Xencor Inc
Form 10-Q
May 15, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

or

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

Commission file number: 001-36182

Xencor, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-1622502**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
111 West Lemon Avenue, Monrovia, CA	**91016**
(Address of Principal Executive Offices)	(Zip Code)

(626) 305-5900

(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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer o Accelerated filer o Non-accelerated filer x Smaller reporting company o

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

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

Class	**Outstanding at April 30, 2014**
Common stock, $0.01 par value	31,361,493

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Xencor, Inc.

Quarterly Report on FORM 10-Q for the quarter ended March 31, 2014

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In this report, unless otherwise stated or the context otherwise indicates, references to Xencor, the company, we, us, our and similar referenc refer to Xencor, Inc. The Xencor logo is a registered trademark of Xencor, Inc. This report also contains registered marks, trademarks and trade names of other companies. All other trademarks, registered marks and trade names appearing in this report are the property of their respective holders.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of federal securities laws. Forward-looking statements include statements that may relate to our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs and other information that is not historical information. Many of these statements appear, in particular, under the headings Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations . Forward-looking statements can often be identified by the use of terminology such as subject to , believe , anticipate , plan , expect , intend , estimate , proj will , should , would , could , can , the negatives thereof, variations thereon and similar expressions, or by discussions of strategy.

All forward-looking statements, including, without limitation, our examination of historical operating trends, are based upon our current expectations and various assumptions. We believe there is a reasonable basis for our expectations and beliefs, but they are inherently uncertain. We may not realize our expectations, and our beliefs may not prove correct. Actual results could differ materially from those described or implied by such forward-looking statements. The following uncertainties and factors, among others (including those set forth under Risk Factors), could affect future performance and cause actual results to differ materially from those matters expressed in or implied by forward-looking statements:

- our plans to develop and commercialize our product candidates;
- our ongoing and planned clinical trials;
- the timing of and our ability to obtain and maintain regulatory approvals for our product candidates;
- our estimates regarding expenses, future revenue, capital requirements and needs for additional financing;
- our ability to identify additional products or product candidates with significant commercial potential that are consistent with our business objectives;
- the rate and degree of market acceptance and clinical utility of our products;
- the capabilities and strategy of our suppliers and vendors including key manufacturers of our clinical drug supplies;

- significant competition in our industry;
- costs of litigation and the failure to successfully defend lawsuits and other claims against us;
- our partners ability to advance drug candidates into, and successfully complete, clinical trials;
- our ability to receive research funding and achieve anticipated milestones under our collaborations;
- our intellectual property position;
- loss or retirement of key members of management;
- costs of compliance and our failure to comply with new and existing governmental regulations;
- failure to successfully execute our growth strategy, including any delays in our planned future growth; and
- our failure to maintain effective internal controls.

Consequently, forward-looking statements should be regarded solely as our current plans, estimates and beliefs. You should not place undue reliance on forward-looking statements. We cannot guarantee future results, events, levels of activity, performance or achievements. We do not undertake and specifically decline any obligation to update, republish or revise forward-looking statements to reflect future events or circumstances or to reflect the occurrences of unanticipated events.

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PART I FINANCIAL INFORMATION

Item1. Financial Statements

Xencor, Inc.

Condensed Balance Sheets

(In thousands, except share amounts)

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Current assets		
Cash	$ 72,536	$ 77,975
Accounts receivable	511	59
Prepaid expenses and other current assets	159	60
Total current assets	73,206	78,094
Property and equipment		
Computers, software and equipment	3,580	3,514
Furniture and fixtures	89	89
Leasehold improvements	3,081	3,081
Less accumulated depreciation and amortization	(6,410)	(6,377)
Property and equipment, net	340	307
Other assets		
Patents, licenses, and other intangible assets, net	8,899	8,814
Other assets	50	100
Total other assets	8,949	8,914
Total assets	$ 82,495	$ 87,315
Liabilities and stockholders equity		
Current liabilities		
Accounts payable	$ 2,104	$ 2,633
Accrued expenses	1,465	1,393
Current portion of deferred revenue	3,251	3,444
Current portion of capital lease obligations	7	9
Total current liabilities	6,827	7,479
Deferred revenue, less current portion	5,603	6,302
Capital lease obligations, less current portion		1
Total liabilities	12,430	13,782
Commitments and contingencies		
Stockholders equity		
Common stock, $0.01 par value: 200,000,000 authorized shares at March 31, 2014 and December 31, 2013; 31,361,444 issued and outstanding at March 31, 2014 and 31,354,467 issued and outstanding shares at December 31, 2013	314	314
Additional paid-in capital	301,073	300,790
Accumulated deficit	(231,322)	(227,571)

Total stockholders equity		70,065		73,533
Total liabilities and stockholders equity	$	82,495	$	87,315

The accompanying notes are an integral part of these unaudited condensed financial statements.

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Xencor, Inc.

Condensed Statements of Operations

(unaudited)

(In thousands, except share and per share amounts)

	Three Months ended March 31,	
	2014	**2013**
Revenue		
Collaborations, licenses and milestones	$ 2,184	$ 1,345
Operating expenses		
Research and development	4,228	4,560
General and administrative	1,723	746
Total operating expenses	5,951	5,306
Loss from operations	(3,767)	(3,961)
Other income (expenses)		
Interest income	18	1
Interest expense	(2)	(661)
Other (expense) income		9
Total other income (expense), net	16	(651)
Net loss	$ (3,751)	$ (4,612)
Basic and diluted net loss per common share	$ (0.12)	$ (63.78)
Weighted average shares used to compute basic and diluted net loss per common share	31,360,879	72,302

The accompanying notes are an integral part of these unaudited condensed financial statements.

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Xencor, Inc.

Condensed Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months ended March 31,	
	2014	**2013**
Cash flows from operating activities		
Net loss	$ (3,751)	$ (4,612)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	320	139
Stock-based compensation	278	5
Abandonment of capitalized intangible assets	10	168
Gain on disposal of assets		(9)
Accrued interest on convertible promissory notes (See Note 3)		660
Changes in operating assets and liabilities:		
Accounts receivable	(452)	(172)
Prepaid expenses and other current assets	(99)	
Other assets	50	
Accounts payable	(529)	1,610
Accrued expenses	72	(565)
Deferred revenue	(892)	4,422
Net cash (used in) provided by operating activities	(4,993)	1,646
Cash flows from investing activities		
Purchase of intangible assets	(382)	(521)
Purchase of property and equipment	(66)	(36)
Proceeds from sale of property and equipment		9
Net cash used in investing activities	(448)	(548)
Cash flows from financing activities		
Proceeds from issuance of common stock upon exercise of stock awards	4	
Payments on capital lease obligations	(2)	(2)
Net cash provided by (used in) financing activities	2	(2)
Net increase (decrease) in cash	(5,439)	1,096
Cash, beginning of period	77,975	2,312
Cash, end of period	$ 72,536	$ 3,408
Supplemental disclosures of cash flow information		
Cash paid for:		
Interest	$ 2	$
Taxes	$	$

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

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Xencor, Inc.

Notes to Condensed Financial Statements

March 31, 2014

1. Description of Business

Xencor, Inc. (we, us, our, or the Company) was incorporated in California in 1997 and reincorporated in Delaware in September 2004. We are a clinical-stage biopharmaceutical company focused on discovering and developing engineered monoclonal antibodies to treat severe and life-threatening diseases with unmet medical needs. We use our proprietary XmAb technology platform to create next-generation antibody product candidates designed to treat autoimmune and allergic diseases, cancer, and other conditions. Our engineered Fc domains, the XmAb technology, are applied to our pipeline of antibody-based drug candidates to increase immune inhibition, improve cytotoxicity, or extend half-life. We also enter into collaborations with pharmaceutical companies to allow them to use our XmAb technology in their drug development activities.

Our operations are based in Monrovia, California and we operate in one segment.

Unaudited Interim Financial Information

The accompanying financial information as of March 31, 2014 is unaudited. The Condensed Financial Statements included in this report reflect all adjustments (consisting only of normal recurring adjustments) that our management considers necessary for the fair statement of results of operations for the interim periods covered and of the financial condition of the Company at the date of the interim balance sheet. December 31, 2013 balances were derived from the audited Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2013 filed with the Securities and Exchange Commission on March 31, 2104. The accompanying Condensed Balance Sheet does not include all the disclosures required by generally accepted accounting principles in the United States of America, or GAAP. The results for interim periods are not necessarily indicative of the results for the entire year or any other interim period. The accompanying Condensed Financial Statements and related financial information should be read in conjunction with the audited financial statements and the related notes thereto for the year ended December 31, 2013 included in the Company s Annual Report on Form 10-K.

Initial Public Offering

We completed our initial public offering (IPO) in December 2013, pursuant to which we issued 14,639,500 shares of common stock which included shares we issued pursuant to our underwriters exercise of their over-allotment option, and received net proceeds of $72.5 million, after

underwriting discounts, commissions and estimated offering expenses. In addition, in connection with the completion of our IPO, all then outstanding convertible preferred stock converted into common stock.

2. Summary of Significant Accounting Policies

Use of Estimates

The preparation of the financial statements in accordance with GAAP requires the Company to make estimates and judgments in certain circumstances that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. In preparing these financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. On an ongoing basis, the Company evaluates its estimates, including those related to revenue recognition, fair values of assets, convertible preferred stock and common stock, income taxes, pre-clinical study and clinical trial accruals and other contingencies. Management bases its estimates on historical experience or on various other assumptions that it believes to be reasonable under the circumstances. Actual results could materially differ from these estimates.

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Reverse Stock Split

On November 1, 2013, the Company affected a 1 for 3.1 reverse stock split. All information in this report relating to the number of shares, price per share and per share amounts of stock prior to November 1, 2013 gives retroactive effect to the 1 for 3.1 reverse stock split of the Company s stock.

Research and Development Expenses

Costs incurred in research and development activities are expensed as incurred, including expenses that may or may not be reimbursed under research and development collaboration agreements. Research and development costs include, but are not limited to, salaries, benefits, stock-based compensation, laboratory supplies and equipment, allocated overhead, fees for professional service providers and costs associated with product development efforts, including preclinical studies and clinical trials.

The Company estimates preclinical study and clinical trial expenses based on the services performed, pursuant to contracts with research institutions and clinical research organizations that conduct and manage preclinical studies and clinical trials on its behalf. In accruing service fees, the Company estimates the time period over which services will be performed and the level of effort to be expended in each period. If the actual timing of the performance of services or the level of effort varies from the estimate, the Company will adjust the accrual accordingly. Payments made to third parties under these arrangements in advance of the receipt of the related services are recorded as prepaid expenses until the services are rendered.

Fair Value of Financial Instruments

Our financial instruments primarily consist of cash, trade accounts receivable, convertible promissory notes, accounts payable and accrued expenses. The fair value of cash and cash equivalents, trade accounts receivable, convertible promissory notes, accounts payable and accrued expenses closely approximate their carrying value due to their short maturities. The carrying amounts of convertible promissory notes approximate their fair value, as the interest rates, in consideration of the conversion feature, approximate the interest rates presently available to us.

We determine the fair value of the principal amount of financial and nonfinancial assets and liabilities using the fair value hierarchy, which describes three levels of inputs that may be used to measure fair value, as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities;

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Level 1 assets consist of highly-liquid money market funds. There were no transfers between Level 1 and Level 2 assets during the periods presented.

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The assets recorded at fair value are classified within the hierarchy as follows for the periods reported (in millions):

	March 31, 2014		March 31, 2013	
	Total Fair Value	Level 1	Total Fair Value	Level 1
Money Market Funds	$	$	$ 3.3	$ 3.3

For disclosure purposes at March 31, 2014 and March 31, 2013 the fair value of the principal amount of our outstanding convertible promissory notes are classified within the hierarchy as follows (in millions):

	March 31, 2014		March 31, 2013	
	Total Fair Value	Level 3	Total Fair Value	Level 3
Convertible Promissory Notes	$	$	$ 15.1	$ 15.1

These convertible promissory notes were originally issued during 2009 and 2010. Considering 1) the lack of time value, 2) the absence of an established market for the convertible promissory notes, and, 3) our knowledge of the terms, rates, risk and returns provided by the convertible promissory notes as compared to financing available for privately-held biopharmaceutical companies, we determined that the carrying value of the convertible promissory notes approximates their fair value. There were no transfers between Level 3, Level 2 and, Level 1 during the periods presented.

Net Loss Per Share of Common Stock

We compute net loss per common share by dividing the net loss attributable to common stockholders by the weighted-average number of common shares outstanding during the period. Potentially dilutive securities consisting of stock options, convertible preferred stock and convertible promissory notes are not included in the diluted net loss per common share calculation for all periods presented, because the inclusion of such shares would have had an antidilutive effect.

	Three Months Ended March 31,	
	2014	2013
	(in thousands, except per share amounts)	
Basic and diluted numerator:		
Net loss attributable to common stockholders	$ (3,751)	$ (4,612)
Denominator:		
Weighted-average common shares outstanding- basic and diluted	31,360,879	72,302
Basic and diluted net loss per common share	$ (0.12)	$ (63.78)

For the three months ended March 31, 2014 and March 31, 2013, we excluded the following securities from the calculation of diluted net loss per share as the effect would have been antidilutive.

	As of March 31,	
	2014	2013
	(in thousands)	
Convertible preferred stock		12,189
Convertible promissory notes		2,845
Employee stock purchase plan shares	45	
Options to purchase common stock	1,213	1,277
	1,258	16,311

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Revenue Recognition

We have, to date, earned revenue from research collaborations, which may include research and development services, licenses of our internally-developed technologies, or a combination of both. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; transfer or access of technology has been completed or services have been rendered; our price to the customer is fixed or determinable and collectability is reasonably assured.

The terms of our licensing and research and development agreements include non-refundable upfront fees, licensing fees, contingent payment and contractual obligations for the achievement of pre-defined preclinical, clinical, regulatory and sales based events. The agreements also include royalties on sales of any commercialized products.

Multiple-Element Revenue Arrangements. Certain of our collaboration and license agreements represent multiple-element revenue arrangements. To account for such transactions, we determine the elements, or deliverables, included in the arrangement and determine which deliverables are separate units for accounting purposes. We consider delivered items to be separate units of accounting if the delivered items have stand-alone value to the customer. If the delivered items are separate units we allocate the consideration received or due under the arrangement to the various elements based on each elements relative selling price.

Milestone Revenue. Our collaboration and license agreements generally include contingent contractual payments related to achievement of specific research, development and regulatory milestones and sales-based milestones that are based solely upon the performance of the licensor or collaborator. Research, development and regulatory contingent contractual payments and milestone payments are typically payable under our collaborations when our collaborator selects a compound, or initiates or advances a covered product candidate in preclinical or clinical development, upon submission for marketing approval of a covered product with regulatory authorities, upon receipt of actual marketing approvals of a covered product or for additional indications, or upon the first commercial sale of a covered product. Sales-based contingent contractual payments are typically payable when annual sales of a covered product reach specific levels.

We recognize any payment that is contingent upon the achievement of a substantive milestone entirely in the period in which the milestone is achieved. A milestone is defined as an event that can only be achieved based in whole or in part either on our performance, or the performance of our collaborators, or the occurrence of a specific outcome resulting from our past performance for which there is a substantive uncertainty at the date the arrangement is entered into that the event will be achieved.

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Long-Lived Assets

Management reviews long-lived and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset (or asset group) may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value for our long-lived assets is determined using the expected cash flows discounted at a rate commensurate with the risks involved.

Stock-Based Compensation

We recognize compensation expense using a fair-value-based method for costs related to all share-based payments, including stock options and stock issued under our 2013 Employee Stock Purchase Plan (ESPP). Stock-based compensation cost related to employees and directors is measured at the grant date, based on the fair-value based measurement of the award using the Black-Scholes method, and is recognized as expense over the requisite service period on a straight-line basis. We are required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. We recorded stock-based compensation expense for stock-based awards to employees and directors of approximately $278,000 and $5,000 for the three months ended March 31, 2014 and 2013, respectively.

The expected term for purchases under the ESPP was based on the purchase periods included in the offering. The expected volatility is determined using historical volatilities of similar peer companies based on stock prices over a look-back period corresponding to the expected term. The risk-free interest rate was determined using the yield available for zero-coupon U.S. government issues with a remaining term equal to the expected term. The forfeiture rate was determined to be zero as there is insufficient historical pre-vesting forfeiture rate information since the inception of the plan. The Company has never paid a dividend, and as such, the dividend yield is zero. See Note 4 for further information on the ESPP.

Options granted to individual service providers that are not employees or directors are accounted for at estimated fair value using the Black-Scholes option-pricing method and are subject to periodic re-measurement over the period during which the services are rendered.

Concentrations of Risk

Cash is maintained at financial institutions and, at times, balances may exceed federally insured limits. Amounts on deposit in excess of federally insured limits at March 31, 2014 approximated $72.0 million.

A significant portion of our revenue was earned from four partners for the three months ended March 31, 2014 and from three partners for the three months ended March 31, 2013. The following table represents the amounts (in millions) and the percentage of all significant revenue

earned in the periods indicated:

	Three Months Ended March 31,			
	2014		2013	
	Amounts	Percentages	Amounts	Percentages
Alexion	$ 0.3	11.4%	$ 0.1	12.4%
Amgen	0.6	25.6%	0.6	41.5%
CSL	0.7	32.5%	0.6	43.7%
Merck	0.5	22.9%		
Other	0.1	7.6%	0.03	2.4%

As of March 31, 2014, $0.5 million in accounts receivable was due from one partner; as of March 31, 2013, $0.5 million in accounts receivable was due from another partner.

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Patents, Licenses, and Other Intangible Assets

The cost of acquiring licenses is capitalized and amortized on the straight-line basis over the shorter of the term of the license or its estimated economic life, ranging from five to 25 years. Third-party costs incurred for acquiring patents are capitalized. Capitalized costs are accumulated until the earlier of the period that a patent is issued or we abandon the patent claims. Cumulative capitalized patent costs are amortized on a straight-line basis from the date of issuance over the shorter of the patent term or the estimated useful economic life of the patent, ranging from 13 to 20 years. The carrying value of intangible assets is evaluated when indicators of impairment are identified. We review the license arrangements and the amortization period on a regular basis and adjust the carrying value or the amortization period of the licensed rights if there is evidence of a change in the carrying value or useful life of the asset.

3. Convertible Promissory Notes and Conversion of Convertible Preferred Stock

As of March 31, 2013, the Company had $21.6 million in outstanding convertible promissory notes which included $15.1 million in principal and $6.5 million in accrued interest. The notes carried an accrued interest rate of 12.5% and included contingent redemption features which provided that the notes would convert into preferred stock upon certain liquidation or change of control events. During June 2013, the convertible promissory notes were exchanged for convertible preferred stock. In connection with the completion of the Company s IPO in December 2013, all outstanding shares of convertible preferred stock converted into 16,620,274 shares of common stock.

4. Equity Incentive Plans

Our Board of Directors and the requisite stockholders previously approved the Amended and Restated 2000 Stock Incentive Plan, or the 2000 Plan, and the 2010 Equity Incentive Plan, or the 2010 Plan, and collectively with the 2000 Plan the Prior Plans. The 2000 Plan terminated August 2010. In November 2013, our Board of Directors and stockholders approved the 2013 Equity Incentive Plan, or the 2013 Plan. The 2013 Plan became effective as of December 3, 2013 the date of the Company s IPO. As of December 2, 2013, we suspended the 2010 Plan and no additional awards may be granted under the 2010 Plan. Any shares of common stock covered by awards granted under the Prior Plans that terminate after December 2, 2013 by expiration, forfeiture, cancellation or other means without the issuance of such shares will be added to the 2013 Plan reserve.

As of March 31, 2014, the total number of shares of common stock available for issuance under the 2013 Plan was 5,418,943, which includes 2,662,065 of common stock that were available for issuance under the Prior Plans as of the effective date of the 2013 Plan. Unless otherwise determined by the Board, beginning January 1, 2014, and continuing until the expiration of the 2013 Plan, the total number of shares of common stock available for issuance under the 2013 Plan will automatically increase annually on January 1 by 4% of the total number of issued and outstanding shares of common stock as of December 31 of the immediate preceding year. On January 1, 2014, the total number of shares of common stock available for issuance under the 2013 Plan was automatically increased by 1,254,179 shares, which number is included in the number of shares available for issuance above. As of March 31, 2014 715,500 options had been issued under the 2013 Plan.

In November 2013, our Board of Directors and stockholders approved the 2013 Employee Stock Purchase Plan, or the ESPP, which became effective as of December 5, 2013. Under the ESPP our employees may elect to have between 1-15% of their compensation withheld to purchase Company stock at a discount. The ESPP has an initial two year term that includes four six month purchase periods and employee withholding

amounts may be used to purchase Company stock during each six month purchase period. The total number of shares that can be purchased with the withholding amounts are based on the lower of 85% of the Company s stock price at the initial offering date or, 85% of the Company s stock price at each purchase date. We have reserved a total of 581,286 shares of common stock for issuance under the ESPP. Unless otherwise determined by our Board, beginning on January 1, 2014, and continuing until the expiration of the ESPP, the total number shares of common stock available for issuance under the ESPP will automatically increase annually on January 1 by the lesser of (i) 1% of the total number of issued and outstanding shares of common stock as of December 31 of the immediately preceding year, or (ii) 621,814 shares of common stock. On January 1, 2014, the total number of shares of common stock available for issuance under the ESPP was automatically increased by 313,545 shares, which number is included in the number of shares reserved for issuance above. As of March 31, 2014, we have not issued any shares of common stock under the ESPP.

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The following table summarizes option activity under our 2013 Plan and related information:

	Number of Shares subject to outstanding options		Weighted Average Exercise Price (Per Share)
Balances at December 31, 2013	1,794,214	$	1.66
Options granted	700,500	$	11.20
Options forfeited			
Options exercised	(6,977)	$	0.59
Balance at March 31, 2014	2,487,737	$	4.34

As of March 31, 2014, options to purchase 1,212,950 shares of common stock were outstanding that are vested and therefore exercisable with a weighted-average exercise price of $0.59 per share and a weighted-average remaining contractual life of 3.7 years. The aggregate intrinsic value of options outstanding was $18.4 million. The aggregate intrinsic value of outstanding options that are exercisable was $13.5 million and the intrinsic value of options exercised during the three months ended March 31, 2014 was $78,000. We calculate the intrinsic value as the difference between the exercise price of the options and the closing price of common stock of $11.73 per share as of March 31, 2014.

Total employee, director and non-employee stock-based compensation expense recognized was as follows (in thousands):

	Three Months Ended March 31,			
	2014		2013	
General and administrative	$	128.0	$	3.0
Research and development		150.0		2.0
	$	278.0	$	5.0

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Weighted average fair value of options granted during the period ended March 31, 2014 was $7.44 per share; there were no options granted during the period ended March 31, 2013. We estimated the fair value of each stock option using the Black-Scholes option-pricing model based on the date of grant of such stock option with the following weighted average assumptions for the three months ended March 31, 2014 and 2013:

	Options		ESPP	
	Three Months Ended March 31,		Three Months Ended March 31,	
	2014	2013	2014	2013
Expected term (years)	6.0	6.0	0.5-2.0	
Expected volatility	75.2%	75.2-86.7%	70.6%	
Risk-free interest rate	2.0 1%	2.19%	0.07-0.46%	
Expected dividend yield	0.00%	0.00%	0.00%	

At March 31, 2014, the Company had $4.8 million of total unrecognized compensation expense, net of estimated forfeitures, related to outstanding stock options that will be recognized over the next 3.5 years.

5. Collaboration Research and Licensing Agreements

Following are a summary description of the arrangements that generated revenue in the three month periods ended March 31, 2014 and March 31, 2013.

Amgen, Inc.

In December 2010, we entered into a Collaboration and Option Agreement with Amgen, Inc. (Amgen), pursuant to which we agreed to collaborate with Amgen to research, develop and commercialize XmAb5871. Under the agreement, we granted to Amgen an option to acquire an exclusive license to research, develop, manufacture and commercialize XmAb5871. The term of the option began at the effective date of the Agreement and expires 90 days after delivery of the data from a Phase 2 proof-of-concept (POC) clinical trial. During the option period and prior to Amgen exercising its option under the agreement, we retain ownership of the compound and are responsible for all clinical development of the compound through completion of the Phase 2 POC clinical trial and delivery of the clinical study data for the POC clinical trial. We received a nonrefundable upfront payment of $11.0 million upon execution of the agreement. We are eligible to receive milestone payments through the option period and following the exercise of the option by Amgen, additional milestone payments and royalties. We determined that substantially all of the future milestones and related payments were substantive and contingent and we did not allocate any of the upfront consideration to the milestones.

We determined that the arrangement is one with multiple deliverables and we identified the multiple elements at the inception of the agreement. We determined that the deliverables under the arrangement were the research and development services and the option to acquire the rights to XmAb5871. Since the option is a contingent and a substantive element, no portion of the upfront fee was allocated to it. The upfront payment was allocated to the research and development services and is being recognized ratably over the estimated service period to complete the Phase 2 POC trial and delivery of the clinical study reports to Amgen. We have estimated that the term of the service period to be 72 months from inception of the agreement through completion of the POC trial.

During the first quarter of 2013, we initiated a Phase 1b clinical trial under the arrangement and we received a milestone payment of $2.0 million. We are recognizing that payment over the term in which service under the agreement relate.

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During the three months ended March 31, 2014 we recognized $0.6 million of revenue under this arrangement and during the three months ended March 31, 2013 we recognized $0.6 million of revenue under this arrangement. As of March 31, 2014 we have deferred revenue related to this agreement of $6.3 million.

Merck Sharp & Dohme Corp.

In July 2013, we entered into a License Agreement with Merck Sharp & Dohme Corp (Merck). Under the terms of the agreement, we provided Merck with a non-exclusive commercial license to certain patent rights to our Fc domains to apply to one of their compounds. We also provided Merck with contingent options to take additional non-exclusive commercial licenses. The contingent options provide Merck an opportunity to take non-exclusive commercial licenses at an amount less than the amount paid for the original license. The agreement provided for an upfront payment of $1.0 million and annual maintenance fees totaling $0.5 million. We are also eligible to receive future milestones and royalties as Merck advances the compound into clinical development.

We determined that the deliverables under this agreement were the non-exclusive commercial license and the options. The options are considered substantive and contingent and no amount of the upfront payment was allocated to these options. We also determined that the future milestones and related payments were substantive and contingent and did not allocate any of the upfront payment to the milestones.

In the first quarter of 2014, Merck initiated a Phase 1 clinical trial which triggered a milestone payment to us. During the three months ended March 31, 2014 we recognized $0.5 million of revenue under this arrangement. As of March 31, 2014 there is no deferred revenue related to this arrangement.

Alexion Pharmaceuticals, Inc.

In January 2013, we entered into an option and license agreement with Alexion Pharmaceuticals, Inc. (Alexion). Under the terms of the agreement, we granted to Alexion an exclusive research license, with limited sublicensing rights, to make and use our Xtend technology to evaluate and advance compounds against six different target programs during a five-year research term under the agreement, up to completion of the first multi-dose human clinical trial for each target compound. Alexion may extend the research term for an additional three years upon written notice to us and payment of an extension fee of $2.0 million. Alexion is responsible for conducting all research and development activities under the agreement at its own expense.

In addition, we granted to Alexion an exclusive option, on a target-by-target basis, to obtain an exclusive commercial, worldwide, royalty-bearing license, with sublicensing rights, under our Xtend technology to develop and commercialize products that contain the target for which the option is exercised. In order to exercise this option, Alexion must pay a $4.0 million option fee with respect to each target for which the option is exercised. Alexion may exercise this option at any time during the research term.

Under the agreement, we received an upfront payment of $3.0 million. Alexion is also required to pay an annual maintenance fee of $0.5 million during the research term of the agreement and $1.0 million during any extension of the research term. In addition, if certain development,

regulatory and commercial milestones are achieved, we are eligible to receive up to $66.5 million for the first product to achieve such milestones on a target-by-target basis. If licensed products are successfully commercialized, we are also entitled to receive royalties based on a percentage of net sales of such products sold by Alexion, its affiliates or its sublicensees, which percentage is in the low single digits.

During the three months ended March 31, 2014 we recognized $0.3 million of revenue under this arrangement and during the three months ended March 31, 2013 we recognized $0.1 million of revenue under this arrangement. As of March 31, 2014 we have deferred revenue related to this arrangement of $2.3 million.

CSL Limited

In 2009, we entered into a Research License and Commercialization Agreement with CSL Limited (CSL). Under the agreement, we provided CSL with a research license to one of our technologies and up to five commercial options. The upfront payment of $0.75 million received at inception and the annual research license renewal payments are being recognized as revenue ratably over the five-year term of the research license. We identified the deliverables under the agreement at inception as the five-year research licenses and options to acquire commercial licenses. We determined that the deliverables under this agreement were the non-exclusive commercial license and the options. The options are considered substantive and contingent and no amount of the upfront payment was allocated to these options. We also determined that the future milestones and related payments

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were substantive and contingent and did not allocate any of the upfront payment to the milestones. The upfront payment and the annual license fees were allocated to the research license and are being recognized into income over the research term and payments for commercial options are being recognized in the period the commercial option was exercised since the options were contingent and substantive.

In May 2013, we entered into an amendment to a February 2009 Research License and Commercialization Agreement with CSL, which eliminated a contingent milestone payment requirement and reduced the royalty rate on net sales for the licensed product CSL362. The amendment provided for a payment upon signing of $2.5 million. We determined that the amendment was a material modification to the original agreement and evaluated the remaining deliverables at the date of the amendment. We determined that the remaining deliverables were the research license which expired in February 2014 and four additional options to take commercial licenses through the term of the research period. The options are considered to be substantive and contingent and we did not allocate any of the proceeds received in the amendment to the options. The amendment proceeds are being recognized into income over the remaining period of the research term.

During the three months ended March 31, 2014 we recognized $0.7 million of revenue under this arrangement and during the three months ended March 31, 2013 we recognized $0.1 million of revenue under this arrangement. As of March 31, 2014 we have no deferred revenue related to this arrangement.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and the financial statements and accompanying notes thereto for the fiscal year ended December 31, 2013 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the year ended December 31, 2013.

This Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Such forward-looking statements, which represent our intent, belief, or current expectations, involve risks and uncertainties. We use words such as may, will, expect, anticipate, estimate, intend, plan, predict, potential, believe, should and similar expressions to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Such statements may include, but are not limited to, statements concerning: (i) the initiation, cost, timing, progress and results of our research and development activities, preclinical studies and future clinical trials, including our expected timeline for nominating clinical development candidates under our strategic alliances and our expected timeline for filing applications with regulatory authorities;(ii) our ability to obtain and maintain regulatory approval of our future product candidates, and any related restrictions, limitations, and/or warnings in the label of an approved product candidate; (iii) our ability to obtain funding for our operations; (iv) our plans to research, develop and commercialize our future product candidates; (v) our ability to attract collaborators with development, regulatory and commercialization expertise; (vi) our ability to obtain and maintain intellectual property protection for our technology; (vii) the size and growth potential of the markets for our technology and future product candidates, and our ability to serve those markets; (viii)our ability to successfully commercialize our technology and our future product candidates; (ix) our ability to develop sales and marketing capabilities, whether alone or with potential future collaborators; (x) regulatory developments in the United States and foreign countries; and (xi) the performance of our collaboration partners, licensees, third-party suppliers and manufacturers. Although we believe the expectations reflected in these forward-looking statements are reasonable, such statements are inherently subject to risk and we can give no assurances that our expectations will prove to be correct. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. As a result of many factors, including without limitation those set forth under Risk Factors under Item 1A of Part II below, and elsewhere in this Quarterly Report on Form 10-Q, our actual results may differ materially from those anticipated in these forward-looking statements. We undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this report or to reflect actual outcomes.

Overview

We are a clinical-stage biopharmaceutical company focused on discovering and developing engineered monoclonal antibodies to treat severe and life-threatening diseases with unmet medical needs. We use our proprietary XmAb technology platform to create next-generation antibody product candidates designed to treat autoimmune and allergic diseases, cancer and other conditions. In contrast to conventional approaches to antibody design, which focus on the portion of antibodies that interact with target antigens, we focus on the portion of the antibody that interacts with multiple segments of the immune system. This portion, referred to as the Fc domain, is constant and interchangeable among antibodies. Our engineered Fc domains, the XmAb technology, can be readily substituted for natural Fc domains. We believe our Fc domains enhance antibody performance by, for example, increasing immune inhibitory activity, improving cytotoxicity or extending circulating half-life, while maintaining 99.5% identity in structure and sequence to natural antibodies. By improving over natural antibody function, we believe that our XmAb-engineered antibodies offer innovative approaches to treating disease and potential clinical advantages over other treatments.

Our business strategy is based on the plug-and-play nature of the XmAb technology platform to modify features of natural antibodies and create numerous differentiated antibody product candidates. We have internally generated a pipeline that has allowed us to selectively partner certain

development programs while maintaining full ownership of other programs. We also have a number of technology licenses under which we have licensed the XmAb technology platform to pharmaceutical and biotechnology companies for use in a limited number of programs, providing multiple revenue streams that require no further resources from Xencor. There are currently six antibody product candidates in clinical trials that have been engineered with XmAb technology, including five candidates being advanced by licensees and development partners. We have several U.S. patents and U.S patent applications, in addition to foreign counterparts, on file to protect our XmAb technology platform.

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We were founded in 1997 based on protein engineering technology developed by our co-founders Bassil Dahiyat, Ph.D. and Stephen Mayo, Ph.D. at the California Institute of Technology. We began our first therapeutic monoclonal antibody engineering and discovery programs in 2002 and entered into our first XmAb technology license in 2004.

We have no products approved for commercial sale and have not generated any revenues from product sales, and we continue to incur significant research and development expenses and other expenses related to our ongoing operations. To date, we have funded our operations primarily through the sale of stock and convertible promissory notes and through payments generated from our product development partnership and licensing arrangements.

We have incurred losses in each year since our inception. Our net losses were $3.7 million and $4.6 million for the three months ended March 31, 2014 and 2013, respectively. As of March 31, 2014, we had an accumulated deficit of $231.1 million. Substantially all of our operating losses resulted from expenses incurred in connection with our product candidate development programs, our research activities and general and administrative costs associated with our operations.

Company Programs

XmAb5871. In December 2010, we entered into a Collaboration and Option Agreement with Amgen for an option for the acquisition by Amgen of exclusive rights to our XmAb5871 product candidate and received an $11.0 million upfront payment. In January 2013, we initiated a Phase 1b/2a clinical trial for XmAb5871 and received a $2.0 million milestone payment. We expect to have preliminary results from the Phase 1b/2a trial treating patients with rheumatoid arthritis with active disease on stable non-biologic DMARD therapy in the second half of 2014. For more information on our agreement with Amgen, see the section entitled Collaboration and Option Agreement with Amgen beginning on page 15 of our Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 31, 2014.

XmAb7195. We expect to file an investigational new drug application (IND) with the FDA for our XmAb7195 program in the first half of 2014 and to begin dosing subjects in a Phase 1a clinical trial. We expect to have preliminary data from the initial Phase 1a clinical trial at the end of 2014 and complete the trial in 2015. Further, we plan on initiating a Phase 1b clinical trial of XmAb7195 in healthy volunteers and in patients with mild-to-moderate asthma in 2015. For more information on our XmAb7195 Program, see the section entitled XmAb7195, an IgE Inhibitor for the Treatment of Asthma and Allergic Diseases beginning on page 11 of our Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 31, 2014

XmAb5574/MOR208. MorphoSys initiated a Phase 2 clinical trial with XmAb5574/MOR208 in May 2013, treating patients with non-Hodgkin lymphoma (NHL) and a second Phase 2 clinical trial in April 2013 to treat patients with acute lymphoblastic leukemia (ALL). In conjunction with the initiation of these trials, we received two milestone payments totaling $3.0 million. In addition, an investigator-sponsored trial in chronic lymphocytic leukemia (CLL) in combination with lenalidomide began in January 2014. For more information on our agreement with MorphoSys, see the section entitled Collaboration and License Agreement with MorphoSys AG beginning on page 16 of our Annual Report on Form 10-K filed with the SEC on March 31, 2014.

Licensing Partnerships: We currently have six licensing partnerships for the licensing of our XmAb technology. These arrangements provide upfront payments and annual licensing fees in addition to potential milestones and contractual payments as our partners advance compounds that

incorporate our technology into clinical development. In the first quarter of 2014, Merck initiated a Phase 1 clinical trial which triggered a milestone payment. There are currently four compounds in clinical development from our licensing partners that have incorporated our XmAb technology.

Bispecific program: We continue to advance our pipeline based on bispecific Fc antibodies, which allow us to create dual-antigen targeting molecules. By using an Fc domain as an integral part of the molecule, we maintain the advantages of natural antibody features, including potentially enabling it to retain half-life, simplify manufacturing and modulate potency to reduce toxicity. In the first quarter of 2014, we presented data featuring our novel approach for recruiting cytotoxic T cells against tumors using novel XmAb heterodimeric Fc domains.

We have initiated preclinical toxicology studies and also started cell line development for our first bispecific drug candidates and remain on track to advance one of our lead bispecific antibodies into development by mid-year. We have produced a preclinical candidate targeting CD3 and CD38, and confirmed potent activity and the multi-day half-life in mouse models that is typical of standard antibodies and produced a preclinical candidate targeting CD3 and CD123 for use in acute myeloid leukemia.