of our interest in the collaboration.

Our level of debt and debt service obligations could have important effects on your investment in the notes. These effects may include:

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

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

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

Our products cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. 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 September 30, 2005, we had an accumulated deficit of $666.0 million.

For the nine months ended September 30, 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 $12.5 million or $0.15 per common share (basic) and $0.13 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 October 2005, we announced the initiation of the second clinical trial of CHIR-12.12 in patients with multiple myeloma.
- 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 March of 2005, we entered into a contract with the 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.
- In June of 2005, we announced the formation of a collaboration to jointly develop and commercialize antibody drugs for certain targets discovered by Lexicon.
- We have licensed our bacterial cell expression ("BCE") technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to approximately 35 companies. As of September 30, 2005, we were aware of two antibody products in late-stage clinical testing which are manufactured using our BCE technology: Celltech Group plc's CIMZIA™(CDP870) anti-TNFalpha antibody fragment for rheumatoid arthritis and Crohn's disease and Genentech's Lucentis™ (ranibizumab) antibody fragment to vascular endothelial growth factor for wet age-related macular degeneration.
- In September of 2005, we signed a letter agreement with Cubist to develop production processes and to manufacture a novel two-antibody biologic in quantities sufficient to conduct Phase III clinical trials.

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 these products, we may not have the capabilities, resources or rights to do so on our own. We do not know whether Aphton, Celltech, Chiron, Cubist, Genentech, Lexicon, Millennium or Triton 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. Lastly, neither CIMZIA™(CDP870) nor Lucentis™ has received marketing approval from the FDA or any foreign governmental agency, and therefore we cannot assure you that either product will prove to be safe and effective, will be approved for marketing or will be successfully commercialized.

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

- In 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 in the second quarter of 2005, the collaboration was terminated.
- In November of 2004, we announced the licensing of our BPI product platform, including our NEUPREX® product, to Zephyr. In July of 2005, we announced our decision to terminate the license agreement with Zephyr due to Zephyr not meeting the financing requirements of the license agreement.

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 BCE technology licensing program, we have access to numerous phage display technologies licensed to us by other parties. However, our experience with some of these technologies remains relatively limited and, to varying degrees, we are still dependent on the licensing parties for training and technical support for these technologies. In addition, our use of these technologies is limited by certain contractual provisions in the licenses relating to them and, although we have obtained numerous licenses, intellectual property rights in the area of phage display are particularly complex. 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, 2005 through October 27, 2005, our share price has ranged from a high of $2.74 to a low of $0.98. On October 27, 2005, the closing price of the common shares as reported on the Nasdaq National Market was $1.71 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 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 approval in the United States in October of 2003 to market RAPTIVA® and in the European Union in 2004 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. In addition, safety concerns may arise in the course of on-going clinical trials or patient treatment as a result of adverse events or reactions. 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 tested its rheumatoid arthritis and Crohn's disease drug, Remicade®, in a phase III clinical trial of patients with moderate to severe plaque psoriasis, achieving the primary endpoint, and has announced that the drug has been approved to treat plaque psoriasis in the European Union, psoriatic arthritis in the U.S. and, in combination with methotrexate, 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 has completed enrollment in a Phase IIb study in 200-300 women undergoing cardiac bypass surgery. 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, 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.

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

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

Due to the uncertainties regarding biotechnology patents, we also have relied and will continue to rely upon trade secrets, know-how and continuing technological advancement to develop and maintain our competitive position. All of our employees have signed confidentiality agreements under which they have agreed not to use or disclose any of our proprietary information. Research and development contracts and relationships between us and our scientific consultants and potential customers provide access to aspects of our know-how that are protected generally under confidentiality agreements. These confidentiality agreements may 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 BCE technology, we have in the past and may in the future agree to accept equity securities of the licensee in payment of license fees. The future value of these or any other shares we receive is subject both to market risks affecting our ability to realize the value of these shares and more generally to the business and other risks to which the issuer of these shares may be subject.

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

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

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

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; J. David Boyle II, 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.

In June of 2005, we drew down a loan of $8.8 million against a $50.0 million secured note that is due in 2015 at an interest rate of 5.64%.

The table below presents the amounts and related weighted interest rates of our cash equivalents in overnight funds and commercial paper at September 30, 2005 and December 31, 2004:

	Maturity	Fair Value (in thousands)	Average Interest Rate
September 30, 2005	Daily	$ 45,778	2.94%
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.

We are continuing to enhance internal financial controls and staffing consistent with the requirements of the Sarbanes-Oxley Act of 2002. Apart from this, there were no changes in our internal controls over financial reporting during 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 September 30, 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 September 30, 2005, our internal control over financial reporting is effective based on those criteria.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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. 2005004386, by an alleged participant in one of the clinical trials of RAPTIVA®. The lawsuit was thereafter removed to the United States District Court, Northern District of Illinois, No. 05C 3251. 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 trials. The complaint seeks unspecified compensatory damages alleged to be in excess of $100,000. Although we have not yet fully assessed the merits of this lawsuit, we intend to vigorously investigate and pursue available defenses. We do not believe that this matter, or the resolution of this matter, will have a material impact upon the our future consolidated financial position or results of operations

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

None.

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:

10.54	Letter Agreement dated September 20, 2005 between XOMA (US) LLC and Cubist Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission.
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 J. David Boyle II, 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 J. David Boyle II, Chief Financial Officer, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1	Press Release dated November 2, 2005, furnished herewith.

XOMA Ltd.

SIGNATURES

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

XOMA Ltd.

Date: November 2, 2005

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

Date: November 2, 2005

By: /s/ J. David Boyle II
J. David Boyle II
Vice President, Finance and
Chief Financial Officer

Exhibit 10.54

[***] indicates that a confidential portion of the text of this agreement has been omitted. The non-public information has been filed separately with the Securities and Exchange Commission.

CONFIDENTIAL

September 16, 2005

Cubist Pharmaceuticals, Inc.
65 Hayden Avenue
Lexington, MA 02421
Attention: Lindon Fellows

Re: Proposed Production Services Relationship

Dear Lindon:

We have been discussing the establishment of a strategic manufacturing relationship between our companies under which XOMA will develop, establish and scale-up the manufacturing process for Cubist's HepeX-B product candidate (the "Product"), which is a combination of two fully human monoclonal antibodies, and commit to manufacture a minimum amount of Product (i.e., a number of production lots) to provide for clinical trials and potential commercial launch. The parties understand that successful completion of the Services (as defined below) is the critical path item to the commercial launch of the Product.

The purpose of this letter of understanding (this "Letter Agreement") is to provide an overview of the major terms anticipated in the Definitive Agreement (as defined below) and to describe the course of action and terms during the interim period prior to the execution of the Definitive Agreement. Any disclosures made between our companies will be subject to the Mutual Confidentiality Agreement between our companies effective as of December 22, 2004 (the "Confidentiality Agreement").

Scope of the Project

1. XOMA will develop processes intended for commercial approval for the manufacture of two monoclonal antibodies (which will together form the Product) (the "Commercial Processes"), including validated testing and documentation in a form ready for submission to the United States Food and Drug Administration ("FDA") and that can be adapted by Cubist for submission to equivalent foreign agencies (the "Services"). It is the intention of the parties that the Services will be completed no later than [***]. The parties also agree that in order for the Services to be completed in a satisfactory manner, there must be timely performance by both parties and the costs associated with the development of the Commercial Processes must be controlled in the manner set forth in this Letter Agreement.

Definitive Agreement

2. The parties intend to establish a definitive process development and manufacturing agreement (a "Definitive Agreement") as rapidly as possible and XOMA has begun drafting a Definitive Agreement. The Definitive Agreement shall cover in more detail (a) the Services described in this Letter Agreement and (b) a mechanism for planning the manufacture of additional clinical materials and commercial quantities of Product. The parties shall begin negotiating the terms of the Definitive Agreement as promptly as practicable after execution of this Letter Agreement.

Interim Course of Action and Terms

3. Work on this project will commence immediately upon execution of this Letter Agreement. Among other things, the parties agree to undertake the following activities:

   a. Cubist will deliver all information necessary for XOMA to undertake its responsibilities hereunder, together with relevant details of any hazards and/or characterization relating to the Cubist materials (including the Master Cell Bank tests) to be used, and the storage and use of Cubist materials.

   b. Cubist will send [***] at XOMA's request once XOMA has satisfactorily determined that the materials meet XOMA's criteria for acceptance, which are attached to this Letter Agreement as Appendix B.

   c. The parties' respective technical staffs will transfer the existing process technology from Cubist to XOMA.

   d. XOMA will apply its reasonable diligence and technical expertise to reviewing this process, recommending modifications, planning and implementing any necessary improvements thereon, and will take other steps necessary or appropriate to initiate scale-up and manufacture of HepeX-B, including, without limitation, those activities outlined in Appendix A hereto.

   e. The work of each party will be performed in a professional and workmanlike manner in accordance with the standards of performance in the industry, this Letter Agreement, all applicable laws and all business conduct and health and safety guidelines or other relevant policies.

   f. The parties will commence work according to the initial work plan and cost estimate attached as Appendix A.

   g. The parties will meet no less frequently than monthly in order to discuss the progress of the development of the Commercial Processes. The parties shall alternate responsibility for taking the minutes of such meeting, and draft minutes shall be distributed to the other party for comment prior to being finalized.

   h. The parties will work to establish a Quality Agreement on or before the completion of the Definitive Agreement.

   i. In addition, XOMA shall produce development reports for Cubist at certain critical stages on which the parties shall agree.

Price

4. The parties agree to the following with respect to price:

   a. XOMA and Cubist estimate that the cost of developing the Commercial Processes is approximately [***]. A breakdown of this estimate is contained in Appendix A hereto.

   b. Cubist and XOMA agree on the need to control costs associated with development of the Commercial Processes. To that end, the parties have agreed that XOMA will perform the Services on a fee-for service basis (as described more fully below), but that in no event will the total cost to Cubist for the Services exceed [***]; provided, however, that the total cost of the Services may exceed [***] to the extent that the actual cost to XOMA of raw materials and resins exceeds [***].

   c. In the event that the total cost of the Services to Cubist is less than [***] prior to any payment pursuant to this paragraph 3(c), then Cubist shall pay XOMA an additional [***].

   d. In the event that the Services are completed within [***] of the date of this Letter Agreement, then Cubist shall pay XOMA an additional [***], which amount shall be in addition to any other amounts owed hereunder and shall not be subject to the limits set forth in paragraph 4(b).

   e. For the purposes of clarity, payment for the Services will include any and all costs (whether internal or external) incurred by XOMA in connection with (i) developing, validating and performing required quality control tests with respect to the Commercial Processes, (ii) completing any documentation, including the CMC section for submission to regulatory agencies to allow use of the Phase 3 clinical materials, (iii) permitting and/or conducting any regulatory audits by Cubist or regulatory agencies and responding to any questions from regulatory agencies, (iv) providing any Product that is manufactured during the development of the Commercial Processes to Cubist, and (v) any other activity reasonably requested by Cubist, at Cubist's expense, in connection with seeking commercial approval of the Commercial Processes; provided, however, that the Services, as defined herein, shall not include any process /cleaning validation and stability testing which shall be negotiated separately by the Parties.

Calculation of Fees and Expenses

5. For the Services contemplated by this Letter Agreement (excluding batch production costs for any [***] batches, the costs for which are addressed below), which includes work associated with the transfer, scale-up and development work outlined on Appendix A hereto, XOMA's costs shall be at the applicable FTE rates set forth in the table below (excluding the third party goods and services referred to below) and such costs shall be all-inclusive and shall be subject to the overall limits described in paragraph 4(b) above. In addition, a [***] will be added to [***] as representation of an agreed upon profit to XOMA on the direct expenses related to the development Services. For purposes of clarity, such costs shall include all facilities costs (including allocated rent and allocated utilities),

corporate costs, equipment depreciation, and any other cost incurred by XOMA, but shall not include charges for third party goods and services directly related to the Commercial Processes. Charges for third party goods and services directly related to development of the Commercial Processes, including obtaining, testing and purifying raw materials and resins, will be passed through to Cubist at XOMA's cost without mark-up but subject to paragraph 4(b) above.

Functional Area	Annual FTE Rate
[***]	[***]
[***]	[***]
[***]	[***]
[***]	[***]

For Services associated with batch production costs for any [***] batches, XOMA will be reimbursed a flat fee as described in the table in Appendix A [***].

6. While XOMA does not anticipate the need for significant equipment purchases prior to execution of the Definitive Agreement, XOMA and Cubist will identify equipment necessary to commence manufacturing of the Product in XOMA facilities. [***]

Payment and Invoicing

7. Cubist and XOMA agree to the following with respect to payment and invoicing:

   a. Concurrent with the execution of this Letter Agreement, Cubist will pay XOMA an advance (the "Advance") of [***], which amount will be an advance against which fees for the Services will be credited.

   b. Within [***] days of the end of each calendar month after execution of this Letter Agreement, XOMA will send Cubist a detailed report (each, a "Monthly Report") which documents all costs for the Services during such calendar month. Such report shall also reconcile the fees incurred in such calendar month against the remaining amount of the Advance.

   c. Absent a good faith dispute, within [***] days of receiving a Monthly Report indicating that the remaining amount of the Advance is less than [***], Cubist shall pay XOMA an additional [***]. Each such additional payment will be an addition to the Advance, and subsequent Monthly Reports will credit such additional amount in calculating the remaining amount of the Advance.

   d. Cubist shall have the right to audit the information underlying the Monthly Reports, and XOMA shall cooperate fully in any such audit, in both cases subject to customary standards of reasonableness.

Termination

8. XOMA and Cubist will work diligently to complete a Definitive Agreement. If for any reason the Definitive Agreement is not signed within [***] following the execution of this Letter Agreement, either party may terminate the relationship embodied in this Letter Agreement with [***] prior written notice to the other party.

Effect of Termination

9. In the event of any such termination by either party, XOMA shall be entitled to retain from the Advance all amounts due to XOMA in accordance with paragraph 4 above. XOMA shall also be entitled to retain an additional [***] of the Advance, in consideration of opportunity costs and work already performed. The balance, if any, of the Advance shall be returned to Cubist within [***] days of termination of this Letter Agreement. In no event shall money owed by Cubist to XOMA pursuant to this paragraph 9 exceed the amount of the Advance. Upon any such termination, both companies agree to return the other's materials in accordance with, and otherwise to adhere to, the applicable terms of the Confidentiality Agreement. In addition, upon termination of this Letter Agreement, to the extent reasonably requested by Cubist and at Cubist's cost, XOMA shall promptly transfer and/or deliver to Cubist (i) any Product developed by XOMA, (ii) any raw materials and resins purchased in connection with performance of the Services, (iii) any documentation reasonably related to the Commercial Processes, including documentation related to cell line characterization and optimization, analytical development and assay development, validation-related documentation, any relevant protocols and SOPs, and any other documentation reasonably request by Cubist, (iv) any assays used in connection with the development of the Commercial Process, and (v) any master or working cell bank related to the Product. For purposes of clarity, in the event that this Letter Agreement is terminated, it is the intention of the parties that Cubist be able to recommence the development of the Commercial Processes with a third party with as little interruption as possible, and therefore, that pursuant to this paragraph, Cubist shall have access to and the right to use any and all information, processes, intellectual property and materials developed by XOMA in the course of its work hereunder reasonably required to do so. It is also agreed that Cubist shall be responsible for all costs associated with XOMA's compliance with the terms of this paragraph.

Manufacturing Rights

10. It is the parties' intention to enter into a Definitive Agreement within [***] of the date hereof. However, it is understood that Cubist requires the flexibility to manufacture the Product at multiple manufacturers, and that Cubist requires the ability to transfer the process to a third party [***] either (a) in the event that any agreement between Cubist and XOMA, including this Letter Agreement, is terminated or performance of the Services is significantly delayed or (b) solely for purposes of obtaining multiple sources for commercial supply of the Product. To that end, Cubist and third party manufacturers working at Cubist's request will be entitled to use the manufacturing process developed pursuant to this Letter Agreement and/or the Definitive Agreement without royalty or other obligations to XOMA. XOMA and Cubist make no representation or warranty and shall have no obligation to the other as to non-infringement with respect to intellectual property claims of third parties.

Miscellaneous

11. Neither party to this Letter Agreement may use the other party's name, logos, copyrights or trademarks without the prior written permission of such other party. Any publication, news release or other public announcement relating to this Letter Agreement or to the performance hereunder, except as required by law, shall first be reviewed and approved by both Parties, which approval shall not be unreasonably withheld.

12. Except as set forth above, each company shall be solely responsible for its own costs and expenses in negotiating the Definitive Agreement.

13. This Letter Agreement shall be governed by the laws of the State of New York without regard to the conflicts of laws provisions thereof. XOMA and Cubist each agree to resolve any dispute regarding this Letter Agreement in the state and federal courts of the State of New York, and each party hereby consents to the jurisdiction of such courts.

We are very pleased at the prospect of a strategic manufacturing relationship with Cubist and look forward to working with you. If this Letter Agreement and the attachments accurately set forth our current understanding, please countersign where indicated below.

Very truly yours,

XOMA (US) LLC

By: _____
Robert S. Tenerowicz
Vice President, Operations

Agreed and accepted as of the date first above written:

CUBIST PHARMACEUTICALS, INC.

By: _____
Lindon M. Fellows
Senior Vice President, Technical Operations

Appendix A

INITIAL WORK PLAN AND COST ESTIMATE

[***]

Appendix B

XOMA ACCEPTANCE CRITERIA

[***]

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: November 2, 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, J. David Boyle II, 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: November 2, 2005

/s/ J. David Boyle II

J. David Boyle II
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 September 30, 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: November 2, 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 September 30, 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: November 2, 2005

/s/ J. David Boyle II

J. David Boyle II
Vice President, Finance and Chief Financial Officer

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

News Release

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

XOMA Reports Third Quarter 2005 Financial Results
****

Highlights: Multiple Myeloma Phase I with Chiron, New Cubist Contract and BCE Licenses

Berkeley, CA – November 2, 2005 — XOMA Ltd. (Nasdaq: XOMA), a leader in discovery and development of antibody therapeutics for cancer and immunological disorders, today announced its financial results for the quarter and year to date ended September 30, 2005.

For the third quarter of 2005, the Company reported a net loss of ($9.0) million or ($0.10) per share on a fully diluted basis, compared with a net loss of ($20.1) million or ($0.24) per share in the third quarter of 2004. These results reflect higher revenues, reduced R&D expenses and the elimination of losses from the RAPTIVA® collaboration agreement with Genentech, Inc. (NYSE: DNA) that was restructured in January of 2005.

For the first nine months of 2005, XOMA recorded net income of $12.5 million or $0.13 per share (fully diluted), a figure that includes a non-recurring gain of $40.9 million, recognizing the extinguishment of a long-term loan due to Genentech as part of the January 2005 restructuring.

As of September 30, 2005, XOMA held $45.8 million in cash, cash equivalents and short-term investments, compared with $24.3 million at December 31, 2004, primarily due to proceeds of a financing completed in February of 2005. A more detailed discussion of XOMA's financial results is provided below and in XOMA's third quarter 2005 Form 10-Q filing.

"The new contract with Cubist, along with the NIAID agreement, increases utilization of our antibody development and manufacturing infrastructure and brings in revenues," said David Boyle, XOMA's chief financial officer. "With the higher revenues and reduced spending in the first nine months of 2005, XOMA has cut its operating loss to less than half of levels for the same period in 2004, demonstrating continued progress towards our goal of sustainable profitability."

Third Quarter 2005 highlights

- Chiron Corporation (Nasdaq: CHIR) and XOMA commenced Phase I clinical testing of CHIR-12.12 in multiple myeloma subjects. A Phase I study in chronic lymphocytic leukemia (CLL) is ongoing. XOMA and Chiron are evaluating CHIR-12.12 for additional B-cell malignancies.
- Wyeth (NYSE: WYE) was granted a non-exclusive worldwide license to XOMA's bacterial cell expression (BCE) system. Crucell expanded their existing BCE license to include certain phage display applications. XOMA has now granted BCE licenses to approximately 40 companies, two of which have products in Phase III trials; if these products are approved, XOMA would be due royalties.
- Cubist and XOMA established a strategic antibody manufacturing relationship with an initial agreement under which XOMA will develop new processes to manufacture a novel two-antibody biologic (HepeX-B™) in quantities sufficient to conduct Phase III clinical trials.
- As disclosed by Genentech on October 10th, RAPTIVA® sales for the United States were $20.9 million for the third quarter of 2005 compared to $16.3 million for the same quarter of 2004. International sales for the third quarter of 2005 increased to $10.0 million as disclosed by Serono S.A A. (virt-x:

SEO and NYSE: SRA) on October 25th. XOMA is entitled to a royalty on worldwide sales of RAPTIVA® in all indications.

- XOMA is developing several compounds under its internal product development programs. In the BPI program, NEUPREX® is undergoing investigator sponsored studies and XOMA is evaluating its use for biodefense indications.
- Another molecule in internal development, XMA005.2, a novel, high-affinity antibody, is in preclinical evaluation for arthritis indications.
- Alan M Solinger, MD, joined XOMA as vice president of clinical immunology, bringing extensive medical and development experience to support XOMA's internal and collaborative clinical programs.

"I'm pleased with the progress of our two multiple-antibody collaborations, with Chiron and Lexicon, as well as with signing a second antibody development and manufacturing contract, with Cubist," said John L. Castello, president, chairman and CEO of XOMA. "Through such strategic collaborations and manufacturing contracts, XOMA continues to fill the product development pipeline and strengthen our financial position."

Financial Discussion

Revenues

Revenues for the three months ended September 30, 2005 were $4.4 million, compared with $0.6 million for the three months ended September 30, 2004. Revenues for the first nine months of 2005 increased to $12.6 million from $1.5 million in the first nine months of 2004.

License and collaborative fee revenues increased to $0.9 million in the third quarter, compared with $0.5 million for the same period of 2004. These include upfront and milestone payments related to the outlicensing of XOMA products and technologies and other collaborative arrangements.

Contract revenues increased to $1.9 million for the third quarter of 2005, compared with zero in the third quarter of 2004, primarily due to clinical trial services performed on behalf of Genentech and recognition of revenues for contract manufacturing services performed under the NIAID contract that began in March of 2005.

Royalties recorded for the three months ended September 30, 2005 increased to $1.7 million, compared with $29,000 for the 2004 quarter, primarily reflecting RAPTIVÂ® royalties earned under the restructured arrangement with Genentech. Beginning on January 1, 2005, XOMA earns a mid-single digit royalty on sales of RAPTIVA® worldwide.

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

Expenses

Research and development expenses for the three months ended September 30, 2005 decreased to $9.4 million from $12.6 million for the third quarter of 2004. This reflects reduced spending on MLN2222, XMP.629, RAPTIVA®, the TPO-mimetic and new product research, partially offset by increased spending on the Chiron oncology, Aphton anti-gastrin antibody collaborations, the NIAID contract and the Lexicon collaboration. General and administrative expenses decreased to $3.2 million and $10.7 million for the third quarter and first nine months of 2005 as compared with $4.0 million and $11.5 million the same periods in 2004.

Collaborative arrangement expenses, which related exclusively to RAPTIVA®, were zero for the three and nine months ended September 30, 2005. These expenses were $3.9 million and $12.3 million for the three and nine months ended September 30, 2004, respectively. The 2004 amount represents XOMA's 25% share of commercialization costs for RAPTIVA®, in excess of Genentech's revenues, less cost of goods sold and R&D cost-sharing arrangements. Under 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 is 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 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 September 30, 2005 balance sheet as convertible long-term debt.

Under its collaborative arrangement with XOMA, Chiron has made available a $50.0 million credit facility under which XOMA can receive financing for up to 75% of its share of development expenses. In June of 2005, XOMA drew down an initial $8.8 million under this facility.

Liquidity and Capital Resources

Cash, cash equivalents and short-term investments at September 30, 2005 were $45.8 million, compared with $24.3 million at December 31, 2004. The $21.5 million increase primarily reflects cash proceeds of $56.6 million from the February 2005 financing plus a June 2005 drawdown of $8.8 million under the Chiron loan, partially offset by cash used in operations of $41.1 million. Cash used in operations for the nine months ending September 30, 2005 include a $14.3 million decrease in accrued liabilities and a $3.5 million increase in accounts receivables.

Product Highlights

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

This anti-CD11a antibody therapeutic, developed through a collaboration between Genentech and XOMA, received US Food and Drug Administration (FDA) approval in October of 2003 for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy.

Outside the United States and Japan, RAPTIVA® is sold by Serono SA, which received European Commission Marketing Authorisation in September of 2004 to treat patients with moderate-to-severe chronic plaque psoriasis for whom other systemic treatments or phototherapy have been inadequate or inappropriate. RAPTIVA® is now approved in 44 countries worldwide.

In the third quarter of 2005, Genentech reported US sales increased 28% to $20.9 million, from $16.3 million in the third quarter of 2004. Serono reported international sales of $10.0 million, an increase of 932.6% over the third quarter of 2004. For the first nine months of 2005, US sales of RAPTIVA® were reported to be $58.8 million compared to approximately $37.7 million for the same period last year. Sales of RAPTIVA® outside of the US for the first nine months of 2005 were reported to be $21.9 million compared to $1.2 million for the same period in 2004.

Oncology Therapeutic Antibodies Collaboration with Chiron

In October 2005, Chiron and XOMA initiated a second clinical trial of CHIR 12.12, a fully human, antagonist antibody that targets the CD40 antigen. This single agent, open-label Phase I study will evaluate the drug's safety, dose tolerability and pharmacokinetic profile in up to 40 subjects with multiple myeloma, using translational medicine to monitor biomarkers and correlate them with responses to therapy, guiding the dose regimen and selection of subjects.

Multiple myeloma (MM) is a progressive cancer of plasma cells (B-lymphocytes), key components of the human immune system that produce antibodies to fight infection. As the second most prevalent blood cancer after non-Hodgkin's lymphoma, nearly 16,000 new MM cases are expected in 2005 and 50,000 Americans currently live with the disease.

A similar Phase I study is already underway at three leading cancer centers in the United States in up to 40 subjects with advanced CLL. Chiron and XOMA are also evaluating clinical testing of CHIR-12.12 in patients with other B-cell cancers. Under an agreement announced in March of 2004, the companies are jointly researching and developing multiple antibody product candidates, sharing expenses and revenues, generally on a 70-30 basis, with XOMA's share being 30%.

Lexicon Genetics Collaboration

This three-year collaboration, announced in June of 2005, combines Lexicon's biotherapeutics target discovery capabilities with XOMA's antibody generation platform to speed the development of novel therapeutic antibodies. Lexicon selects targets from its Genome 5000™ gene knockout technology program; XOMA generates and engineers antibody candidates for development using its phage display libraries and Human Engineering™ technology, and will be principally responsible for manufacturing antibodies for clinical trials and commercialization. Costs and profits will be allocated 65/35 between Lexicon and XOMA, respectively.

As an initial target, XOMA and Lexicon have already selected a secreted protein involved in metabolic functions such as insulin sensitivity and weight gain in response to diet. Antibodies to this target may be developed to treat obesity, type 2 diabetes and other metabolic diseases.

Antibody Process Development and Manufacturing Contracts

In September, XOMA established a strategic antibody manufacturing relationship with Cubist Pharmaceuticals. Under this agreement, XOMA will develop new processes to manufacture a novel two-antibody biologic (HepeX-B™) in quantities sufficient to conduct Phase III clinical trials. HepeX-B™ is a combination of two fully human monoclonal antibodies that target the hepatitis B virus (HBV) surface. The product, which has been granted Orphan Drug Status in both the U.S. and the European Union, is currently in evaluation in Phase III trials for the prevention of HBV re-infection in liver transplant patients. If these trials are successful, the companies may extend the relationship to a commercial supply agreement for product launch.

Already in progress is a $15.0 million, 18-month contract to develop and manufacture three monoclonal antibodies as biodefense agents against botulinum neurotoxin. XOMA was awarded this contract in March of 2005 by the National Institute of Allergy and Infectious Diseases (NIAID), a part of the National Institutes of Health, and it is 100% funded with federal funds from NIAID under Contract No. HHSN266200500004C.

XOMA Internal Programs:

BPI

XOMA remains committed to the future development of drugs from its BPI platform, including its NEUPREX® formulation. The safety profile of NEUPREX® continues to be an attractive clinical feature evidenced by ongoing investigator-sponsored studies. Several clinical investigators are conducting or plan to conduct studies in target indications including pediatric open-heart surgery, burns and bone marrow transplant (BMT). The BMT studies may provide proofs of concept for acute radiation syndrome for possible biodefense application. XOMA has decided to cease investigating at this time the use of NEUPREX® as a possible treatment for plague.

XMA005.2

This Human-Engineered™ monoclonal antibody is a high-affinity molecule, with potent inhibitory activity against its inflammatory target. This high potency means that it may be suitable for use as a monthly-dose injectable therapeutic. XOMA is currently evaluating XMA005.2 in preclinical studies targeting multiple indications, including osteoarthritis and rheumatoid arthritis, where monthly dosing could be a significant marketing advantage. The company plans to start clinical testing for this molecule in the first half of 2007.

Bacterial Cell Expression (BCE) System License Program

XOMA has built a development infrastructure for producing antibodies in bacteria that includes proprietary capabilities and a strong patent portfolio. Bacterial cell expression (BCE) is an enabling technology used to discover and screen, as well as develop and manufacture, recombinant proteins and antibodies for commercial purposes. BCE is an essential technology used in multiple systems for high-throughput screening of antibody domains, including expression of antibodies by phage display. With a growing market for antibody therapeutics and the increasing use of phage display for antibody discovery, licenses to XOMA's BCE technology assets have become increasingly attractive to companies engaged in biopharmaceutical discovery and development.

In September of 2005, XOMA announced the grant of a non-exclusive, worldwide license to Wyeth for use of XOMA's BCE technology. In October, XOMA announced that Crucell has expanded its existing BCE license to improve Crucell's ability to perform phage display in the field of infectious disease with third party collaborators.

To date, XOMA has granted BCE licenses to approximately 40 companies, many of which are applicable to products in early phases of development. Two antibody products in late-stage clinical testing are manufactured under license using XOMA's BCE technologies. These are Celltech Group plc's CIMZIA™ anti-TNF alpha antibody fragment in trials for Crohn's disease and rheumatoid arthritis, and Genentech's Lucentis™ (ranibizumab) antibody fragment against Vascular Endothelial Growth Factor (VEGF) in trials for wet age-related macular degeneration. It is XOMA's policy to disclose its license interest in such products when they reach Phase III development.

Investor Conference Call

XOMA has scheduled an investor conference call regarding this announcement to be held tomorrow, Thursday, November 3, 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 1132738. 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 December 5, 2005. Access numbers for the replay are 1-800-642-1687 (U.S./Canada) or 1-706-645-9291 (International); Conference I.D. is the same as for the call: 1132738.

About XOMA

XOMA is a pioneer and leader in the discovery, development and manufacture of therapeutic antibodies, with a therapeutic focus that includes cancer and immune diseases. XOMA has a royalty interest in RAPTIVA® (efalizumab), a monoclonal antibody product marketed worldwide (by Genentech, Inc. and Serono, SA) to treat moderate-to-severe plaque psoriasis. XOMA's discovery and development capabilities include antibody phage display, bacterial cell expression (BCE), and Human Engineering™ technologies, plus a fully integrated drug development infrastructure. XOMA's development collaborators include Aphton Corporation, Chiron Corporation and Lexicon Genetics Incorporated. The company pipeline also includes proprietary programs in preclinical and clinical development. 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, its goal of sustainable profitability, future sales of RAPTIVA® and development of RAPTIVA® and CHIR 12.12, 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; XOMA's ability to achieve profitability will depend on the success of the sales efforts for RAPTIVA®, revenues related to manufacturing and development services it provides, its ability to effectively manage and anticipate its expenditures and the availability of capital market and other financing. The sales efforts for RAPTIVA® may not be successful if Genentech, Inc. or its partner, Serono S.A., 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® or CHIR 12.12 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, quarterly report on Form 10-Q and other SEC filings.

Condensed Financial Statements Follow

XOMA Ltd.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2005 (unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 14,584	$ 23,808
Short-term investments	31,194	511
Receivables	4,366	707
Related party receivables	96	167
Prepaid expenses	2,022	1,414
Total current assets	52,262	26,607
Property and equipment, net	18,549	19,306
Related party receivables – long-term	130	188
Deposits and other	3,086	159
Total assets	$ 74,027	$ 46,260
LIABILITIES AND SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)		
Current liabilities:		
Accounts payable	$ 2,454	$ 1,919
Accrued liabilities	5,789	19,331
Notes payable	—	116
Capital lease obligations	49	237
Deferred revenue	3,048	2,000
Total current liabilities	11,340	23,603
Deferred revenue – long-term	4,833	6,333
Convertible debt – long-term	60,000	—
Interest bearing obligation – long-term	8,844	40,934
Total liabilities	85,017	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, 210,000,000 shares authorized, 86,294,010 and 85,587,174 shares outstanding at September 30, 2005 and December 31, 2004, respectively	43	43
Additional paid-in capital	654,965	653,537
Accumulated comprehensive (loss) income	(32)	280
Accumulated deficit	(665,967)	(678,471)
Total shareholders' equity (net capital deficiency)	(10,990)	(24,610)
Total liabilities and shareholders' equity (net capital deficiency)	$ 74,027	$ 46,260

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

	Three months ended September 30,		Nine months ended September 30,	
	2005	2004	2005	2004
Revenues:				
License and collaborative fees	$ 856	$ 530	$ 4,036	$ 1,442
Contract revenue	1,858	—	4,050	—
Royalties	1,712	29	4,492	65
Total revenues	4,426	559	12,578	1,507
Operating costs and expenses:				
Research and development (including contract related of $956 and $2,741, respectively, for the three and nine months ended September 30, 2005, and zero for the same periods of 2004)	9,383	12,562	28,932	38,439
General and administrative	3,243	4,015	10,703	11,538
Collaboration arrangement	—	3,857	—	12,286
Total operating costs and expenses	12,626	20,434	39,635	62,263
Loss from operations	(8,200)	(19,875)	(27,057)	(60,756)
Other income (expense):				
Investment and interest income	454	158	1,441	452
Interest expense	(1,236)	(307)	(3,014)	(925)
Other income (expense)	(10)	(119)	41,174	(125)
Income (loss) from operations before income taxes	(8,992)	(20,143)	12,544	(61,354)
Provision for income taxes	2	—	40	—
Net income (loss)	$ (8,994)	$ (20,143)	$ 12,504	$ (61,354)
Basic net income (loss) per common share	$ (0.10)	$ (0.24)	$ 0.15	$ (0.73)
Diluted net income (loss) per common share	$ (0.10)	$ (0.24)	$ 0.13	$ (0.73)
Shares used in computing basic net income (loss) per common share	86,277	85,284	86,091	84,619
Shares used in computing diluted net income (loss) per common share	86,277	85,284	117,666	84,619