XOMA LTD /DE/
Form 10-K
March 11, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from to

Commission File No. 0-14710

XOMA Ltd.

(Exact name of registrant as specified in its charter)

Bermuda	**52-2154066**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2910 Seventh Street, Berkeley, California 94710	**(510) 204-7200**
(Address of principal executive offices, including zip code)	**(Telephone Number)**

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

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

Common Shares, U.S. $.0005 par value

Preference Share Purchase Rights

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

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

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 ¨

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

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

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

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

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

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

DOCUMENTS INCORPORATED BY REFERENCE:

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

Table of Contents

XOMA Ltd.

2007 FORM 10-K ANNUAL REPORT

TABLE OF CONTENTS

PART I

Item 1.	Business	1
Item 1A.	Risk Factors	18
Item 1B.	Unresolved Staff Comments	36
Item 2.	Properties	36
Item 3.	Legal Proceedings	36
Item 4.	Submission of Matters to a Vote of Security Holders	37

PART II

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

PART III

Item 10.	Directors, Executive Officers, and Corporate Governance	60
Item 11.	Executive Compensation	60
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters	60
Item 13.	Certain Relationships and Related Transactions, and Director Independence	60
Item 14.	Principal Accounting Fees and Services	60

PART IV

Item 15.	Exhibits, Financial Statement Schedules	61
SIGNATURES		62
INDEX TO FINANCIAL STATEMENTS		F-1
INDEX TO EXHIBITS		i

Table of Contents

PART I

Item 1. Business

Overview

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

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

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

Strategy

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

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

Focus on mid-term and longer-term opportunities to enhance our portfolio of proprietary products through internal discovery programs, licensing, acquisition, and in-kind product trades. We intend to continue internal drug discovery efforts and advance multiple preclinical programs to generate new

Table of Contents

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

Continue to pursue opportunities to discover, develop and manufacture therapeutic antibodies for biodefense. We have a successful history of providing contract services to the U.S. government for the development of anti-botulinum neurotoxin antibodies. We intend to pursue additional contracts with the U.S. government for the development of anti-botulinum neurotoxin antibody products, the development of antibodies against other biodefense threats, and the manufacture and stock-piling of antibodies for biodefense. In addition, we intend to leverage our experience and expertise in biodefense and pursue business opportunities with allied governments in Europe and Asia that have similar biodefense needs.

Expand our collaboration agreements for antibody discovery and development. We believe we possess a comprehensive and highly advanced suite of technologies and capabilities in the discovery, optimization, development and production of antibody products. Major pharmaceutical and biotechnology companies collaborate with us for access to our technologies and capabilities. These collaborations provide us with rights in strategically valuable products and revenues including upfront payments, annual license fees, research and development manufacturing revenue, milestones and royalties on sales. We intend to expand our collaboration activity through existing and/or new collaboration agreements.

*Increase licensing revenues from existing and future proprietary technologies***.** We have a history of generating significant revenue from our proprietary technologies, including our BCE technology, which we have licensed to more than 50 companies in exchange for complementary technologies, licensing fees, royalties and other revenues. Our technology licensing activities generated $36.5 million in revenue for the year ended December 31, 2007, including $30.0 million in BCE license fees from our August 2007 contract with Pfizer. We also license our Human Engineering (HE) technology, which allows modification of non-human monoclonal antibodies to reduce or eliminate detectable immunogenicity and make them suitable for medical purposes in humans. We believe that we can continue to generate significant revenues from BCE, HE and other proprietary technologies in the future.

Proprietary Products

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

XOMA 052 (formerly XMA005.2) is a Human Engineered monoclonal antibody with a high-affinity and high-potency inhibitory activity against its inflammatory target. This high potency means that it may allow us to evaluate less frequent dosing than most current therapeutics. We are currently conducting two Phase 1 clinical trials in type II diabetes patients, one in the U.S. and one in Europe. Based on positive results in the Phase 1 type II diabetes studies, we also plan to pursue the evaluation of XOMA 052 in the treatment of gout, rheumatoid arthritis, and sJIA.

XOMA 629 (a reformulation of XMP.629) is a topical anti-bacterial formulation of a peptide derived from bactericidal/permeability-increasing protein (BPI), an integral part of the protective human immune system. XOMA is developing XOMA 629 as a possible treatment for superficial skin infections. The emergence of infections resistant to current antibiotics has encouraged our researchers to review the properties of the compound for its dermatological applications. Based on an internal evaluation of this program in 2007 the Company has chosen to focus its development efforts on the use of this product in superficial skin infections, including impetigo and the eradication of staphylococcus aureus, including methicillin-resistant staphylococcus aureus (MRSA).

Table of Contents

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

Partnership Products

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

HCD122 (formerly CHIR-12.12) with Novartis (formerly Chrion Corporation): We have a 30% interest in HCD122, which is a fully human anti-CD40 antagonist antibody intended as a treatment for B-cell mediated diseases, including malignancies and autoimmune diseases. This antibody has a dual mechanism of action blocking a tumor cell growth and survival signal as well as recruiting immune effector cells to kill tumor cells. HCD122 is the first product candidate selected under the multi-product antibody development and commercialization agreement for the treatment of cancer announced by Chiron and us, initiated in March of 2004. The first Investigational New Drug (IND) application was submitted in December of 2004. In April of 2005, we announced the initiation of a Phase 1 study for patients with advanced chronic lymphocytic leukemia (CLL) and in October of 2005, we initiated a second Phase 1 study for patients with multiple myeloma (MM). Phase 1 trials of HCD122 in patients with relapsed and refractory MM and CLL are ongoing. We expect to expand clinical development with one or more additional indications in 2008. In addition, there are multiple undisclosed preclinical stage programs that we are investigating as a result of our collaboration with Novartis.

Therapeutic Antibodies with SPRI: SPRI is part of the Schering Plough Corporation, a global pharmaceutical company which reported net sales of $12.7 billion in 2007. During 2006, we signed a contract with SPRI for therapeutic monoclonal antibody discovery and development against multiple targets selected by them, and we are currently conducting multiple discovery programs through this partnership.

Therapeutic Antibodies with Takeda: Takeda is a major Japanese pharmaceutical company which reported net sales of $11.1 billion in 2007. During 2006, we signed a contract with Takeda for therapeutic monoclonal antibody discovery and development against multiple targets selected by them, and we are currently conducting multiple discovery programs through this partnership.

Metabolic Disease Target with Lexicon Pharmaceuticals, Inc. (Lexicon): In June of 2005, we began a collaboration to jointly develop and commercialize multiple antibody drugs for metabolic disease targets discovered by Lexicon using their proprietary gene knock-out technology. The initial targets are secreted proteins involved in various metabolic functions. When knocked out, the target genes result in mouse strains that display unique and desirable physiological functions, suggesting an important role of the target in disease. Antibodies to these targets may be developed to treat a variety of metabolic diseases.

Royalties and Technology Licenses

Royalties

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

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

Table of Contents

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

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

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

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

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

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

Technology Licenses

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

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

Table of Contents

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

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

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

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

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

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

Table of Contents

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

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

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

Biodefense and Contract Manufacturing

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

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

Products Available for Out-Licensing

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

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

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

Table of Contents

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

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

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

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

In October of 2004, we entered into an agreement with Triton BioSystems, Inc. (Triton) under which Triton has in-licensed the exclusive worldwide right to use the ING-1 monoclonal antibody with Triton s Targeted Nano-Therapeutics (TNT) System. The TNT System is an innovative product that ablates tumors by using tiny magnetic spheres delivered, to the tumor, systemically with antibodies and heated by means of a magnetic field directed to the tumor. The combination of the ING-1 antibody with the TNT System is intended to create a novel, highly selective, safe, and effective treatment for adenocarcinomas, such as breast, colorectal, lung, ovary and prostate. ING-1 remains available for licensing outside the field covered by the Triton license.

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

Table of Contents

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

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

Table of Contents

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

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

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

Current Agreements

Genentech

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

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

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

Table of Contents

Novartis

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

Schering Plough

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

Schering Plough/AVEO

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

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

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

Takeda

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

Table of Contents

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

Lexicon

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

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

Pfizer

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

NIAID

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

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

Attenuon

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

Table of Contents

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

Triton

In October of 2004, we entered into an agreement with Triton under which Triton licensed the exclusive worldwide rights from us to use our ING-1 monoclonal antibody with Triton s TNTSystem. The TNT System ablates tumors by using tiny magnetic spheres delivered, to the tumor, systemically with antibodies and heated by means of a magnetic field directed to the tumor. The combination of the ING-1 antibody with the TNT System is intended to create a novel, highly selective, safe, and effective treatment for adenocarcinomas, such as breast, colorectal, lung, ovary and prostate. The license to Triton includes United States and foreign patent rights related to our ING-1 and HE technologies along with several pending applications. ING-1 remains available for licensing outside the field covered by the Triton license. Under the terms of the contract, we received an upfront license fee and will receive milestones and royalties.

Recently Terminated Agreements

Taligen

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

Competition

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

Table of Contents

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

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

Regulatory

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

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

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

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

Table of Contents

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

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

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

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

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

Table of Contents

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

Patents and Trade Secrets

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

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

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

Table of Contents

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

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

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

Research and License Agreements

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

In December of 2007, we entered into an agreement with The Regents of the University of California (Regents) to license the rights to antibodies directed against anti-botulinum neurotoxin Types A, B and E. Under the agreement, XOMA will make milestone payments and the Regents will receive royalties on commercial sales of the antibody products. With this license, we have the exclusive right under pending patent applications to develop for commercial applications these antibodies intended to treat botulism poisoning. The antibodies covered by the license agreement are currently being developed by XOMA under a $16.3 million contract award from the National Institute of Allergy and Infectious Diseases (NIAID), a division of the National Institutes of Health, (Contract No. HHSN266200600008C/N01-Al-60008) to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of biological agents used in bioterrorism.

In August of 1990, we entered into a research collaboration and license agreement with NYU whereby we obtained an exclusive license to patent rights for DNA materials and genetic engineering methods for the production of BPI and fragments thereof. BPI is part of the body s natural defense system against infection and we are investigating the use of products based on BPI for various indications. We have obtained an exclusive, worldwide license for the development, manufacture, sale and use of BPI products for all therapeutic and diagnostic uses, have paid a license fee, will make milestone payments and pay royalties to NYU on the sale of such products. The license becomes fully paid upon the later of the expiration of the relevant patents or fifteen years after the first commercial sale, subject to NYU s right to terminate for certain events of default.

Each party has the right to terminate the agreement upon a material breach by the other party of the performance of its obligations under the agreement, subject to customary cure periods. Upon termination of the agreement prior to the expiration of the relevant patents, all rights in and to NYU s intellectual property revert to NYU.

In July of 1998, we entered into a license agreement with Incyte whereby we obtained an exclusive (even as to Incyte), freely sublicenseable, worldwide license to all of Incyte s patent rights relating to

Table of Contents

BPI. We will pay Incyte a royalty on sales of BPI products covered by the license, up to a maximum of $11.5 million and made a $1.5 million advance royalty payment, one-half in cash and one-half in our common shares. We also issued warrants to Incyte to purchase 250,000 of our common shares at $6.00 per share. As of December 31, 2007, 125,000 of these warrants remain outstanding. Due to offsets against other royalties, we may not ultimately incur increased total BPI royalty payments as a result of this license. The agreement expires in July of 2008 unless, on or prior to such date, the license granted therein becomes fully paid up in accordance with its terms. Incyte has the right to terminate the agreement (subject to a customary cure period) upon a breach by us of any of our material obligations under the agreement.

International Operations

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

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

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

Employees

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

Available Information

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

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

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

Table of Contents

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

Our policies related to corporate governance, including our Code of Ethics applying to our directors, officers and employees (including our principal executive officer and principal financial and accounting officer) that we have adopted to meet the requirements set forth in the rules and regulations of the SEC and its corporate governance principles are available.

The charters of the Audit, Compensation and Nominating & Governance Committees of our Board of Directors are available. We intend to satisfy the applicable disclosure requirements regarding amendments to, or waivers from, provisions of our Code of Ethics by posting such information on our website.

Item 1A. Risk Factors

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

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

Currently, our revenues rely significantly upon sales of RAPTIVA® and LUCENTIS®, in which we have only royalty interests. RAPTIVA® was approved by the FDA on October 27, 2003, for the treatment of chronic moderate-to-severe plaque psoriasis in adults who are candidates for systemic therapy or phototherapy. Genentech and Merck Serono, Genentech s international marketing partner for RAPTIVA®, are responsible for the marketing and sales effort in support of this product. In September of 2004, Merck Serono announced that RAPTIVA® had received approval for use in the European Union and the product was launched in several European Union countries in the fourth quarter of 2004. LUCENTIS® was approved by the FDA on June 30, 2006, for the treatment of age-related macular degeneration. Genentech and Novartis, Genentech s international marketing partner for LUCENTIS®, are responsible for the marketing and sales effort in support of this product. We have no role in marketing and sales efforts, and Genentech, Merck Serono and Novartis do not have an express contractual obligation to us regarding the marketing or sales of RAPTIVA® or LUCENTIS® .

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

Genentech s and Merck Serono s willingness and ability to implement their marketing and sales effort and achieve sales;

the strength of competition from other products being marketed or developed to treat psoriasis;

the occurrence of adverse events which may give rise to safety concerns;

physicians and patients acceptance of RAPTIVA® as a treatment for psoriasis and LUCENTIS® as a treatment for age-related macular degeneration;

Genentech s ability to provide manufacturing capacity to meet demand for the products; and

pricing and reimbursement issues.

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

Table of Contents

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

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

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

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

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

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

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

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

As of December 31, 2007, we (including our subsidiaries) had approximately $50.9 million of indebtedness outstanding. We may not be able to generate cash sufficient to pay the principal of, interest on and other amounts due in respect of our indebtedness when due. We and our subsidiaries may also incur additional debt that may be secured. In connection with our collaboration with Novartis, Novartis has extended a line of credit to us (through our U.S subsidiary) for $50.0 million to fund up to 75% of our expenses thereunder, of which $20.6 million was drawn as of December 31, 2007. This line of credit is secured by a pledge of our interest in the collaboration. On November 9, 2006, XOMA (US) LLC

entered into a five-year, $35.0 million term loan facility with Goldman Sachs Specialty Lending Holdings, Inc. (Goldman Sachs) and borrowed the full amount thereunder. The outstanding balance as of December 31, 2007 was $30.3 million. The loan is guaranteed by XOMA and is

Table of Contents

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

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

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

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

Most of our therapeutic products have not received regulatory approval. If these products do not receive regulatory approval, neither our third party collaborators nor we will be able to manufacture and market them.

Our products cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. The United States government and governments of other countries extensively regulate many aspects of our products, including:

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

In the United States, the FDA regulates pharmaceutical products under the Federal Food, Drug, and Cosmetic Act and other laws, including, in the case of biologics, the Public Health Service Act. At the present time, we believe that most of our products will be regulated by the FDA as biologics. Initiation of clinical trials requires approval by health authorities. Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients under the supervision of a qualified principal investigator. Clinical trials must be conducted in accordance with FDA and International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH) Good Clinical Practices and the European Clinical Trials Directive under protocols that detail the objectives of the study, the parameters to be

Table of Contents

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

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

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. Even if the FDA or other regulatory agency approves a product candidate, the approval may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, marketing and/or production of such product. Even for approved products such as RAPTIVA® and LUCENTIS®, the FDA may impose ongoing requirements for post-approval studies, including additional research and development and clinical trials, and may subsequently withdraw approval based on these additional trials. The FDA and other agencies also may impose various civil or criminal sanctions for failure to comply with regulatory requirements, including withdrawal of product approval. State regulations may also affect our proposed products. The FDA has substantial discretion in both the product approval process and manufacturing facility approval process and, as a result of this discretion and uncertainties about outcomes of testing, we cannot predict at what point, or whether, the FDA will be satisfied with our or our collaborators submissions or whether the FDA will raise questions which may be material and delay or preclude product approval or manufacturing facility approval. As we accumulate additional clinical data, we will submit it to the FDA, which may have a material impact on the FDA product approval process.

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

Our potential products will require significant additional research and development, extensive preclinical studies and clinical trials and regulatory approval prior to any commercial sales. This process is lengthy and expensive, often taking a number of years. As clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals, the length of time necessary to complete clinical trials and to submit an application for marketing approval for a final decision by a regulatory authority varies significantly. As a result, it is uncertain whether:

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

Table of Contents

we will be able to provide necessary additional data,

results of future clinical trials will justify further development, or

we will ultimately achieve regulatory approval for any of these products.

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

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

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

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

Table of Contents

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

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

Because all of our products are still being developed, we have sustained losses in the past and we expect to sustain losses in the future.

We have experienced significant losses and, as of December 31, 2007, we had an accumulated deficit of $739.9 million.

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

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

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

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

In April of 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech s humanized monoclonal antibody product RAPTIVA®. In April of 1999, March of 2003, and January of 2005, the companies amended the agreement. In October of 2003, RAPTIVA® was approved by the FDA for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy and, in September of 2004, Merck Serono announced the product s approval in the European Union. In January of 2005, we entered into a restructuring of our collaboration agreement with Genentech which ended our existing cost and profit sharing arrangement related to RAPTIVA® in the United States and entitles us to a royalty interest on worldwide net sales.

In November of 2001, we entered into a collaboration with Millennium to develop two of Millennium s products for certain vascular inflammation indications. In October of 2003, we announced that we had discontinued one of these products, MLN2201. In December of 2003, we announced the initiation of Phase I testing on the other product, MLN2222. As of May of 2006, we completed the transfer of the data from the Phase I study to Millennium as per our amended agreement.

In March of 2004, we announced we had agreed to collaborate with Chiron Corporation (now Novartis) for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, the companies will jointly research, develop, and commercialize multiple

Table of Contents

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

In October of 2004, we announced the licensing of our ING-1 product to Triton for use with their TNT System.

In March of 2005, we entered into a contract with NIAID to produce three monoclonal antibodies designed to protect United States citizens against the harmful effects botulinum neurotoxin of used in bioterrorism. In July of 2006, we entered into an additional contract with NIAID for the development of an appropriate formulation for human administration of these three antibodies in a single injection.

In June of 2005, we announced the formation of a collaboration to jointly develop and commercialize antibody drugs for certain targets discovered by Lexicon.

We have licensed our BCE technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to over 50 companies. As of December 31, 2007, we were aware of one antibody product manufactured using this technology that has received FDA approval, Genentech s LUCENTIS® (ranibizumab injection) for treatment of neovascular (wet) age-related macular degeneration, and one antibody manufactured using this technology that is in late-stage clinical testing, UCB s CIMZIA® (certolizumab pegol, CDP870) an anti-TNF alpha antibody fragment for rheumatoid arthritis and Crohn s disease.

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

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

In December of 2003, we agreed to collaborate with Alexion Pharmaceuticals, Inc. (Alexion) for the development and commercialization of an antibody to treat chemotherapy-induced thrombocytopenia. The TPO mimetic antibody was designed to mimic the activity of human thrombopoietin, a naturally occurring protein responsible for platelet production. In November of 2004, in conjunction with Alexion, we determined that the lead molecule in our TPO mimetic collaboration did not meet the criteria established in the program for continued development. In the first quarter of 2005, the companies determined not to continue with this development program and in the second quarter of 2005, the collaboration was terminated.

Table of Contents

In November of 2004, we announced the licensing of our BPI product platform, including our NEUPREX® product, to Zephyr Sciences, Inc. In July of 2005, we announced our decision to terminate the license agreement with Zephyr due to Zephyr not meeting the financing requirements of the license agreement.

In September of 2004, we entered into a collaboration with Aphton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In January of 2006, Aphton announced that its common stock had been delisted from Nasdaq. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code.

In September of 2005, we signed a letter agreement with Cubist to develop production processes and to manufacture a novel two-antibody biologic in quantities sufficient to conduct Phase 3 clinical trials. In July of 2006, Cubist announced that it had decided to cease investment in this product because of stringent FDA requirements for regulatory approval, and as a result we have terminated our letter agreement with Cubist.

In September of 2006, we entered into an agreement with Taligen which formalized an earlier letter agreement, which was signed in May of 2006, for the development and Good Manufacturing Practices (cGMP) manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement (the letter agreement) which provides that we will not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provides that we will conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate (Avecia). The letter agreement also provides that, subject to payment by Taligen of approximately $1.7 million, we will grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license under our-owned project innovations. We have received $0.6 million as the first installment under the payment terms of the letter agreement and are entitled to receive two additional payments totaling approximately $1.1 million upon fulfillment of certain obligations. We have not received any further payments from Taligen and do not know whether we will receive the remaining $1.1 million. This amount has not been recognized as revenue and is not included as an accounts receivable asset as of December 31, 2007.

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

Certain of our technologies are relatively new and are in-licensed from third parties, so our capabilities using them are unproven and subject to additional risks.

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

Table of Contents

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

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

- sales and estimated or forecasted sales of products for which we receive royalties,
- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of products,
- developments regarding regulatory filings,
- announcements of new collaborations,
- failure to enter into collaborations,
- developments in existing collaborations,
- our funding requirements and the terms of our financing arrangements,
- technological innovations or new indications for our therapeutic products,
- introduction of new products or technologies by us or our competitors,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares issued and outstanding,
- the number of shares trading on an average trading day,

announcements regarding other participants in the biotechnology and pharmaceutical industries, and

market speculation regarding any of the foregoing.

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

Genentech is responsible for manufacturing or arranging for the manufacturing of commercial quantities of RAPTIVA® and LUCENTIS®. Should Genentech have difficulty in providing manufacturing capacity to produce these products in sufficient quantities, we do not know whether they will be able to meet market demand. If not, we will not realize revenues from the sales of these products. If any of our other products are approved, because we have never commercially introduced any pharmaceutical products, we do not know whether the capacity of our existing manufacturing facilities can be increased to produce sufficient quantities of our products to meet market demand. Also, if we or our third party collaborators or licensees need additional manufacturing facilities to meet market demand, we cannot predict that we will successfully obtain those facilities because we do not know whether they will be available on acceptable terms. In addition, any manufacturing facilities acquired or used to meet market demand must meet the FDA s quality assurance guidelines.

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

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

Table of Contents

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

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

Products and technologies of other companies may render some or all of our products noncompetitive or obsolete.

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

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

These factors may enable others to develop products and processes competitive with or superior to our own or those of our collaborators. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later; as a result, we may not be able to track development of competitive products, particularly at the early stages. Positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product s failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

Table of Contents

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

RAPTIVA®

In April of 2004, Amgen Inc. and its partner Wyeth Pharmaceuticals, a division of Wyeth, announced that their rheumatoid arthritis and psoriatic arthritis drug, Enbrel®, had been approved by the FDA for the same psoriasis indication as RAPTIVA® and, in September of 2004, they announced that the product received approval in the European Union in this same indication;

Abbott Laboratories has recently announced that it has successfully completed two Phase 3 psoriasis trials showing clinical benefits of its rheumatoid arthritis and psoriatic arthritis drug Humira for the treatment of psoriasis. They indicated that they will submit regulatory applications in the United States and Europe in the first half of 2007;

In September of 2006, Centocor, Inc. (Centocor) , a unit of Johnson & Johnson, announced that its rheumatoid arthritis and Crohn s disease drug, Remicade® (infliximab) had been approved by the FDA for the treatment of adult patients with chronic severe (i.e. extensive and/or disabling) plaque psoriasis who are candidates for systemic therapy and when other systemic therapies are medically less appropriate. This drug had already been approved to treat plaque psoriasis in the European Union, psoriatic arthritis in the United States and, in combination with methotrexate, in the European Union;

Biogen Idec Inc. (Biogen) sold its worldwide rights to Amevive®, which has been approved in the United States and Canada to treat the same psoriasis indication as RAPTIVA®, to Astellas Pharma US, Inc., in March of 2006;

In October of 2007, Johnson & Johnson announced positive results from a Phase 3 clinical trial in moderate to severe plaque psoriasis of ustekinumab (CNTO 1275), a fully human monoclonal antibody that targets the cytokines interleukin-12 (IL-12) and interleukin-23 (IL-23). The BLA and MAA regulatory submissions for chronic moderate-to-severe plaque psoriasis were filed with the US FDA and EMEA in the EU in December of 2007; the BLA was accepted for review by the US FDA in February of 2008; and

other companies are developing monoclonal antibody or other products for treatment of inflammatory skin disorders.

LUCENTIS®

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

XOMA 052

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

Amgen has been developing AMG 108, a fully human monoclonal antibody that targets inhibition of the action of IL-1, and they announced the initiation of a Phase 2 safety trial in rheumatoid arthritis patients in September of 2006;

In February of 2008, Regeneron Pharmaceuticals, Inc. (Regeneron) announced it had received marketing approval from the FDA for ARCALYST(TM) (rilonacept) Injection for Subcutaneous Use, an interleukin-1 blocker or IL-1 Trap, for the treatment of Cryopyrin-Associated Periodic Syndromes

Table of Contents

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

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

XOMA 629

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

HCD122

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

Biodefense

In May of 2006, the US Department of Health & Human Services (DHHS) awarded Cangene Corporation a five-year, $362 million contract under Project Bioshield. The contract requires Cangene to manufacture and supply 200,000 doses of an equine heptavalent botulism anti-toxin to treat individuals who have been exposed to the toxins that cause botulism.

Emergent BioSolutions, Inc. is currently in development of a botulism immunoglobulin candidate that may compete with our anti-botulinum neurotoxin monoclonal antibodies

We are aware of additional companies that are pursuing biodefense-related antibody products. PharmAthene, Elusys Therapeutics, Inc. and Human Genome Sciences, Inc. are developing anti-anthrax antibodies. Cangene and Emergent BioSolutions, Inc. are developing anti-anthrax immune globulin products. These products may compete with our efforts in the areas of other monoclonal antibody-based biodefense products, and the manufacture of antibodies to supply strategic national stockpiles.

Table of Contents

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

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

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

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

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

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

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

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

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our partners hold and are in the process of applying for a number of patents in the United States and abroad to protect our products and important processes and also have obtained or have the right to obtain exclusive

Table of Contents

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

- whether any pending or future patent applications held by us will result in an issued patent, or that if patents are issued to us, that such patents will provide meaningful protection against competitors or competitive technologies,

- whether competitors will be able to design around our patents or develop and obtain patent protection for technologies, designs or methods that are more effective than those covered by our patents and patent applications, or

- the extent to which our products could infringe on the intellectual property rights of others, which may lead to costly litigation, result in the payment of substantial damages or royalties, and/or prevent us from using technology that is essential to our products.

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

Table of Contents

As we do more business internationally, we will be subject to additional political, economic and regulatory uncertainties.

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

imposition of government controls,

export license requirements,

political or economic instability,

trade restrictions,

changes in tariffs,

restrictions on repatriating profits,

exchange rate fluctuations,

withholding and other taxation, and

difficulties in staffing and managing international operations.

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

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

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

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

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. We had approximately 311 employees as of December 31, 2007, and we anticipate that we will require additional experienced executive, accounting,

research and development, legal, administrative and other personnel in the future. There is intense competition for the services of these personnel, especially in California. Moreover, we expect that the high cost of living in the San Francisco Bay Area, where our headquarters and manufacturing facilities are located, may impair our ability to attract and retain employees in the future. If we do not succeed in attracting new personnel and retaining and motivating existing personnel, our operations may suffer and we may be unable to implement our current initiatives or grow effectively.

Table of Contents

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

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

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

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

We may be subject to increased risks because we are a Bermuda company.

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

blacklisting of our common shares by certain pension funds,

legislation restricting certain types of transactions, and

punitive tax legislation.

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

If you were to obtain a judgment against us, it may be difficult to enforce against us because we are a foreign entity.

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

Table of Contents

Our shareholder rights agreement or bye-laws may prevent transactions that could be beneficial to our shareholders and may insulate our management from removal.

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

Our bye-laws:

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

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

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

Item 3. Legal Proceedings

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

Table of Contents

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

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

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

Executive Officers

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

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

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

Business Experience

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

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

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

Table of Contents

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

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

PART II

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

Market for Registrant s Common Equity

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

	Price Range	
	High	**Low**
2007		
First Quarter	$ 3.50	$ 2.14
Second Quarter	3.80	2.88
Third Quarter	3.77	1.96
Fourth Quarter	4.39	2.95
2006		
First Quarter	$ 2.46	$ 1.57
Second Quarter	2.32	1.59
Third Quarter	1.90	1.60
Fourth Quarter	2.50	1.86

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

Dividend Policy

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

Plan-Based Awards

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

Table of Contents

Performance Graph

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

FIVE-YEAR PERFORMANCE GRAPH

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

Debt and Equity Issuances

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

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

Table of Contents

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

Item 6. Selected Financial Data

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

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share amounts)				
Consolidated Statement of Operations Data					
Total revenues (1)	$ 84,252	$ 29,498	$ 18,669	$ 3,665	$ 24,412
Total operating costs and expenses (2)	86,796	70,182	54,694	81,761	81,950
Loss from operations	(2,544)	(40,684)	(36,025)	(78,096)	(57,538)
Other income (expense), net (3)	(9,782)	(11,157)	38,807	(846)	(1,115)
Net income (loss) before taxes	(12,326)	(51,841)	2,782	(78,942)	(58,653)
Income tax expense			3		
Net income (loss)	$ (12,326)	$ (51,841)	$ 2,779	$ (78,942)	$ (58,653)
Basic net income (loss) per common share	$ (0.10)	$ (0.54)	$ 0.03	$ (0.93)	$ (0.78)
Diluted net income (loss) per common share	$ (0.10)	$ (0.54)	$ 0.03	$ (0.93)	$ (0.78)

	December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
Balance Sheet Data					
Cash and cash equivalents	$ 22,500	$ 28,002	$ 20,804	$ 23,808	$ 84,812
Short-term investments	16,067	18,381	22,732	511	436
Restricted cash	6,019	4,330			
Current assets	58,088	65,888	50,288	26,607	97,234
Working capital	34,488	43,221	33,744	3,004	66,776
Total assets	84,815	91,478	72,577	46,260	118,850
Current liabilities	23,600	22,667	16,544	23,603	30,458
Long-term liabilities (4)	60,897	106,984	76,706	47,267	40,178
Redeemable convertible preferences shares, at par value (5)	1	1	1	1	1
Accumulated deficit	(739,859)	(727,533)	(675,692)	(678,471)	(599,529)
Total shareholders equity (net capital deficiency)	318	(38,173)	(20,673)	(24,610)	48,214

We have paid no dividends

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

Table of Contents

(2) Increases in 2007 and 2006 reflect increased spending on our development of XOMA 052 and our contracts with NIAID, SPRI, AVEO and Takeda. 2004 and 2003 include approximately $16.4 million and $7.5 million, respectively, of collaboration arrangement expenses related to our collaboration with Genentech on RAPTIVA® . This agreement was amended and, effective January 1, 2005, we no longer incurred these expenses.

(3) 2007 and 2006 include interest expense of $6.1 and $6.9 million, respectively, related to the revaluation of the embedded derivative to fair market value and the payment in common shares, of the additional interest feature, on our convertible debt. 2005 includes a one-time gain of $40.9 million as a result the restructuring of the Genentech agreement in January 2005.

(4) In 2007, we eliminated the remaining $44.5 million in convertible debt issued in 2006. The balance as of December 31, 2007 includes $30.3 million from our Goldman Sachs term loan, $20.6 million for our Novartis note, and $10.0 million in long-term deferred revenue. In 2006, we exchanged convertible senior notes (issued in 2005) for $60.0 million of 6.5% Convertible SNAPs℠ due 2012 and issued an additional $12.0 million of 6.5% SNAPs℠ to the public for cash. The balance as of December 31, 2006 also includes our $35.0 million term loan from Goldman Sachs completed in November of 2006. 2005 includes liabilities incurred in connection with our $60.0 million aggregate principal amount of convertible senior notes due 2012 issued in February of 2005.

(5) Aggregate liquidation preference of $29.6 million.

Quarterly Results of Operations (Unaudited)

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

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

(6) Revenues in the quarter ended September 30, 2007 include a $30.0 million non-recurring license fee from Pfizer.

(7)

Operating expenses for the quarter ended September 30, 2007 include a non-recurring credit of $2.8 million related to an agreement reached with a major collaborator regarding material costs previously recorded under the collaboration agreement.

Table of Contents

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

Overview

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

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

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

Critical Accounting Policies and the Use of Estimates

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

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

Revenue Recognition

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

Table of Contents

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

License and Collaborative Fees

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

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

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

Contract Revenue

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

Royalty Revenue

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

Research and Development Expenses

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

Table of Contents

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

Long-Lived Assets

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

Share Based Compensation

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

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

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

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

Income Taxes

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

Table of Contents

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

Results of Operations

Revenues

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

Research and Development Expenses

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

Table of Contents

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

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

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

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

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

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

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

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

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

Table of Contents

In 2007, two development programs (XOMA 052 and NIAID) each individually accounted for more than 10% but less than 20%, and no development program accounted for more than 20% of our total research and development expenses. In 2006, three development programs (Novartis, NIAID and XOMA 052) each individually accounted for more than 10% but less than 20%, and no development program accounted for more than 20% of our total research and development expenses. In 2005, one development program (Novartis) accounted for more than 30% but less than 40% and no development program accounted for more than 40% of our total research and development expenses.

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

General and Administrative Expenses

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

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

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

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

Investment and Interest Income

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

Interest Expense

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

Table of Contents

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

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

Income Taxes

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

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

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

Accounting for Share-Based Compensation

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

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

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

Table of Contents

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

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

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

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

Liquidity and Capital Resources

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

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

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

Table of Contents

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

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

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

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

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

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

Goldman Sachs Term Loan

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

Table of Contents

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

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

Novartis Note

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

Convertible Debt

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

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

Table of Contents

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

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

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

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

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

Purchase Obligations

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

Schedule of Contractual Obligations

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

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

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

Table of Contents

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

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

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

Based on current spending levels, anticipated revenues, collaborator funding, and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through at least the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. For a further discussion of the risks related to our business and their effects on our cash flow and ability to raise new funding on acceptable terms, see Risk Factors included in Item 1A.

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

Recent Accounting Pronouncements

Fair Value Measurements

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

Fair Value Option for Financial Assets and Financial Liabilities

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

Table of Contents

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

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

Accounting for Collaborative Agreements

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

Subsequent Events

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

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

Certain statements contained herein related to the sufficiency of our cash resources, levels of future revenues, losses, expenses and cash, future sales of approved products, as well as other statements related to current plans for product development and existing and potential collaborative and licensing relationships, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things, the period for which our cash resources are sufficient could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated, if anticipated revenues or cost sharing arrangements do not materialize, if funds are not otherwise available on acceptable terms; revenue levels may be other than as expected if sales of approved products are lower than expected; losses may be other than as expected for any of the reasons affecting revenues and expenses; expense levels and cash utilization may be other than as expected due to unanticipated changes in our research and

Table of Contents

development programs; and the sales efforts for approved products may not be successful if the parties responsible for marketing and sales fail to meet their commercialization goals, due to the strength of the competition, if physicians do not adopt the product as treatment for their patients or if remaining regulatory approvals are not obtained. These and other risks, including those related to the results of pre-clinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; our ability to meet the demand of the United States government agency with which we have entered our first government contract; competition; market demands for products; scale-up and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in Item 1A Risk Factors .

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

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

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

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

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

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

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

Table of Contents

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

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

Item 8. Financial Statements and Supplementary Data

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

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets	F-3
Consolidated Statements of Operations	F-4
Consolidated Statements of Shareholders Equity (Net Capital Deficiency)	F-5
Consolidated Statements of Cash Flows	F-6
Notes to the Consolidated Financial Statements	F-7

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

Not applicable.

Item 9A. Controls and Procedures

Under the supervision and with the participation of our management, including our Chairman of the Board, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Our disclosure controls and procedures are intended to ensure that the information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to our management, including the Chairman of the Board, Chief Executive Officer and President and Vice President, Finance and Chief Financial Officer, as the principal executive and financial officers, respectively, to allow timely decisions regarding required disclosures. Based on this evaluation, our Chairman of the Board, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

We continue to enhance internal financial controls and staffing consistent with the requirements of the Sarbanes-Oxley Act of 2002. Apart from this, there were no changes in our internal controls over financial reporting during 2007 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial accounting.

57

Table of Contents

Management s Report on Internal Control over Financial Reporting

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

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

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

Changes in Internal Control over Financial Reporting

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

Table of Contents

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders of XOMA Ltd.

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

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

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

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

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

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

/s/ ERNST & YOUNG LLP

Palo Alto, California

March 10, 2008

Item 9B. Other Information

None.

Table of Contents

PART III

Item 10. Directors, Executive Officers, Corporate Governance

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

Item 11. Executive Compensation

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

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

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

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

Not applicable.

Item 14. Principal Accounting Fees and Services

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

Table of Contents

PART IV

Item 15. Exhibits, Financial Statement Schedules

(a) The following documents are included as part of this Annual Report on Form 10-K:

(1) Financial Statements:

All financial statements of the registrant referred to in Item 8 of this Report on Form 10-K.

(2) Financial Statement Schedules:

All financial statements schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto or is not applicable or required.

(3) Exhibits:

See Index to Exhibits On page i of this report.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on this 11th day of March 2008.

XOMA LTD.

By: /s/ STEVEN B. ENGLE
Steven B. Engle

Chairman of the Board, Chief Executive Officer and President

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

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

/s/ PATRICK J. ZENNER	Director	March 11, 2008
(Patrick J. Zenner)		

Table of Contents

Index to Consolidated Financial Statement s

Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets	F-3
Consolidated Statements of Operations	F-4
Consolidated Statements of Shareholders Equity (Net Capital Deficiency)	F-5
Consolidated Statements of Cash Flows	F-6
Notes to the Consolidated Financial Statements	F-7

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of XOMA Ltd.

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

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

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

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

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

/s/ ERNST & YOUNG LLP

Palo Alto, California

March 10, 2008

Table of Contents

XOMA Ltd.

CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share amounts)

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

Total liabilities and shareholders equity (net capital deficiency)	$ 84,815	$ 90,077

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

Table of Contents

XOMA Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

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

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

Table of Contents

XOMA Ltd.

CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

(NET CAPITAL DEFICIENCY)

(in thousands)

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

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

Table of Contents

XOMA Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

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

Cash and cash equivalents at the end of the period	$ 22,500	$ 28,002	$ 20,804

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Business and Summary of Significant Accounting Policies

Business

XOMA Ltd. (XOMA or the Company), a Bermuda company, is a biopharmaceutical company that discovers and develops for commercialization antibodies and other genetically-engineered protein products to treat immunological and inflammatory disorders, cancer and infectious diseases. The Company s products are presently in various stages of development and most are subject to regulatory approval before they can be introduced commercially. The Company receives royalties from Genentech, Inc. (Genentech) on two approved products, RAPTIVA®, for the treatment of moderate-to-severe plaque psoriasis, and LUCENTIS®, for the treatment of neovascular (wet) age-related macular degeneration. XOMA s pipeline includes both proprietary products and collaborative programs at various stages of preclinical and clinical development.

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

Consolidation

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

Use of Estimates and Reclassifications

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

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

Concentration of Risk

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Significant Accounting Policies

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

Revenue Recognition

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

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

License and Collaborative Fees

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

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

Contract Revenue

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Royalty Revenue

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

Research and Development

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

Long-Lived Assets

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

Share-Based Compensation

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

	Year Ended December 31, 2007	2006
Research and development	$ 1,005	$ 468
General and administrative	1,853	510

Total share-based compensation expense	$ 2,858	$ 978

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

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

Net Income (Loss) Per Common Share

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

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

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

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

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

Cash and Cash Equivalents

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	December 31, 2007			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 5,011	$	$	$ 5,011
Cash equivalents	17,493	1	(5)	17,489
Total cash and cash equivalents	$ 22,504	$ 1	$ (5)	$ 22,500

	December 31, 2006			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	$ 7,585	$	$	$ 7,585
Cash equivalents	20,415	2		20,417
Total cash and cash equivalents	$ 28,000	$ 2	$	$ 28,002

Short-term Investments

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

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

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

	December 31, 2006

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

Restricted Cash

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

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

Receivables

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

	December 31,	
	2007	**2006**
Trade receivables	$ 11,655	$ 11,458
Unbilled receivables		148
Other receivables	480	439
Total	$ 12,135	$ 12,045

Property and Equipment

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

Accrued Liabilities

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

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

Deferred Revenue

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

Fair Value of Financial Instruments

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

Supplemental Cash Flow Information

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Segment Information

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

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

Recent Accounting Pronouncements

Fair Value Measurements

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

Fair Value Option for Financial Assets and Financial Liabilities

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounting for Collaborative Agreements

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

2. License Agreements

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

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

3. Collaborative and Licensing Agreements

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

Genentech

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

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

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

Novartis

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

NIAID

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

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

Schering Plough

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

Schering Plough/AVEO

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Takeda

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

Lexicon

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

Pfizer

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

Other

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Convertible Notes and Other Arrangements

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

Term Loan

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

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

Novartis

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Convertible Senior Notes

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

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

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

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

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

	December 31,	
	2007	2006
Convertible debt	$	$ 41,363
Embedded derivative		5,207
Premium		253
Total	$	$ 46,823

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

Genentech

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

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

The credit limit under the convertible subordinated debt agreement to finance XOMA s share of development costs was increased to $80.0 million. The convertible subordinated note was to mature upon the earlier of (a) April of 2005, except for advances made after April of 2003, in which case payment would be due on the second anniversary date(s) of such advances or (b) within 90 days after first product approval which occurred on October 27, 2003. At XOMA s election, the convertible subordinated note was to be repaid in cash or with shares with the conversion price to be calculated at the time of payment based on the fair market value at the time of election. If repayment were triggered by product approval, XOMA could elect to defer payment of up to $40.0 million as an offset against the Company s proceeds from its 25% share of United States operating profits on the product. Following product approval, on November 3, 2003, XOMA announced its election to defer payment of approximately $40.0 million of this debt as provided above and on December 22, 2003, the Company issued 2,959 of convertible preference shares to repay the approximately $29.6 million remaining outstanding balance.

An additional $15.0 million debt facility was established to finance XOMA s share of United States commercialization costs. The note payable was to mature upon the earlier of (a) April of 2005, except for advances made after April of 2003 in which case payment was due on the second anniversary date(s) of such advances or (b) within 90 days after first product approval by the FDA which occurred on October 27, 2003. At December 31, 2003, the outstanding balance under this note totaled approximately $13.2 million. Under the terms of the agreement, the outstanding balance of $3.0 million related to 2002 commercialization costs was repaid in cash in January of 2004. The balance of $10.2 million which relates to 2003 commercialization costs was repaid in cash in May of 2004.

XOMA granted Genentech a security interest in the Company s profit share on RAPTIVA® as collateral against any unpaid past due amounts of the loans.

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Share Capital

Common Shares

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

Preference Shares

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

Series A: As of December 31, 2007, the Company has authorized 210,000 Series A Preference Shares of which none were outstanding at December 31, 2007 and 2006. (See Shareholder Rights Plan below.)

Series B: As of December 31, 2007, the Company has authorized 8,000 Series B Preference Shares. In December of 2003, the Company issued 2,959 of the Series B preference shares to Genentech in repayment of $29.6 million of the outstanding balance under the convertible subordinated debt agreement. Pursuant to the rights of the Series B preference shares, the holders of Series B preference shares will not be entitled to receive any dividends on the Series B preference shares. The Series B preference shares will rank senior with respect to rights on liquidation, winding-up and dissolution of XOMA to all classes of common shares. Upon any voluntary or involuntary liquidation, dissolution or winding-up of XOMA, holders of Series B preference shares will be entitled to receive $10,000 per share of Series B preference shares before any distribution is made on the common shares. The holder of the Series B preference shares has no voting rights, except as required under Bermuda law.

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

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

Incentive Compensation Plans

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

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

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

Employee Share Purchase Plan

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

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

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

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

Shareholder Rights Plan

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Shares Reserved for Future Issuance

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

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

Share Options and Warrants

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

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

Share Option Plan

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Share Plan

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

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

Directors Share Option Plan and Other Options

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Share Option Plans Summary

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

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

* Weighted-average exercise price:

(1) Option price less than market price on date of grant as provided for in the Restricted Share Plan; shares issued in 2005 were canceled in order to conform to revised terms of the plan, applied retroactively.

(2) Option price equal to market price on date of grant.

(3) Option price greater than market price on date of grant.

(4) The Company adjusts for forfeitures as they occur.

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

Range of	**Options Outstanding**			**Options Exercisable**	
Exercise Prices	**Number**	**Life***	**Price****	**Number**	**Price****

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

* Weighted-average remaining contractual life

** Weighted-average exercise price

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Warrants

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

6. Commitments and Contingencies

Collaborative Agreements, Royalties and Milestone Payments

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

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

Purchase Obligations

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

Leases

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

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

	Operating Leases
2008	$ 2,287
2009	1,675
2010	1,714
2011	1,610
2012	1,279

Thereafter	1,800
Minimum lease payments	$ 10,365

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

Legal Proceedings

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

7. Income Taxes

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

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

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

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

	Amounts (in millions)	Expiration Dates
Federal		
NOLs	$ 149.7	2008 2027
Credits	11.3	2008 2027
State		
NOLs	96.3	2012 2017
Credits	14.9	Do not expire
Foreign		
NOLs	296.7	Do not expire

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

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

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

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

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

8. Related Party Transactions

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

Table of Contents

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Deferred Savings Plan

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

10. Subsequent Events

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

Table of Contents

Index to Exhibits

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

10.7	Form of Employment Agreement entered into between XOMA (US) LLC and certain of its executives, with reference schedule (Exhibit 10.1)[11]

Table of Contents

Exhibit Number	
10.7A	Consulting Agreement effective as of August 3, 2007 between XOMA (US) LLC and John L. Castello (Exhibit 10.8)[9]
10.8	Form of Change of Control Severance Agreement entered into between XOMA Ltd. and certain of its executives, with reference schedule (Exhibit 10.2)[11]
10.9	Lease of premises at 890 Heinz Street, Berkeley, California dated as of July 22, 1987 (Exhibit 10.12)[12]
10.1	Lease of premises at Building E at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of April 21, 1988 (Exhibit 10.13)[12]
10.11	Lease of premises at Building C at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of August 26, 1987 (Exhibit 10.14)[12]
10.12	Letter of Agreement regarding CPI adjustment dates for leases of premises at Buildings C, E and F at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 (Exhibit 10.15)[12]
10.13	Lease of premises at 2910 Seventh Street, Berkeley, California dated March 25, 1992 (Exhibit 10.16)[12]
10.13A	Fifth amendment to lease of premises at 2910 Seventh Street, Berkeley, California dated June 1, 2006 (Exhibit 10.58)[13]
10.14	Lease of premises at 5860 and 5864 Hollis Street, Emeryville, California dated as of November 2, 2001 (with addendum) (Exhibit 10.19)[14]
10.15	Lease of premises at 2850 Seventh Street, Second Floor, Berkeley, California dated as of December 28, 2001 (with addendum and guaranty) (Exhibit 10.20)[14]
10.16	Amended and Restated Research and License Agreement dated September 1, 1993, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28)[12]
10.16A	Third Amendment to License Agreement dated June 12, 1997, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28A)[12]
10.16B	Fourth Amendment to License Agreement dated December 23, 1998, between the Company and New York University (Exhibit 10.22B)[15]
10.16C	Fifth Amendment to License Agreement dated June 25, 1999, between the Company and New York University (Exhibit 10.21C)[16]
10.16D	Sixth Amendment to License Agreement dated January 25, 2000, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.1)[17]
10.16E	Seventh Amendment to License Agreement by and among New York University, XOMA Technology Limited and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3)[18]

Table of Contents

Exhibit Number	
10.17	Technology Acquisition Agreement dated June 3, 1994, between Connective Therapeutics, Inc. (now called Connetics Corporation) and the Company (with certain confidential information deleted) (Exhibit 10.46)[19]
10.17A	Amendment Number One to Technology Acquisition Agreement dated December 8, 1999, between Connetics Corporation and XOMA (US) LLC (with certain confidential information deleted) (Exhibit 10.23A)[16]
10.17B	Agreement dated December 8, 1999, by and between The Immune Response Corporation and XOMA (US) LLC (with certain confidential information deleted) (Exhibit 10.23B)[16]
10.18	Second Amended and Restated Collaboration Agreement dated January 12, 2005, by and between XOMA (US) LLC and Genentech, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.26C)[7]
10.19	License Agreement between Incyte Pharmaceuticals, Inc. and XOMA Corporation effective as of July 9, 1998 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 1)[4]
10.19A	Amendment No. 1 to License Agreement by and among Incyte Corporation, XOMA Technology Limited and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3)[18]
10.19B	Registration Rights Agreement dated as of July 9, 1998, by and among the Company and Incyte Pharmaceuticals, Inc. (Exhibit 3)[4]
10.2	Development and License Agreement, dated November 26, 2001, by and among XOMA (US) LLC, XOMA Ireland Limited and Millennium Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2)[20]
10.20A	Omnibus Agreement dated as of October 8, 2004, by and among XOMA (US) LLC, XOMA Ireland Limited and Millennium Pharmaceuticals, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10)[21]
10.20B	Investment Agreement, dated as of November 26, 2001, by and among XOMA, Millennium Pharmaceuticals, Inc. and mHoldings Trust (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3)[20]
10.20C	Letter Agreement, dated May 16, 2003, by and among XOMA Ltd., Millennium Pharmaceuticals, Inc. and mHoldings Trust (Exhibit 6)[22]
10.20D	Letter Agreement, dated February 24, 2004, by and between XOMA Ltd. and Millennium Pharmaceuticals, Inc. (Exhibit 8)[23]
10.20E	Convertible Subordinated Promissory Note dated November 26, 2001 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 4)[20]
10.20F	Amendment No. 1 to Convertible Subordinated Promissory Note dated November 5, 2002 (Exhibit 10.3A)[24]

Table of Contents

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

Table of Contents

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

Table of Contents

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

Footnotes:

* Filed herewith.

1 Incorporated by reference to the referenced exhibit to the Company s Registration Statement on Form S-4 filed November 17, 1998, as amended.

2 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

3 Incorporated by reference to the referenced exhibit to the Company s Amendment No. 1 to Form 8-K/A filed April 18, 2003.

4 Incorporated by reference to the referenced exhibit to the Company s Current Report on Form 8-K filed July 16, 1998.

5 Incorporated by reference to the referenced exhibit to the Company s Current Report on Form 8-K filed February 13, 2006.

6 Incorporated by reference to the referenced exhibit to the Company s Registration Statement on Form S-8 filed August 28, 2003.

7 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2004.

8 Incorporated by reference to the referenced exhibit to the Company s Current Report on Form 8-K filed November 6, 2007.

9 Incorporated by reference to the referenced exhibit to the Company s Current Report on Form 8-K filed August 7, 2007.

10 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

11 Incorporated by reference to the referenced exhibit to the Company s Current Report on Form 8-K filed August 16, 2007.

12 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1997, as amended.

13 Incorporated by reference to the referenced exhibit to the Company s Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006.

14 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

15 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1998.

16 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1999.

17 Incorporated by reference to the referenced exhibit to the Company s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000.

18 Incorporated by reference to the referenced exhibit to the Company s Amendment No. 1 on Form 8-K/A filed November 30, 2004.

19 Incorporated by reference to the referenced exhibit to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 1994.

20 Incorporated by reference to the referenced exhibit to the Company s Amendment No. 1 to Current Report on Form 8-K/A filed December 13, 2001, as amended by Amendment No. 2 to Current Report on Form 8-K/A filed October 24, 2002.

Table of Contents

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