

# XENCOR INC

## FORM 10-Q (Quarterly Report)

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2016

or

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

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Commission file number: 001-36182

**Xencor, Inc.**

(Exact Name of Registrant as Specified in its Charter)

**Delaware**  
(State or Other Jurisdiction of Incorporation  
or Organization)

**20-1622502**  
(I.R.S. Employer Identification No.)

**111 West Lemon Avenue, Monrovia, CA**  
(Address of Principal Executive Offices)

**91016**  
(Zip Code)

**(626) 305-5900**  
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

Class	Outstanding at October 25, 2016
Common stock, \$0.01 par value	41,138,851

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**Xencor, Inc.**

**Quarterly Report on FORM 10-Q for the quarter ended September 30, 2016**

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

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

- our plans to develop and commercialize our product candidates;
- our ongoing and planned clinical trials;
- the timing of and our ability to obtain and maintain regulatory approvals for our product candidates;
- our estimates regarding expenses, future revenue, capital requirements and needs for additional financing;
- our ability to identify additional products or product candidates with significant commercial potential that are consistent with our business objectives;
- the rate and degree of market acceptance and clinical utility of our products;
- the capabilities and strategy of our suppliers and vendors including key manufacturers of our clinical drug supplies;
- significant competition in our industry;
- costs of litigation and the failure to successfully defend lawsuits and other claims against us;
- our partners’ ability to advance drug candidates into, and successfully complete, clinical trials;
- our ability to receive research funding and achieve anticipated milestones under our collaborations;
- our intellectual property position;
- loss or retirement of key members of management;
- costs of compliance and our failure to comply with new and existing governmental regulations;
- failure to successfully execute our growth strategy, including any delays in our planned future growth; and
- our failure to maintain effective internal controls.

The factors, risks and uncertainties referred to above and others are more fully described under the heading “Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December, 31, 2015 and subsequent Quarterly Reports on Form 10-Q. Forward-looking statements should be regarded solely as our current plans, estimates and beliefs. You should not place undue reliance on forward-looking statements. We cannot guarantee future results, events, levels of activity, performance or achievements. We do not undertake and specifically decline any obligation to update, republish or revise forward-looking statements to reflect future events or circumstances or to reflect the occurrences of unanticipated events.

**PART I — FINANCIAL INFORMATION**

Item I. Financial Statements

**Xencor, Inc.**  
**Balance Sheet s**  
(In thousands, except share amounts)

	September 30, 2016 (unaudited)	December 31, 2015
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 14,787	\$ 12,590
Marketable securities	89,518	83,840
Accounts receivable	3,089	44
Prepaid expenses and other current assets	3,448	1,201
Total current assets	110,842	97,675
Property and equipment, net	3,050	2,310
Patents, licenses, and other intangible assets, net	10,565	9,971
Marketable securities - long term	197,570	96,891
Other assets	103	63
Total assets	<u>\$ 322,130</u>	<u>\$ 206,910</u>
<b>Liabilities and stockholders' equity</b>		
Current liabilities		
Accounts payable	\$ 7,334	\$ 6,400
Accrued expenses	6,536	3,634
Current portion of deferred rent	122	108
Current portion of deferred revenue	96,274	33,287
Income taxes	400	—
Total current liabilities	110,666	43,429
Deferred rent, less current portion	431	507
Deferred revenue, less current portion	8,613	542
Total liabilities	<u>119,710</u>	<u>44,478</u>
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$0.01 par value: 10,000,000 authorized shares; -0- issued and outstanding shares at September 30, 2016 and December 31, 2015	—	—
Common stock, \$0.01 par value: 200,000,000 authorized shares at September 30, 2016 and December 31, 2015; 41,138,851 issued and outstanding at September 30, 2016 and 40,551,039 issued and outstanding at December 31, 2015	411	405
Additional paid-in capital	431,154	424,128
Accumulated other comprehensive income loss	(250)	(516)
Accumulated deficit	(228,895)	(261,585)
Total stockholders' equity	<u>202,420</u>	<u>162,432</u>
Total liabilities and stockholders' equity	<u>\$ 322,130</u>	<u>\$ 206,910</u>

*See accompanying notes .*

**Xencor, Inc.**  
**Statements of Comprehensive Income (Loss )**  
**(unaudited)**  
**(In thousands, except share and per share data)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
<b>Revenue</b>				
Collaborations, licenses and milestones	\$ 7,821	\$ 3,503	\$ 81,080	\$ 6,008
<b>Operating expenses</b>				
Research and development	14,069	10,582	38,512	23,263
General and administrative	3,007	3,233	10,000	8,521
<b>Total operating expenses</b>	<b>17,076</b>	<b>13,815</b>	<b>48,512</b>	<b>31,784</b>
<b>Income (loss) from operations</b>	<b>(9,255)</b>	<b>(10,312)</b>	<b>32,568</b>	<b>(25,776)</b>
<b>Other income (expenses)</b>				
Interest income	579	274	1,306	425
Interest expense	(2)	(4)	(39)	(11)
Other income	3	5	5	13
<b>Total other income, net</b>	<b>580</b>	<b>275</b>	<b>1,272</b>	<b>427</b>
<b>Income (loss) before income tax</b>	<b>(8,675)</b>	<b>(10,037)</b>	<b>33,840</b>	<b>(25,349)</b>
Provision (benefit) for income tax	(598)	—	1,150	—
<b>Net income (loss)</b>	<b>(8,077)</b>	<b>(10,037)</b>	<b>32,690</b>	<b>(25,349)</b>
<b>Other comprehensive income (loss)</b>				
Net unrealized gain (loss) on marketable securities	(466)	84	266	(6)
<b>Comprehensive income (loss)</b>	<b>\$ (8,543)</b>	<b>\$ (9,953)</b>	<b>\$ 32,956</b>	<b>\$ (25,355)</b>
Basic net income (loss) per common share	\$ (0.20)	\$ (0.25)	\$ 0.80	\$ (0.66)
Diluted net income (loss) per common share	\$ (0.20)	\$ (0.25)	\$ 0.78	\$ (0.66)
Basic weighted average common shares outstanding	41,033,973	40,473,520	40,814,587	38,514,179
Diluted weighted average common shares outstanding	41,033,973	40,473,520	41,861,361	38,514,179

*See accompanying notes .*

**Xencor, Inc.**  
**Statement of Stockholders' Equity**  
**(in thousands, except share data)**

Stockholders' Equity	Common Stock		Additional Paid in-Capital	Accumulated		Total Stockholders' Equity
	Shares	Amount		Other Comprehensive Loss	Accumulated Deficit	
<b>Balance, December 31, 2015</b>	40,551,039	\$ 405	\$ 424,128	\$ (516)	\$ (261,585)	\$ 162,432
Issuance of common stock upon exercise and vesting of stock awards	569,046	6	942	—	—	948
Issuance of common stock under the Employee Stock Purchase Plan	18,766	—	226	—	—	226
Comprehensive income	—	—	—	266	32,690	32,956
Stock-based compensation	—	—	5,858	—	—	5,858
<b>Balance, September 30, 2016 (unaudited)</b>	<u>41,138,851</u>	<u>\$ 411</u>	<u>\$ 431,154</u>	<u>\$ (250)</u>	<u>\$ (228,895)</u>	<u>\$ 202,420</u>

*See accompanying notes .*

**Xencor, Inc.**  
**Statements of Cash Flow s**  
**(unaudited)**  
**(in thousands)**

	Nine Months Ended	
	September 30,	
	2016	2015
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ 32,690	\$ (25,349)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	999	768
Amortization of premium on marketable securities	1,398	642
Stock-based compensation	5,858	3,386
Abandonment of capitalized intangible assets	107	280
Gain on disposal of assets	—	(9)
Gain on sale of marketable securities available for sale	(6)	(4)
Changes in operating assets and liabilities:		
Accounts receivable	(3,044)	2,558
Interest receivable	(541)	(659)
Prepaid expenses and other assets	(2,288)	(715)
Accounts payable	934	3,417
Accrued expenses	2,902	1,608
Income taxes	400	—
Deferred rent	(62)	595
Deferred revenue	71,058	43,993
Net cash provided by operating activities	<u>110,405</u>	<u>30,511</u>
<b>Cash flows from investing activities</b>		
Purchase of marketable securities	(202,147)	(168,489)
Purchase of intangible assets	(1,207)	(1,220)
Purchase of property and equipment	(1,233)	(1,724)
Proceeds from sale and maturities of marketable securities	95,205	28,008
Proceeds from sale of property and equipment	—	9
Net cash used in investing activities	<u>(109,382)</u>	<u>(143,416)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of common stock	—	122,906
Proceeds from issuance of common stock upon exercise of stock awards	948	543
Proceeds from issuance of common stock under the Employee Stock Purchase Plan	226	247
Common stock issuance costs	—	(7,702)
Net cash provided by financing activities	<u>1,174</u>	<u>115,994</u>
<b>Net increase in cash and cash equivalents</b>	<u>2,197</u>	<u>3,089</u>
<b>Cash and cash equivalents</b> , beginning of period	12,590	54,649
<b>Cash and cash equivalents</b> , end of period	<u>\$ 14,787</u>	<u>\$ 57,738</u>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for:		
Income taxes	\$ 760	\$ —
<b>Supplemental disclosures of non-cash investing activities</b>		
Unrealized gain on marketable securities, net of tax	\$ 266	\$ 6

*See accompanying notes .*

**Xencor, Inc.**

**Notes to Financial Statements  
(unaudited)**

**September 30, 2016**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited interim financial statements for Xencor, Inc. (the Company) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. The financial statements include all adjustments (consisting only of normal recurring adjustments) that the management of the Company believes are necessary for a fair presentation of the periods presented. The preparation of interim financial statements requires the use of management's estimates and assumptions that affect reported amounts of assets and liabilities at the date of the interim financial statements and the reported revenues and expenditures during the reported periods. These interim financial results are not necessarily indicative of the results expected for the full fiscal year or for any subsequent interim period.

The accompanying unaudited interim financial statements and related notes should be read in conjunction with the audited financial statements and notes thereto included in the Company's 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 8, 2016.

***Marketable Securities***

The Company has an investment policy that includes guidelines on acceptable investment securities, minimum credit quality, maturity parameters and concentration and diversification. The Company invests its excess cash primarily in marketable securities issued by investment grade institutions.

The Company considers its marketable securities to be available-for-sale. These assets are carried at fair value and the unrealized gains and losses are included in accumulated other comprehensive income (loss). Accrued interest on marketable securities is included in marketable securities. If a decline in the value of a marketable security in the Company's investment portfolio is deemed to be other-than-temporary, the Company writes down the security to its current fair value and recognizes a loss as a charge against income. The Company reviews its portfolio of marketable securities, using both quantitative and qualitative factors, to determine if declines in fair value below cost are other-than-temporary.

***Recent Accounting Pronouncements***

In March 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which amends the current stock compensation guidance. The amendments simplify the accounting for the taxes related to stock based compensation, including adjustments to how excess tax benefits and a company's payments for tax withholdings should be classified. The standard is effective for fiscal periods beginning after December 15, 2016, with early adoption permitted.

In April 2016, the FASB issued ASU No. 2016-10 "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing" which amends and clarifies the revenue recognition guidance on accounting for licenses of intellectual property (IP) and identifying performance obligations. The amendment clarifies how an entity should evaluate the nature of its promise in granting a license of IP which will determine whether it recognizes revenue over time or at a point in time and also clarifies when a promised good or service is separately identifiable, which is an important step in determining whether goods or services should be accounted for as separate performance obligations. The amendment has the same effective date as the new revenue recognition standard which is for fiscal periods after December 15, 2017.

In May 2016, the FASB issued ASU No. 2016-12 “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients” which provides clarifying guidance in certain narrow areas, adds some practical expedients and includes assessing the collectability criterion, presentation of sales taxes and other similar taxes collected from customers, noncash consideration, contract modifications at transition, completed contracts at transition and technical correction. The amendment has the same effective date as the new revenue recognition standard which is for fiscal periods after December 15, 2017.

In June 2016, the FASB issued ASU No. 2016-13 “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” which amends the guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For available for sale debt securities, credit losses related to available-for sale debt securities should be recorded through an allowance for credit losses. The amendment is effective for fiscal years beginning after December 15, 2019 including interim periods within those fiscal years.

The Company is currently evaluating the impact of the adoption of the new accounting pronouncements on its financial statements and related disclosures.

There have been no other material changes to the significant accounting policies previously disclosed in the Company’s 2015 Annual Report on Form 10-K.

## **2. Fair Value of Financial Instruments**

Financial instruments included in the financial statements include cash equivalents, marketable securities, trade accounts receivable, accounts payable and accrued expenses. Marketable securities and cash equivalents are carried at fair value. The fair value of the other financial instruments closely approximates their fair value due to their short maturities.

The Company accounts for recurring and non-recurring fair value measurements in accordance with FASB Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*. ASC 820 defines fair value, establishes a fair value hierarchy for assets and liabilities measured at fair value, and requires expanded disclosure about fair value measurements. The ASC 820 hierarchy ranks the quality of reliable inputs, or assumptions, used in the determination of fair value and requires assets and liabilities carried at fair value to be classified and disclosed in one of the following three categories:

*Level 1*— Fair Value is determined by using unadjusted quoted prices that are available in active markets for identical assets or liabilities.

*Level 2*— Fair Value is determined by using inputs other than Level 1 quoted prices that are directly or indirectly observable. Inputs can include quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in markets that are not active. Related inputs can also include those used in valuation or other pricing models, such as interest rates and yield curves that can be corroborated by observable market data.

*Level 3*— Fair value is determined by inputs that are unobservable and not corroborated by market data. Use of these inputs involves significant and subjective judgments to be made by the reporting entity –e.g. determining an appropriate discount factor for illiquidity associated with a given security.

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The Company measures the fair value of financial assets using the highest level of inputs that are reasonably available as of the measurement date. The assets recorded at fair value are classified within the hierarchy as follows for the periods reported (in thousands):

	September 30, 2016			December 31, 2015		
	Total	Level 1	Level 2	Total	Level 1	Level 2
	Fair Value			Fair Value		
Money Market Funds	\$ 10,861	\$ 10,861	\$ —	\$ 9,453	\$ 9,453	\$ —
Corporate Securities	172,943	—	172,943	114,846	—	114,846
Government Securities	114,145	—	114,145	65,885	—	65,885
	<u>\$ 297,949</u>	<u>\$ 10,861</u>	<u>\$ 287,088</u>	<u>\$ 190,184</u>	<u>\$ 9,453</u>	<u>\$ 180,731</u>

Our policy is to record transfers of assets between Level 1 and Level 2 at their fair values as of the end of each reporting period, consistent with the date of the determination of fair value. During the three and nine months ended September 30, 2016, there were no transfers between Level 1 and Level 2. The Company does not have any Level 3 assets or liabilities.

### 3. Net Income (Loss) Per Share

We compute net income (loss) per common share by dividing the net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period without consideration of common stock equivalents. Diluted income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders by the weighted-average number of common stock equivalents outstanding for the period. The treasury stock method is used to determine the dilutive effect of the Company's stock option grants. Potentially dilutive securities consisting of stock issuable under options and our 2013 Employee Stock Purchase Plan (ESPP) are not included in the diluted net loss per common share calculation where the inclusion of such shares would have had an antidilutive effect.

Basic and diluted income (loss) per common share is computed as follows (in thousands except share and per share data):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands, except per share data)			
<b>Numerator:</b>				
Net income (loss) used for calculation of basic and diluted EPS	\$ (8,077)	\$ (10,037)	\$ 32,690	\$ (25,349)
<b>Denominator:</b>				
Weighted-average shares outstanding, basic	41,033,973	40,473,520	40,814,587	38,514,179
Dilutive effect of stock options	—	—	1,046,774	—
Weighted average shares outstanding, diluted	<u>41,033,973</u>	<u>40,473,520</u>	<u>41,861,361</u>	<u>38,514,179</u>
Net income (loss) per share, basic	\$ (0.20)	\$ (0.25)	\$ 0.80	\$ (0.66)
Net income (loss) per share, diluted	<u>\$ (0.20)</u>	<u>\$ (0.25)</u>	<u>\$ 0.78</u>	<u>\$ (0.66)</u>

For the three months ended September 30, 2016 all outstanding potentially dilutive securities have been excluded from the calculation of diluted net loss per common share as the effect of including such securities would have been antidilutive. For the nine months ended September 30, 2016 there were no shares from the Company's employee stock purchase plan that had a dilutive effect on shares outstanding. For the three and nine months ended September 30, 2015,

all outstanding potentially dilutive securities have been excluded from the calculation of diluted net loss per common share as the effect of including such securities would have been antidilutive.

#### 4. Comprehensive income (loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). For the three and nine months ended September 30, 2016, the only component of other comprehensive income (loss) is net unrealized gains (losses) on marketable securities. For the three months and nine months ended September 30, 2015, the only component of other comprehensive loss is net unrealized gains (losses) on marketable securities. There were no material reclassifications out of accumulated other comprehensive income (loss) during the three and nine months ended September 30, 2016 and 2015.

#### 5. Marketable Securities

The Company's marketable securities held as of September 30, 2016 and December 31, 2015 are summarized below:

<u>September 30, 2016</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
(in thousands)				
Money Market Funds	\$ 10,861	\$ —	\$ —	\$ 10,861
Corporate Securities	173,145	84	(286)	172,943
Government Securities	114,183	28	(66)	114,145
	<u>\$ 298,189</u>	<u>\$ 112</u>	<u>\$ (352)</u>	<u>\$ 297,949</u>

Reported as

Cash and cash equivalents	\$ 10,861
Marketable securities	287,088
Total investments	<u>\$ 297,949</u>

<u>December 31, 2015</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
(in thousands)				
Money Market Funds	\$ 9,453	\$ —	\$ —	\$ 9,453
Corporate Securities	115,148	6	(308)	114,846
Government Securities	66,099	—	(214)	65,885
	<u>\$ 190,700</u>	<u>\$ 6</u>	<u>\$ (522)</u>	<u>\$ 190,184</u>

Reported as

Cash and cash equivalents	\$ 9,453
Marketable securities	180,731
Total investments	<u>\$ 190,184</u>

The maturities of the Company's marketable securities are as follows:

<u>September 30, 2016</u> (in thousands)	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Mature in one year or less	\$ 89,548	\$ 89,518
Mature after one year through five years	197,780	197,570
	<u>\$ 287,328</u>	<u>\$ 287,088</u>

<u>December 31, 2015</u> (in thousands)	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Mature in one year or less	\$ 83,963	\$ 83,840
Mature after one year through five years	97,284	96,891
	<u>\$ 181,247</u>	<u>\$ 180,731</u>

## 6. Stock Based Compensation

Our Board of Directors and the requisite stockholders previously approved the 2010 Equity Incentive Plan (the 2010 Plan). In October 2013, our Board of Directors approved the 2013 Equity Incentive Plan (the 2013 Plan) and in November 2013 our stockholders approved the 2013 Plan. The 2013 Plan became effective as of December 3, 2013, the date of the Company's initial public offering (IPO). As of December 2, 2013, we suspended the 2010 Plan and no additional awards may be granted under the 2010 Plan. Any shares of common stock covered by awards granted under the 2010 Plan that terminate after December 2, 2013 by expiration, forfeiture, cancellation or other means without the issuance of such shares will be added to the 2013 Plan reserve.

As of September 30, 2016 the total number of shares of common stock available for issuance under the 2013 Plan is 7,157,369, which includes 2,684,456 of common stock that were available for issuance under the 2010 Plan as of the effective date of the 2013 Plan. Unless otherwise determined by the Board, beginning January 1, 2014, and continuing until the expiration of the 2013 Plan, the total number of shares of common stock available for issuance under the 2013 Plan will automatically increase annually on January 1 of each year by 4% of the total number of issued and outstanding shares of common stock as of December 31 of the immediate preceding year. Pursuant to approval by our board on January 1, 2016, the total number of shares of common stock available for issuance under the 2013 Plan was increased by 1,400,000 shares. As of September 30, 2016 a total of 3,279,750 options had been issued under the 2013 Plan.

In November 2013, our Board of Directors and stockholders approved the 2013 Employee Stock Purchase Plan (ESPP), which became effective as of December 5, 2013. We have reserved a total of 581,286 shares of common stock for issuance under the ESPP. Unless otherwise determined by our Board, beginning on January 1, 2014, and continuing until the expiration of the ESPP, the total number of shares of common stock available for issuance under the ESPP will automatically increase annually on January 1 by the lesser of (i) 1% of the total number of issued and outstanding shares of common stock as of December 31 of the immediately preceding year, or (ii) 621,814 shares of common stock. Pursuant to approval by our board, there was no increase in the number of authorized shares in the ESPP in 2016. As of September 30, 2016, we have issued a total of 195,129 shares of common stock under the ESPP.

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Total employee, director and non-employee stock-based compensation expense recognized for the three and nine months ended September 30, 2016 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
General and administrative	\$ 874	\$ 593	\$ 2,699	\$ 1,628
Research and development	992	493	3,159	1,758
	<u>\$ 1,866</u>	<u>\$ 1,086</u>	<u>\$ 5,858</u>	<u>\$ 3,386</u>

The following table summarizes option activity under our stock plans and related information:

	Number of	Weighted	Weighted	Aggregate
	Shares subject	Average	Average	Intrinsic
	to outstanding	Exercise	Remaining	Value
	options	Price	Contractual	(in thousands)
		(Per	Term	
		Share)	(in years)	
Balances at December 31, 2015	3,370,901	\$ 8.50	6.98	
Options granted	1,275,000	\$ 13.85		
Options forfeited	(47,883)	\$ 12.05		
Options cancelled	(1,031)	\$ 15.69		
Options exercised	(569,046)	\$ 1.67		
Balance at September 30, 2016	<u>4,027,941</u>	\$ 11.12	7.88	\$ 53,879
Exercisable	<u>1,723,815</u>	\$ 8.09	6.67	\$ 28,317

We calculate the intrinsic value as the difference between the exercise price of the options and the closing price of common stock of \$24.49 per share as of September 30, 2016.

Weighted average fair value of options granted during the nine-month period ended September 30, 2016 and 2015 was \$9.26 and \$10.73 per share, respectively. There were 930,250 options granted during the period ended September 30, 2015. We estimated the fair value of each stock option using the Black-Scholes option-pricing model based on the date of grant of such stock option with the following weighted average assumptions for the three and nine months ended September 30, 2016 and 2015:

	Options		Options	
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Expected term (years)	6.1	6.4	6.1	6.1
Expected volatility	79.3 %	86.5 %	76.2 %	76.6 %
Risk-free interest rate	1.23 %	1.95 %	1.50 %	1.62 %
Expected dividend yield	— %	— %	— %	— %

	ESPP		ESPP	
	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Expected term (years)	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0
Expected volatility	67.8 - 79.6 %	70.6 - 82.9 %	67.8 - 79.6 %	70.6 - 82.9 %
Risk-free interest rate	.47% - .93 %	.06% - .46 %	.47% - .93 %	.06% - .46 %
Expected dividend yield	— %	— %	— %	— %

As of September 30, 2016, the unamortized compensation expense related to unvested stock options was \$17.6 million, net of estimated forfeitures. The remaining unamortized compensation expense will be recognized over the next three years.

## 7. Commitments and Contingencies

### Operating Leases

The Company leases office and laboratory space in Monrovia, CA through June 2020 with an option to renew for an additional five years.

The Company also leases office space in San Diego, CA through April 2018 and includes an option to renew for a period of one year. In March 2016, the Company signed a lease for additional space contiguous with its existing office space. The combined lease expires in June 2020.

The leases are accounted for as non-cancellable operating leases and future minimum payments are as follows (in thousands):

### **Years ending December 31,**

For the remainder of the fiscal year	\$	196
2017		807
2018		833
2019		859
2020		466
Thereafter		—

Rent expense for the nine months ended September 30, 2016 and 2015 was \$468,000 and \$415,000 respectively.

### Contingencies

From time to time, the Company may be subject to various litigation and related matters arising in the ordinary course of business. The Company does not believe it is currently subject to any material matters where there is at least a reasonable possibility that a material loss may be incurred.

On March 3, 2015, a verified class action complaint, captioned DePinto v. John S. Stafford, et al., C.A. No. 10742, was filed in the Court of Chancery of the State of Delaware against certain of the Company's current and former directors alleging cause of action for Breach of Fiduciary Duty and Invalidity of Director and Stockholder Consents. In general, the complaint alleged that the plaintiff and the class he seeks to represent were shareholders of the Company during the recapitalization and certain related transactions that the Company underwent in 2013 and that the defendants breached their fiduciary duties in the course of approving that series of transactions. It also challenged as invalid certain corporate acts taken in the 2013 time period.

On June 10, 2015, the Company filed a Verified Petition for Relief under Del. C. Section 205 (the 205 Petition) related to the corporate acts challenged in the complaint. The defendants filed an answer to the class action complaint on June 22, 2015. On July 9, 2015, the Court consolidated the 205 Petition with the class action, joined the Company as a

defendant and ordered it to file the claims in the 205 Petition as counter-claims in the class action, which the Company has done.

On August 11, 2015, the Company filed a Motion for Leave to File an Amended Counter-Claim, along with the proposed Amended Counter-Claim and related documents. On October 5, the parties filed a Stipulation of Partial Settlement and related documents disclosing a settlement of the invalidity claims addressed in the complaint, the counter-claim and the proposed amended counter-claim including a request by plaintiff's counsel for reimbursement of legal fees up to \$950,000. On October 7, 2015, Xencor filed the Amended Counter-Claim and related documents. On December 14, 2015, the Court entered an Order and Partial Final Judgment approving the settlement of the invalidity claims, validating each corporate act challenged in the complaint, dismissing with prejudice Count II of the complaint (the invalidity claims) and granting plaintiff's counsel a fee award. We have paid the plaintiff's legal award of \$950,000 net of insurance proceeds of \$187,500 which has been reflected as a charge in our 2015 operations.

On September 27, 2016, the parties engaged in voluntary mediation and agreed to settle the complaint's remaining claims for a total payment of \$2.375 million to the class certified by the Delaware Court of Chancery. The settlement, which is subject to approval by the Court, was reached without any party admitting wrong-doing. Under the terms of the settlement, no payments shall be made to the plaintiffs by the Company or any of the defendants in the lawsuit other than payments covered by the Company's insurance. The Company currently expects that the court will approve the settlement in the first quarter of 2017.

We continue to recognize legal costs related to the litigation as incurred and offset any insurance proceeds when approved and issued. For the period ended September 30, 2016 no amount of loss related to the settlement has been accrued. As of September 30, 2016 we have reported the \$2.375 million settlement as a payable and also reflected a receivable of the same amount for the insurance coverage that will fund the settlement.

## **8. Collaboration and Licensing Agreements**

Following is a summary description of the arrangements that generated revenue in the nine months ended September 30, 2016 and 2015.

### *Novartis*

In June 2016, the Company entered into a Collaboration and License Agreement (the Novartis Agreement) with Novartis Institutes for BioMedical Research, Inc., (Novartis), to develop and commercialize bispecific and other Fc modulated antibody drug candidates using the Company's proprietary XmAb® technologies and drug candidates. Pursuant to the Agreement:

- The Company granted Novartis certain exclusive rights to research, develop and commercialize XmAb14045 and XmAb13676, two development stage products that incorporate the Company's bispecific Fc technology,
- The Company will apply its bispecific technology in up to four target pair antibodies identified by Novartis (each a Global Discovery Program) and,
- The Company will provide Novartis with a non-exclusive license to certain of its Fc technologies to apply against up to ten targets identified by Novartis.

The Company received a non-refundable upfront payment under the Novartis Agreement of \$150 million in July 2016 and is eligible to receive up to \$2.4 billion in future development, regulatory and sales milestones in total for all programs that could be developed under the Novartis Agreement.

Under the Novartis Agreement, the Company granted Novartis a worldwide co-exclusive license with Xencor to research, develop and manufacture XmAb14045 and XmAb13676. The Company also granted Novartis an exclusive license to commercialize XmAb14045 and XmAb13676 in all worldwide territories outside the United States (U.S.). Assuming successful development and commercialization of a product, the Company could receive up to \$325 million in milestone payments for each of XmAb14045 and XmAb13676. The total potential milestones for each product include \$90 million in development milestones, \$110 million in regulatory milestones and, \$125 million in sales milestones. If

commercialized, the Company is eligible to receive tiered low double-digit royalties on global net sales of approved products outside the US.

The Company and Novartis will co-develop XmAb14045 and XmAb13676 worldwide and share development costs equally. The Company may elect to opt-out of the development of either program by providing notice to Novartis. If the Company elects to opt-out with respect to a program, Novartis will receive the Company's U.S. rights to the program and the Company will receive low double-digit royalties on U.S. net sales in addition to the royalties on net sales outside the US.

Pursuant to the Novartis Agreement, the Company will apply its bispecific technology to up to four target pair antibodies selected, available for exclusive license to Novartis and not subject to a Xencor internal program. The Company will apply its bispecific technology to generate bispecific antibody candidates from starting target pair antibodies provided by Novartis for each of the four Global Discovery Programs and return the bispecific product candidate to Novartis for further testing, development and commercialization. Novartis has the right to substitute up to four of the original selected target pair antibodies during the research term provided that Novartis has not filed and received acceptance for an Investigational New Drug Application (IND) with the Xencor provided bispecific candidate. The research term is five years from the date of the Novartis Agreement.

Novartis will assume full responsibility for development and commercialization of each product candidate under each of the Global Discovery Programs. Assuming successful development and commercialization of each Global Discovery Program compound, the Company could receive up to \$250.0 million in milestones for each Global Discovery Program which includes \$50.0 million in development milestones, \$100.0 million in regulatory milestones and \$100.0 million in sales milestones. If commercialized, the Company is eligible to receive mid-single digit royalties on global net sales of approved products.

Under the Novartis Agreement, the Company has the right to participate in the development and commercialization of one of the Global Discovery Programs prior to filing an IND for Global Discovery Program. If the Company elects to participate in development, it will assume responsibility for 25% of the worldwide development costs for the program and 50% of commercialization costs and will receive 50% of the US profits on net sales of the product.

Under the Novartis Agreement, the Company is also granting Novartis a non-exclusive research license to use certain of the Company's Fc technologies, specifically Cytotoxic, Xtend and Immune Inhibitor to research, develop, commercialize and manufacture antibodies against up to ten targets selected by Novartis, available for non-exclusive license and not subject to a Xencor internal program. Novartis will assume all research, development and commercialization costs for products that are developed from application of the Fc technologies. Assuming successful development and commercialization of a compound that incorporates an Fc technology, the Company could receive up to \$76.0 million in milestones for each target which includes \$16.0 million in development milestones, \$30.0 million in regulatory milestones and \$30 million in sales milestones. If commercialized, the Company is eligible to receive low single-digit royalties on global net sales of approved products.

The Company evaluated the Novartis Agreement and determined that it is a revenue arrangement with multiple deliverables or performance obligations. The Company's substantive performance obligations under the Novartis Agreement include:

- delivery of an exclusive license to commercialize XmAb14045 in worldwide territories outside the U.S., with worldwide co-exclusive rights with Xencor to research, develop and manufacture XmAb14045
- delivery of an exclusive license to commercialize XmAb13676 in worldwide territories outside the U.S., with worldwide co-exclusive rights with Xencor to research, develop and manufacture XmAb13676
- application of its bispecific technology to four Novartis selected target pair antibodies and delivery of four bispecific product candidates and,
- delivery of a non-exclusive license to its Fc technologies: Cytotoxic, Xtend and Immune Inhibitor

The Company determined that the \$150 million upfront payment represents the total initial consideration and was allocated to each of the deliverables using the relative selling price method. The Company determined that each of the development and regulatory milestones is substantive. Although sales milestones are not considered substantive, they are still recognized upon achievement of a milestone. After identifying each of the deliverables included in the

arrangement, the Company determined the relative selling price using its best estimate of selling price for each of the deliverables.

The total allocable consideration of \$150 million was allocated to the deliverables based on the relative selling price method as follows:

- \* \$27.1 million to the XmAb14045 Program,
- \* \$31.4 million to the XmAb13676 Program,
- \* \$20.05 million to each of the four Global Discovery Programs and,
- \* \$11.3 million to the Fc licenses

The Company recognized as license revenue the amount of the total allocable consideration allocated to the XmAb13676 and XmAb14045 Programs upon delivery of the exclusive license to Novartis both of which were transferred as of the effective date of the Novartis Agreement. At the time that each Global Discovery Program is accepted by Novartis, the Company will recognize as collaboration revenue of \$20.05 million for each program. Since Novartis has substitution rights for up to four target pair antibodies, revenue recognition may be delayed until the earlier that Novartis has an open IND for a delivered bispecific Discovery Program or the right to substitute the target pair lapses. The Company will recognize as licensing revenue the amount of the total consideration allocated to the Fc license over the five year research term beginning from the effective date of the Novartis Agreement.

During the three and nine months ended September 30, 2016, we recognized \$0.6 million and \$59.1 million of revenue, respectively. As of September 30, 2016 there is \$90.9 million in deferred revenue related to the arrangement.

#### ***Amgen, Inc.***

In September 2015, the Company entered into a research and license agreement (the Amgen Agreement) with Amgen, Inc. (Amgen) to develop and commercialize bispecific antibody product candidates using the Company's proprietary XmAb® bispecific Fc technology. Under the Amgen Agreement, the Company granted an exclusive license to Amgen to develop and commercialize bispecific drug candidates from the Company's preclinical program that bind the CD38 antigen and the cytotoxic T-cell binding domain CD3, (the CD38 Program). The Company will also apply its bispecific technology to five previously identified Amgen provided targets (each a Discovery Program). The Company received a \$45.0 million upfront payment from Amgen and is eligible to receive up to \$1.7 billion in future development, regulatory and sales milestones in total for all six programs and is eligible to receive royalties on any global net sales of products.

In the fourth quarter ended December 31, 2015, the Company transferred the research material and data related to its CD38 Program to Amgen. Amgen will assume full responsibility for the further development and commercialization of product candidates under the CD38 Program. Assuming successful development and commercialization of a product, the Company could receive up to \$355 million in milestones payments which include \$55 million in development milestones, \$70 million in regulatory milestones and, \$230 million in sales milestones. If commercialized, the Company is eligible to receive from high single-digit up to low double-digit royalties on global net sales of approved products under the CD38 Program.

Pursuant to the Amgen Agreement, for each of the five Discovery Programs the Company will apply its bispecific technology to antibody molecules provided by Amgen that bind Discovery Program Targets and return the bispecific product candidates to Amgen for further testing, development and commercialization. Subject to approval by Xencor, Amgen has the right to substitute up to three of the previously identified targets during the research term provided that Amgen has not initiated non-human primate studies with the Xencor provided bispecific candidate. The initial research term is three years from the date of the Amgen Agreement but Amgen, at its option, may request an extension of one year if Xencor has not completed delivery of all five Discovery Program bispecific candidates to Amgen.

Amgen will assume full responsibility for development and commercialization of product candidates under each of the Discovery Programs. Assuming successful development and commercialization of each Discovery Program compound, the Company could receive up to \$260.5 million in milestones for each compound which include \$35.5 million in development milestones, \$55.0 million in regulatory milestones and \$170.0 million in sales milestones. If

commercialized, the Company is eligible to receive mid to high single-digit royalties on global net sales of approved products.

The Company evaluated the Amgen Agreement and determined that it is a revenue arrangement with multiple deliverables or performance obligations. The Company's substantive performance obligations under the Amgen Agreement include delivery of research material and data related to its CD38 Program and application of its bispecific technology to five Amgen provided targets and delivery of the five bispecific product candidates. The Company evaluated the Amgen Agreement and determined that the CD38 Program and each of the five Discovery Programs represent separate units of accounting.

The \$45 million upfront payment represents the total initial consideration and was allocated to each of the deliverables using the relative selling price method. After identifying each of the deliverables included in the arrangement, the Company determined its best estimate of selling price for each of the deliverables.

The total allocable consideration of \$45 million was allocated to the deliverables based on the relative selling price method as follows:

\$13.75 million to the CD38 Program and,  
\$6.25 million to each of the five Discovery Programs

The Company recognized as collaboration revenue the amount of consideration allocated to the CD38 Programs upon delivery of the CD38 research material and data to Amgen in the fourth quarter of 2015.

In the first quarter ended March 31, 2016, Amgen exercised its substitution rights with respect to one of the previously identified Discovery targets. In the first quarter ended March 31, 2016, the Company delivered bispecific product candidates for three Discovery Program targets to Amgen. In the second quarter ended June 30, 2016 the Company delivered a product candidate for a Discovery target. In the third quarter ended September 30, 2016, the Company delivered an additional product candidate for a Discover target. As of September 30, 2016, the Company has delivered five of the discovery programs with Amgen exercising its substitution rights to one program.

At the time that each bispecific Discovery Program is accepted by Amgen, the Company will recognize as collaboration revenue \$6.25 million for each program. Since Amgen has substitution rights for up to three targets, revenue recognition may be delayed until the earlier that Amgen initiates non-human primate studies for a delivered bispecific Discovery Program or the right to substitute the target lapses.

During the three and nine months ended September 30, 2016, we recognized \$6.25 million and \$18.75 million in revenue under this arrangement, respectively. As of September 30, 2016 there is \$12.5 million in deferred revenue related to the arrangement.

#### ***Merck Sharp & Dohme Corporation***

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

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

During each of the three and nine months ended September 30, 2016 and 2015 we recognized \$25,000 and \$75,000 of revenue respectively. As of September 30, 2016, there is \$75,000 of deferred revenue related to this arrangement.

***Alexion Pharmaceuticals, Inc.***

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

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

Under the agreement, we received an upfront payment of \$3.0 million. Alexion is also required to pay an annual maintenance fee of \$0.5 million during the research term of the agreement and \$1.0 million during any extension of the research term. We determined that \$2.5 million of the upfront fee was allocated to the license and is being recognized into income over the initial research term of five years.

In the third quarter of 2014, Alexion achieved a clinical development milestone with an undisclosed molecule to be used against an undisclosed target. We received a milestone related to this trial in March 2015 upon issuance of certain patents related to our Xtend technology. In the fourth quarter of 2015, Alexion exercised its option to take an exclusive commercial license and achieved a further clinical development milestone. As a result of Alexion's exercise to take a commercial option to an undisclosed compound, the Company is eligible to receive additional development, regulatory and sales milestones under the agreement. If commercialized, the Company is eligible to receive royalties on global net sales of approved products.

During the three and nine months ended September 30, 2016 we recognized \$250,000 and \$750,000 of revenue respectively. During the three and nine months ended September 30, 2015 we recognized \$250,000 and \$1.3 million of revenue respectively. As of September 30, 2016, we have deferred revenue related to this arrangement of \$0.8 million.

***Novo Nordisk A/S***

In December 2014, we entered into a collaboration and license agreement with Novo Nordisk A/S (Novo). Under the terms of the agreement we granted Novo a research license to use certain Xencor technologies including our bispecific, Fcy-IIb, Xtend and other technologies during a two-year research term.

We are recognizing the \$2.5 million upfront payment as income over the two-year research term. The research funding is being recognized into income over the period that the services are being provided. We determined that future milestone payments were substantive and contingent and we did not allocate any of the upfront consideration to these milestones.

During each of the three months ended September 30, 2016 and 2015, we recognized \$0.7 million of revenue. During each of the nine months ended September 30, 2016 and 2015, we recognized \$2.1 million of revenue. As of September 30, 2016, we have \$0.6 million in deferred revenue related to this arrangement.

## 9. Income taxes

The provision (benefit) for income taxes for the three and nine months ended September 30, 2016 represents the federal and state alternative minimum tax based on the Company's projected year end effective income tax rates applicable to alternative minimum taxable income which cannot be fully offset by the Company's net operating loss carryforwards.

The Company has deferred tax assets consisting primarily of net operating loss and tax credit carryforwards that have been fully offset by a valuation allowance.

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

*The following discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and the financial statements and accompanying notes thereto for the fiscal year ended December 31, 2015 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the year ended December 31, 2015. This Quarterly Report on Form 10-Q may contain "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended, (the Exchange Act). Such forward-looking statements, which represent our intent, belief, or current expectations, involve risks and uncertainties. We use words such as "may," "will," "expect," "anticipate," "estimate," "intend," "plan," "predict," "potential," "believe," "should" and similar expressions to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Such statements may include, but are not limited to, statements concerning: (i) the initiation, cost, timing, progress and results of our research and development activities, preclinical studies and future clinical trials, including our expected timeline for nominating clinical development candidates under our strategic alliances and our expected timeline for filing applications with regulatory authorities; (ii) our ability to obtain and maintain regulatory approval of our future product candidates, and any related restrictions, limitations, and/or warnings in the label of an approved product candidate; (iii) our ability to obtain funding for our operations; (iv) our plans to research, develop and commercialize our future product candidates; (v) our ability to attract collaborators with development, regulatory and commercialization expertise; (vi) our ability to obtain and maintain intellectual property protection for our technology; (vii) the size and growth potential of the markets for our technology and future product candidates, and our ability to serve those markets; (viii) our ability to successfully commercialize our technology and our future product candidates; (ix) our ability to develop sales and marketing capabilities, whether alone or with potential future collaborators; (x) regulatory developments in the United States and foreign countries; and (xi) the performance of our collaboration partners, licensees, third-party suppliers and manufacturers. Although we believe the expectations reflected in these forward-looking statements are reasonable, such statements are inherently subject to risk and we can give no assurances that our expectations will prove to be correct. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Quarterly Report on Form 10-Q. As a result of many factors, including without limitation those set forth under "Risk Factors" under Item 1A of Part II below, and elsewhere in this Quarterly Report on Form 10-Q, our actual results may differ materially from those anticipated in these forward-looking statements. We undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of this report or to reflect actual outcomes.*

### **Company Overview**

We are a clinical-stage biopharmaceutical company focused on discovering and developing engineered monoclonal antibodies to treat severe and life-threatening diseases with unmet medical needs. We use our proprietary XmAb technology platform to create next-generation antibody product candidates designed to treat autoimmune and allergic diseases, cancer and other conditions. In contrast to conventional approaches to antibody design, which focus on the portion of antibodies that interact with target antigens, we focus on the portion of the antibody that interacts with multiple segments of the immune system. This portion, referred to as the Fc domain, is constant and interchangeable among antibodies. Our engineered Fc domains, the XmAb technology, can be readily substituted for natural Fc domains.

Our business strategy is based on the plug-and-play nature of the XmAb technology, allowing us to create new antibody drug candidates for our internal development or licensing, or to selectively license access to one or more of our XmAb technologies or product candidates to pharmaceutical or biotechnology companies to use in developing their own

proprietary antibodies and drug candidates with improved properties. These licensing transactions provide us with multiple revenue streams that help fund development of our wholly owned product candidates and usually require limited resources or efforts from us. There are currently nine antibody product candidates in clinical trials that have been engineered with XmAb technology, including seven candidates being advanced by licensees and development partners.

Our protein engineering capabilities allow us to continue to expand the functionality of the XmAb technology platform to identify new protein enhancements and create new antibody drug candidates with improved properties. Our bispecific technology, heterodimer Fc domains, enables the creation of bispecific drug candidates, which are antibodies that are engineered to bind two targets simultaneously. The core of our bispecific programs is a novel Fc domain that is a robust and portable scaffold for two, or potentially more, different antigen binding domains. Our Fc domain technology is designed to maintain full-length antibody properties in a bispecific antibody, potentially enabling stable molecules with favorable *in vivo* half-life and allowing for the use of standard antibody production methods. The portability of the bispecific technology, including the ability of bispecific candidates generated from our technology to use standard production methods, allows us to license access to our technology as highlighted in our two bispecific licensing transactions that we entered into in the last year.

In June 2016 we entered into the Novartis Agreement which included a \$150 million upfront payment and up to \$2.4 billion in potential development, regulatory and sales milestones. As part of the Agreement, we will apply our bispecific technology to up to four target pair antibodies selected, available for exclusive license to Novartis and not subject to a Xencor internal program.

We will apply our bispecific technology to generate bispecific antibody candidates from starting target pair antibodies provided by Novartis for each of the four Global Discovery Programs and return the bispecific product candidate to Novartis for further testing, development and commercialization. Assuming successful development and commercialization of each bispecific compound, we could receive up to \$250 million in milestones for each compound which includes \$50 million in development milestones, \$100 million in regulatory milestones and \$100 million in sales milestones. If commercialized, the Company is eligible to receive mid-single digit royalties on global net sales of approved products.

In September 2015 we entered into the Amgen Agreement which included a \$45 million upfront payment and up to \$1.7 billion in future development, regulatory and sales milestones if all programs under the agreement advance into development. In connection with the Amgen Agreement, we are applying our bispecific technology to up to five previously identified molecules identified by Amgen and approved by us. We are applying our bispecific technology to each of the five identified programs and returning the bispecific product candidates to Amgen, who is assuming full responsibility for further testing, development and commercialization. Assuming successful development and commercialization of each bispecific compound, we could receive up to \$260.5 million in milestones which include \$35.5 million in development milestones, \$55 million in regulatory milestones and \$170 million in sales milestones. If commercialized, we are eligible to receive mid to high-single digit royalties on global net sales of approved products. Through September 30, 2016 we have delivered five bispecific product candidates to Amgen under the Agreement.

Since we commenced active operations in 1998, we have devoted substantially all of our resources to staffing our company, business planning, raising capital, developing our technology platforms, identifying potential product candidates, undertaking pre-clinical and IND enabling studies and conducting clinical trials. We have no products approved for commercial sale and have not generated any revenues from product sales, and we continue to incur significant research and development expenses and other expenses related to our ongoing operations. To date, we have funded our operations primarily through the sale of stock and convertible promissory notes and through payments generated from our product development partnership and licensing arrangements. We raised \$80.5 million (\$72.5 million net of expenses) in December 2013 through the sale of common stock in connection with our Initial Public Offering (IPO) and full exercise by the underwriters of their over-allotment. We raised an additional \$122.9 million (\$115.2 million net of expenses) through a follow-on public offering of our common stock and full exercise by the underwriters of their over-allotment in March 2015. In September 2015 we received a \$45 million upfront payment from Amgen in connection with the 2015 Amgen Agreement. In July 2016 we received a \$150 million upfront payment from Novartis in connection with the Novartis Agreement. Although it is difficult to predict our funding requirements, based upon our current operating plan, we anticipate that our cash and cash equivalents and related marketable securities as of September 30, 2016, will enable us to fund operations beyond the end of 2019.

As of September 30, 2016, we had an accumulated deficit of \$229 million. Substantially all of our operating losses that we have incurred resulted from expenses incurred in connection with our product candidate development programs, our research activities and general and administrative costs associated with our operations.

## Company Programs

We are developing a pipeline of candidates for clinical development based on our Immune Inhibitor Domain and Bispecific Domain technologies.

### Immune Inhibitor Pipeline

**XmAb5871** uses our XmAb Immune Inhibitor Fc Domain and targets B cells, an important component of the immune system. We believe that XmAb5871 has the potential to address a key unmet need in autoimmune therapies due to its combination of potent B-cell inhibition without B-cell depletion.

In March 2016 we initiated enrollment for two Phase 2 trials for XmAb5871, one trial in IgG4-Related Disease (IgG4-RD) and a trial in Systemic Lupus Erythematosus (SLE or Lupus). In July 2016 we initiated a Phase 1 trial with a subcutaneous formulation of XmAb5871. Enrollment for the subcutaneous trial has been completed and we expect to provide data from the trial in 2017.

**IgG4-RD:** we are currently enrolling a Phase 2 open-label pilot study of XmAb5871 for IgG4-RD. The current trial design is to enroll approximately 15 patients with scheduled treatment up to 24 weeks. The primary objective of the study is to evaluate the effect of every other week IV administration of XmAb5871 using the recently reported IgG4-RD Responder Index in patients with active IgG4-RD. Secondary objectives are to determine the safety and tolerability profile and to characterize the pharmacokinetics (PK) and immunogenicity of every other week IV administration of XmAb5871.

We plan to provide preliminary data from the Phase 2 trial in November at the American College of Rheumatology Annual meeting.

**SLE:** we are also enrolling a Phase 2 randomized, double blinded, placebo-controlled study of XmAb5871 in SLE. This trial is designed to assess the effect of XmAb5871 on SLE disease activity in a shorter timeframe and using fewer patients compared to standard SLE trials, and XmAb5871 is the first newly developed agent being assessed with this novel trial design. The trial design calls for treating patients with moderate to severe, non-organ threatening SLE with XmAb5871 (or placebo) after their lupus disease activity has improved with a short course of intra-muscular (IM) steroid therapy. Background, potentially confounding, immunosuppressant medications will be stopped. In this double-blinded placebo-controlled study, the ability of XmAb5871 to maintain the improvement in disease activity after IM steroid therapy and in the absence of immunosuppressant medication will be assessed. Historically, SLE trial designs generally add new medications to the many already taken by the patient, and hence display a discernible treatment effect only when restricted to the sickest patients. The trial will enroll approximately 90 subjects, 1:1 randomized to XmAb5871 or placebo, for up to 24 weeks.

**XmAb7195** uses our Immune Inhibitor Fc Domain and is being developed for the treatment of severe asthma and allergic diseases. XmAb 7195 is designed to reduce blood serum levels of IgE, which mediates allergic responses and allergic disease. In January 2015, we reported top-line interim data from Part 1 of the Phase 1a trial of XmAb7195, in which healthy volunteers received a single intravenous (IV) dose. In 2015, we continued the Phase 1a trial of XmAb7195, treating subjects with high baseline IgE levels, and in June 2015, we announced an expansion of the trial, adding cohorts of subjects that receive two IV doses of XmAb7195. We announced complete data from these studies in May 2016. In September 2016, we initiated a multi-dose Phase 1b trial for XmAb7195 with a subcutaneous formulation. The first part of this trial is dosing healthy volunteers with a subcutaneous formulation of XmAb7195. The second part of the trial is dosing of atopic patients with the subcutaneous formulation of XmAb7195 which we began in October 2016.

## **XmAb Bispecific Pipeline**

**XmAb14045** uses our XmAb bispecific Fc technology that allows us to create dual-antigen targeting molecules. In September 2016 we dosed the first patient in a Phase 1 clinical trial for XmAb14045, our first bispecific oncology candidate, for the treatment of acute myeloid leukemia (AML). XmAb14045 targets CD123, an antigen on AML cells and leukemic stem cells, and CD3, an activating receptor on T cells. The trial is a Phase 1, open-label, multiple-dose, dose escalation study to assess safety, tolerability and preliminary anti-tumor activity in AML.

**XmAb13676** is our second bispecific oncology candidate and we have an open IND and are planning enrollment of a Phase 1 trial in late 2016 or early 2017. XmAb13676 is a tumor-targeted antibody that contains both a B-cell tumor antigen binding domain (CD20) and a cytotoxic T-cell binding domain (CD3). The trial will be a Phase 1, open-label, multiple-dose, dose escalation study to assess safety, tolerability and preliminary anti-tumor activity in B-cell malignancies.

In connection with the Novartis Agreement we granted Novartis exclusive licenses to commercialize XmAb14045 and XmAb13676 in all worldwide territories outside the U.S., with worldwide co-exclusive rights with us to research, develop and manufacture XmAb14045 and XmAb13676. We continue to retain U.S. rights to both drug candidates and will co-develop worldwide both candidates with Novartis and share development costs equally. Upon successful development of each of XmAb14045 and XmAb13676 we are eligible to receive up to \$325 million in milestones which includes \$90 million in development milestones, \$110 million in regulatory milestones and \$125 million in sales milestones. If commercialized, the Company is eligible to receive tiered low double-digit royalties on net global sales outside the U.S.

**XmAb18087** is our third CD3 bispecific oncology candidate and we began development of this bispecific antibody in the second half of 2016. XmAb18087 targets the Somatostatin Receptor 2 (SSTR2) and the cytotoxic T-cell binding domain CD3 (CD3) for the treatment of neuroendocrine tumors. We plan to initiate a clinical trial for XmAb18087 in 2017.

**XmAb20717** is our initial checkpoint inhibitor candidate that is being developed using our bispecific technology platform. XmAb20717 targets PD-1 and CTLA-4 and is being developed for broad oncology indications including solid tumors.

## **Out-Licensed Compounds**

In addition to our wholly-owned compounds in clinical development, we have used our XmAb technology to create antibody compounds which have been licensed to other pharmaceutical and biotechnology companies for further development. These licensed compounds do not require additional development effort by us as they advance into development by our partners. If successful, these candidates will generate additional milestone payments and royalties to support our internal development efforts. These include XmAb5574/MOR208 (now MOR208) licensed to MorphoSys AG (MorphoSys), and XmAb13551, a bispecific CD38 x CD3 preclinical candidate, which we developed and licensed to Amgen.

<b>Program</b>	<b>Target</b>	<b>Fc Domain</b>	<b>Primary Stage of</b>		<b>Partner</b>
			<b>Indication</b>	<b>Development</b>	
XmAb5574/MOR208	CD19	Cytotoxic	CLL/NHL/ALL	Phase 2	Morphosys
XmAb13551	CD38 x CD3	Bispecific	Myeloma	Preclinical	Amgen
XmAb14045	CD123 x CD3	Bispecific	AML	Clinical	Novartis*
XmAb13676	CD20 x CD3	Bispecific	B-cell malignancies	Preclinical	Novartis*

\* In connection with our Novartis Agreement, we licensed XmAb14045 and XmAb13676 to Novartis for commercialization in all territories outside the US. We will co-develop both these candidates with Novartis worldwide.

**Our Out-Licensed Technology**

We selectively license our XmAb technology to other companies for use in their own internal development candidates and to potentially make next-generation improvements to their marketed products. These licenses generally require little or no development effort by us and provide us with cash to fund our own research and development programs. These agreements typically provide the licensee with specific rights to use one or more of our Fc technologies to be applied to their proprietary antibodies or targets. The licensee is generally responsible for all development, of any resulting product candidate. As part of these agreements, we are generally entitled to receive upfront fees, annual licensing fees, potential milestone payments and royalties on the sales of any resulting products. In connection with our collaboration with Novo Nordisk, we also received research and development funding.

There are currently eight programs in development with our partners. The most advanced programs are with Alexion and CSL-Janssen, which both entered into Phase 2 clinical development in 2015.

<u>Licensee</u>	<u>Year</u>	<u>Xencor Technology</u>	<u>Indication</u>	<u>Milestones</u>	<u>Royalties</u>	<u>Current Development Stage</u>
Alexion	2013	Xtend	Undisclosed	Yes	Yes	Phase 2
CSL-Janssen	2009	Cytotoxic	Oncology	Yes	Yes	Phase 2
Boehringer Ingelheim	2007	Cytotoxic	Oncology	Yes	Yes	Phase 1 (2 candidates)
Janssen	2009	Xtend	Autoimmune disease	Yes	Yes	Preclinical
NIH (not licensed)		Xtend	HIV	N/A	N/A	Phase 1
Merck	2013	Fc optimization	Autoimmune disease	Yes	Yes	Phase 1
Novo Nordisk	2014	Various, including Bi- specifics	Undisclosed	Yes	Yes	Preclinical 5 Preclinical candidates
Amgen	2015	Bi-specific	Oncology/Autoimmune	Yes	Yes	
Novartis	2016	Various, including Bi- specifics	Undisclosed	Yes	Yes	

**Results of Operations**

***Comparison of the Three Months Ended September 30, 2016 and 2015***

The following table summarizes our results of operations for the three months ended September 30, 2016 and 2015 (in millions):

	<b>Three Months Ended September 30,</b>		
	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenues:			
Research collaboration	\$ 7.0	\$ 0.7	\$ 6.3
Licensing	0.8	0.3	0.5
Milestone	—	2.5	(2.5)
Total revenues	\$ 7.8	\$ 3.5	\$ 4.3
Operating expenses:			
Research and development	14.1	10.6	3.5
General and administrative	3.0	3.2	(0.2)
Total operating expenses	17.1	13.8	3.3
Other income, net	0.6	0.3	0.3
Income (loss) before taxes	(8.7)	(10.0)	1.3
Income tax benefit	(0.6)	—	(0.6)
Net income (loss)	\$ (8.1)	\$ (10.0)	\$ 1.9

*Revenues*

Research collaboration revenues increased by \$6.3 million in the three months ended September 30, 2016 over 2015 amounts primarily due to revenue recognized under the Amgen Agreement.

Licensing revenues were \$0.5 million higher during the three months ended September 30, 2016 over 2015 primarily due to revenue recognized under our Novartis Agreement.

There were no milestone revenues for the three months ended September 30, 2016. Milestone revenues for the same period in 2015 were earned from our CSL collaboration.

*Research and Development Expenses*

The following table summarizes our research and development expenses for the three months ended September 30, 2016 and 2015 (in millions):

	Three Months Ended September 30,		
	2016	2015	Change
<b>Product programs:</b>			
XmAb5871	\$ 5.5	\$ 2.4	\$ 3.1
XmAb7195	2.8	1.8	1.0
Bi-specific	4.9	5.8	(0.9)
Early research and discovery	0.9	0.6	0.3
<b>Total research and development expenses</b>	<b>\$ 14.1</b>	<b>\$ 10.6</b>	<b>\$ 3.5</b>

Research and development expenses increased by \$3.5 million for the three months ended September 30, 2016 over the same period in 2015. Spending on the XmAb5871 and bispecific programs increased during the three months ended September 30, 2016 compared to the same period in 2015. The \$3.1 million increase in spending associated with the XmAb5871 program is primarily due to expenses related to the clinical trials in IgG4-RD and SLE. The increased spending of \$1.0 million in the three months ended September 30, 2016 on XmAb7195 is primarily due to development expenses and the clinical trial costs related to the XmAb7195 Phase 1b trial which began in September 2016.

*General and Administrative Expenses*

The following table summarizes our general and administrative expenses for the three months ended September 30, 2016 and 2015 (in millions):

	Three Months Ended September 30,		
	2016	2015	Change
General and administrative	\$ 3.0	\$ 3.2	\$ (0.2)

General and administrative expenses decreased by \$0.2 million for the three months ended September 30, 2016 over the same period in 2015 primarily due to a decrease in stock-based compensation costs.

*Other Income, Net*

Other income, net was \$600,000 for the three months ended September 30, 2016 compared to \$300,000 for the same period in 2015 reflecting interest income on our investment in marketable securities.

*Income Tax Provision*

The income taxes for the three months ended September 30, 2016 reflected a benefit of \$600,000, and there was no tax provision or benefit in 2015. The income tax benefit reported for the third quarter of 2016 is a result of the federal and state alternative minimum tax based on the Company's projected year end effective income tax rates applicable to alternative minimum taxable income which cannot be fully offset by the Company's net operating loss carryforwards.

### Comparison of the Nine Months Ended September 30, 2016 and 2015

The following table summarizes our results of operations for the nine months ended September 30, 2016 and 2015 (in millions):

	Nine Months Ended September 30,		
	2016	2015	Change
<b>Revenues:</b>			
Research collaboration	\$ 21.1	\$ 2.1	\$ 19.0
Licensing	60.0	0.9	59.1
Milestone	—	3.0	(3.0)
<b>Total revenues</b>	<b>\$ 81.1</b>	<b>\$ 6.0</b>	<b>\$ 75.1</b>
<b>Operating expenses:</b>			
Research and development	38.5	23.3	15.2
General and administrative	10.0	8.5	1.5
<b>Total operating expenses</b>	<b>48.5</b>	<b>31.8</b>	<b>16.7</b>
Other income, net	1.3	0.5	0.8
Income (loss) before taxes	33.9	(25.3)	59.2
Income tax provision	1.2	—	1.2
<b>Net income (loss)</b>	<b>\$ 32.7</b>	<b>\$ (25.3)</b>	<b>\$ 58.1</b>

#### Revenues

Research collaboration revenues for the nine months ended September 30, 2016 increased by \$19.0 million over the same period in 2015 primarily due to revenue recognized under our Amgen Agreement.

Licensing revenues for the nine months ended September 30, 2016 increased by \$59.1 million over the same period in 2015 primarily due to revenue recognized from our Novartis Agreement.

There were no milestone revenues for the nine months ended September 30, 2016. Milestone revenues for the same period in 2015 were from the CSL and Alexion collaborations.

#### Research and Development Expenses

The following table summarizes our research and development expenses for the nine months ended September 30, 2016 and 2015 (in millions):

	Nine Months Ended September 30,		
	2016	2015	Change
<b>Product programs:</b>			
XmAb5871	\$ 13.4	\$ 5.3	\$ 8.1
XmAb7195	6.1	4.3	1.8
Bi-specific	16.8	12.1	4.7
Early research and discovery	2.2	1.6	0.6
<b>Total research and development expenses</b>	<b>\$ 38.5</b>	<b>\$ 23.3</b>	<b>\$ 15.2</b>

Research and development expenses increased \$15.2 million for the nine months ended September 30, 2016 over the same period in 2015. Spending on XmAb5871 increased by \$8.1 million primarily due to expenses related to the initiation of the clinical trials in IgG4-RD and SLE. Increased spending on the XmAb7195 program of \$1.8 million is related to development and clinical costs for the Phase 1b trial initiated in September 2016. Spending on our bispecific programs increased by \$4.7 million primarily due to expenses incurred advancing our XmAb14045 and XmAb13676 candidates into the clinic in 2016 as well as initial development on our next two bispecific candidates XmAb18087 and XmAb20717.

*General and Administrative Expenses*

The following table summarizes our general and administrative expenses for the nine months ended September 30, 2016 and 2015 (in millions):

	Nine Months Ended September 30,		
	2016	2015	Change
General and administrative	\$ 10.0	\$ 8.5	\$ 1.5

General and administrative expenses increased by \$1.5 million for the nine months ended September 30, 2016 over the same period in 2015. The increase is primarily due to an increase in legal and accounting fees for compliance related activities and stock-based compensation costs.

*Other Income, Net*

Other income, net was \$1.3 million for the nine months ended September 30, 2016 compared to \$0.5 million for the same period in 2015 reflecting interest income on our investment in marketable securities.

*Income Tax Provision*

The income tax provision for the nine months ended September 30, 2016 was \$1.2 million and there was no tax provision for the same period in 2015. The provision for income taxes for the nine months ended September 30, 2016 is a result of the federal and state alternative minimum tax based on the Company's projected year end effective income tax rates applicable to alternative minimum taxable income which cannot be fully offset by the Company's net operating loss carryforwards.

*Cash Flows*

The following table sets forth the primary sources and uses of cash for each of the periods presented below (in thousands):

	Nine Months Ended September 30,		
	2016	2015	Change
Net cash provided by (used in):			
Operating activities	\$ 110,405	\$ 30,511	\$ 79,894
Investing activities	(109,382)	(143,416)	34,034
Financing activities	1,174	115,994	(114,820)
Net decrease in cash	<u>\$ 2,197</u>	<u>\$ 3,089</u>	<u>\$ (893)</u>

*Operating Activities*

Cash provided by operating activities for the nine months ended September 30, 2016 increased by \$80 million over the same period in 2015 reflecting the upfront proceeds from the Novartis collaboration in 2016 and the upfront payment received from the Amgen collaboration in 2015.

*Investing Activities*

Investing activities consist primarily of investments in marketable securities available-for-sale, purchases of intangible assets, capitalization of patent and licensing costs and, purchases of property and equipment. Net cash used in investing activities decreased by \$34 million for the nine months ended September 30, 2016 over the same period in 2015 primarily from a reduction in the net purchases of marketable securities over sales and maturities.

### *Financing Activities*

Net cash provided by financing activities consist primarily of net proceeds from the sale of common stock and from the issuance of common stock upon exercise of stock awards. Net financing proceeds decreased by \$114.8 million during the nine months ended September 30, 2016 compared to the same period in 2015 primarily due to the \$115.2 million received from our follow-on financing in March 2015.

### **Liquidity and Capital Resources**

We have financed our operations primarily through private placements of our equity and convertible notes, the public offerings of our common stock, and payments received under our product development partnerships and licensing arrangements.

On March 3, 2015, we finalized the sale of 8,625,000 shares of common stock at an offering price of \$14.25 per share, resulting in net proceeds of approximately \$115.2 million, after deducting underwriting discounts, commissions and offering expenses. In September 2015 we received a \$45 million upfront payment in connection with our 2015 Amgen transaction.

In July 2016, we received a \$150 million upfront payment in connection with our Novartis Agreement.

As of September 30, 2016, we had \$301.9 million of cash, cash equivalents and marketable securities. We expect to continue to receive additional payments from our collaborators for research and development services rendered, additional milestone, contingent payments, opt-in and annual license maintenance payments. Our ability to receive milestone payments and contingent payments from our partners is dependent upon either our ability or our partners' abilities to achieve certain levels of research and development activities and is therefore uncertain at this time.

On September 19, 2016, we entered into an Equity Distribution Agreement (the Distribution Agreement) with Piper Jaffray & Co (Piper Jaffray) pursuant to which we may sell from time to time, at our option, up to an aggregate of \$40 million of common stock through Piper Jaffray as sales agent. The issuance and sale of these shares by Xencor under the Distribution Agreement will be pursuant to our shelf registration statement on Form S-3 (File No.333-213700) declared effective by the SEC on October 5, 2016.

Piper Jaffray may sell the common stock by any method permitted under law deemed to be an "at the market" offering as defined by Rule 15 of the Securities Act of 1933, as amended including without limitation sales made by means of ordinary brokers on the NASDAQ Global market or otherwise at market prices prevailing at the time of sale or as otherwise directed by the Company. Piper Jaffray will use commercially reasonable efforts to sell the common stock from time to time, based on instructions from Xencor. Additionally, under the terms of the Distribution agreement, the Company may sell shares of its common stock through Piper Jaffray on terms agreed upon by both parties.

We are not obligated sell any shares of common stock under the Agreement. The offering of common stock pursuant to the Distribution Agreement will terminate upon the earlier of:

1. the issuance and sale of all of the shares of common stock subject to the Distribution agreement,
2. three years from the Registration effective date, October 5, 2016,
3. the date the Company becomes ineligible to use the Registration statement or,
4. the termination of the Distribution Agreement as provided in the Agreement.

To date, we have not sold any shares under the Distribution Agreement.

### **Funding Requirements**

We have not generated any revenue from product sales to date and do not expect to do so until such time as we obtain regulatory approval of and commercialize one or more of our product candidates. As we are currently in clinical stage of development, it will be some time before we expect to achieve this and it is uncertain that we ever will commercialize one or more of our product candidates. We expect that we will continue to increase our operating

expenses in connection with ongoing as well as additional clinical and pre-clinical development of product candidates in our pipeline.

Although it is difficult to predict our funding requirements, we expect that our existing cash, cash equivalents and marketable securities and certain potential milestone and contingent contractual payments will fund our operating expenses and capital expenditure requirements beyond the end of 2019. We have based these estimates on assumptions that may prove to be wrong, and we could use our capital resources sooner than we currently expect. Additionally, the process of testing product candidates in clinical trials is costly, and the timing of progress in these trials is uncertain. Because our product candidates are in various stages of development and the outcome of these efforts is uncertain, we cannot estimate the actual amounts necessary to successfully complete the development and commercialization of our product candidates or whether, or when, we may achieve profitability.

#### **Off-Balance Sheet Arrangements**

We did not have during the periods presented, and we do not currently have, any off-balance sheet arrangements.

#### **Critical Accounting Policies**

For a discussion on our material changes in critical accounting policies, see “Recent Accounting Pronouncements” in the notes to the financial statements included in this quarterly report on form 10-Q.

### **ITEM 3. Quantitative and Qualitative Disclosures about Market Risk**

Our primary objective when considering our investment activities is to preserve capital in order to fund our operations. Our primary exposure to market risk is related to changes in interest rates. Our current investment policy is to invest principally in deposits and securities issued by the U.S. government and its agencies, government sponsored agency debt obligations, corporate debt obligations and money market instruments. As of September 30, 2016 we had cash and cash equivalents and marketable securities of \$301.9 million consisting of bank deposits, interest-bearing money market accounts, and US government and corporate securities. Our primary exposure to market risk is interest rate sensitivity, which is affected by changes in the general level of U.S. interest rates. Due to the short-term maturities of our cash equivalents and marketable securities and the conservative risk profile of our marketable securities, a substantial change in interest rates would not have a material effect on the fair market value of our cash equivalents and marketable securities. We have the ability to hold our marketable securities until maturity, and we therefore do not expect a change in interest rates to affect our operating results or cash flows to any significant degree.

### **ITEM 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

Our management, including our principal executive and principal financial officers, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in this Quarterly Report on Form 10-Q has been appropriately recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive and principal financial officers, to allow timely decisions regarding required disclosure. Based on that evaluation, our principal executive and principal financial officers have concluded that our disclosure controls and procedures are effective at the reasonable assurance level as of September 30, 2016.

#### **Changes in Internal Control**

There have been no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings.

On March 3, 2015, a verified class action complaint, captioned DePinto v. John S. Stafford, et al., C.A. No. 10742, was filed in the Court of Chancery of the State of Delaware against certain of the Company's current and former directors alleging cause of action for Breach of Fiduciary Duty and Invalidity of Director and Stockholder Consents. In general, the complaint alleged that the plaintiff and the class he seeks to represent were shareholders of the Company during the recapitalization and certain related transactions that the Company underwent in 2013 and that the defendants breached their fiduciary duties in the course of approving that series of transactions. It also challenged as invalid certain corporate acts taken in the 2013 time period. On June 10, 2015, the Company filed a Verified Petition for Relief under Del. C. Section 205 (the 205 Petition) related to the corporate acts challenged in the complaint. The defendants filed an answer to the class action complaint on June 22, 2015. On July 9, 2015, the Court consolidated the 205 Petition with the class action, joined the Company as a defendant and ordered it to file the claims in the 205 Petition as counter-claims in the class action, which the Company has done.

On August 11, 2015, the Company filed a Motion for leave to File an Amended Counter-Claim, along with the proposed Amended Counter-Claim and related documents. On October 5, 2015, the parties filed a Stipulation of Partial Settlement and related documents disclosing a settlement of the invalidity claims addressed in the complaint, the counter-claim and the proposed amended counter-claim including a request by plaintiff's counsel for reimbursement of legal fees up to \$950,000. On October 7, 2015, Xencor filed the Amended Counter-Claim and the related documents. On December 14, 2015, the Court entered an Order and Partial Final Judgment approving the settlement of the invalidity claims, validating each corporate act challenged in the complaint, dismissing with prejudice Count II of the complaint (the invalidity claims) and granting plaintiff's counsel a fee award. We have paid the plaintiff's legal award cost of \$950,000 net of insurance proceeds of \$187,500 which has been reflected as a charge in our 2015 operations.

On September 27, 2016, the parties engaged in voluntary mediation and agreed to settle the complaint's remaining claims for a total payment of \$2.375 million to the class certified by the Delaware Court of Chancery. The settlement, which is subject to approval by the Court, was reached without any party admitting wrong-doing. Under the terms of the settlement, no payments shall be made to the plaintiffs by the Company or any of the defendants in the lawsuit other than payments covered by the Company's insurance. The Company currently expects that the court will approve the settlement in the first quarter of 2017.

We continue to recognize legal costs related to the litigation as incurred and offset any insurance proceeds when approved and issued. For the period ended September 30, 2016 no amount of loss related to the settlement has been accrued. As of September 30, 2016, we have reported the \$2.375 million settlement as a payable and also reflected a receivable of the same amount for the insurance coverage that will fund the settlement.

### Item 1A. Risk Factors

The following risk factors, which supplement or update the risk factors set forth in "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 may affect our future financial condition and results of operations. The risk described below is not the only risk we face. See also "Special Note Regarding Forward-Looking Statements" included in this Quarterly Report on Form 10-Q. In addition to the risks set forth in our Annual Report on Form 10-K for the year ended December 31, 2015, additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business.

***We are obligated to develop and maintain proper and effective internal control over financial reporting. If these internal controls are determined not to be effective, investor confidence in our company may be adversely affected and, as a result, the value of our common stock may be harmed.***

We regularly review and update our internal controls, disclosure controls and procedures, and corporate governance policies. We are required under the Sarbanes-Oxley Act of 2002 to report annually on our internal control over financial reporting, but as an emerging growth company we have been exempt from the requirement to have our independent accountants attest to our internal control over financial reporting. As of December 31, 2016, we will no

longer qualify as an emerging growth company. As a result, our independent registered public accounting firm will be required to issue an attestation report on the effectiveness of our internal control over financial reporting. We are in the process of determining whether our existing internal controls over financial reporting systems are compliant with Section 404. This process requires the investment of substantial time and resources, including by members of our senior management, and may divert internal resources and take a significant amount of time and effort to complete. In addition, even if our management concludes that our internal control over financial reporting is effective, our independent registered public accounting firm may conclude that there are material weaknesses or significant deficiencies with respect to our internal controls or the level at which our controls are documented, designed, implemented or reviewed.

If it were to be determined that our internal control over financial reporting is not effective, such a shortcoming could result in an adverse reaction in the marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively affect the market price of our shares, increase the volatility of our stock price and adversely affect our ability to raise additional funding.

## **Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

### *Recent Sales of Unregistered Securities*

**None**

**Item 6. Exhibits**

- 3.1 Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K, filed with the SEC on December 11, 2013).
- 3.2 Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K, filed with the SEC on December 11, 2013).
- 4.1 Form of Common Stock Certificate of the Company (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1, as amended (File No. 333-191689), originally filed with the SEC on October 25, 2013).
- 4.2 Third Amended and Restated Investor Rights Agreement, dated September 26, 2013, among the Company and certain of its stockholders incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1, as amended (File No. 333-191689), originally filed with the SEC on October 11, 2013).
- 10.1 Equity Distribution Agreement, dated as of September 19, 2016, by and between the Company and Piper Jaffray & Co. (incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K, filed with the SEC on September 19, 2016).
- 10.2\* Amendment No. 1, dated September 21, 2016, to the Collaboration and License Agreement by and between the Company and Novartis Institutes for BioMedical Research, Inc., dated June 26, 2016
- 31.1 Rule 13a-14(a) Certification of Principal Executive Officer.
- 31.2 Rule 13a-14(a) Certification of Principal Financial Officer.
- 32.1 Section 1350 Certification of Principal Executive Officer and Principal Financial Officer.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Schema Document
- 101.CAL XBRL Calculation Linkbase Document
- 101.DEF XBRL Definition Linkbase Document
- 101.LAB XBRL Labels Linkbase Document
- 101.PRE XBRL Presentation Linkbase Document

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\* Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Security and Exchange Commission.

**SIGNATURES**

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

XENCOR, INC.

BY: /s/ BASSIL I. DAHIYAT

Bassil I. Dahiyat, Ph.D.  
President and Chief Executive Officer  
(Principal Executive Officer)

BY: /s/ JOHN J. KUCH

John J. Kuch  
Vice President, Finance  
(Principal Financial Officer)

Dated: November 2, 2016

**EXHIBIT INDEX**

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\* Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted portions have been filed separately with the Security and Exchange Commission.

\*\*\* Text Omitted and Filed Separately  
with the Securities and Exchange Commission.  
Confidential Treatment Requested  
Under 17 C.F.R. Sections 200.80(b)(4)  
and 240.24b-2

**AMENDMENT NO. 1 TO COLLABORATION AND LICENSE AGREEMENT**

This Amendment No. 1 to the Collaboration and License Agreement (“ **this Amendment** ”), is entered into as of September 21, 2016 (the “ **Amendment No. 1 Effective Date** ”) by and between Xencor, Inc., a corporation organized and existing under the Laws of the State of Delaware (“ **Xencor** ”), and Novartis Institutes for BioMedical Research, Inc., a corporation organized and existing under the Laws of the State of Delaware (“ **Novartis** ”). Xencor and Novartis are referred to in this Agreement individually as a “ **Party** ” and collectively as the “ **Parties** ”.

**RECITALS:**

**WHEREAS**, The Parties previously entered into the Collaboration and License Agreement with an effective date of June 26, 2016 (the “ **Agreement** ”).

**WHEREAS**, The Parties wish to amend the terms of the Agreement.

**NOW, THEREFORE** , in consideration of the foregoing premises and the mutual covenants herein contained, the Parties hereby agree as follows:

1. Section 1.1.124 shall be replaced with the following:  
1.1.124 “ **Internal Program** ” means, [...\*\*\*...]

**\*\*\* Confidential Treatment Requested**

[...\*\*\*...].

2. Except as expressly provided in this Amendment, all other terms, conditions and provisions of the Agreement shall continue in full force and effect as provided therein.
3. The Amendment will be construed and the respective rights of the Parties determined in accordance with the substantive Laws of the State of New York, notwithstanding any provisions of New York Law or any other Law governing conflicts of laws to the contrary.
4. The Amendment may be executed in two counterparts, including by facsimile or PDF signature pages, each of which will be deemed an original, but both of which together will constitute one and the same instrument.

**THE REMAINDER OF THIS PAGE HAS BEEN LEFT INTENTIONALLY BLANK**

**\*\*\* Confidential Treatment Requested**

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**IN WITNESS WHEREOF**, the Parties have executed this Amendment as of the Amendment No. 1 Effective Date.

**NOVARTIS INSTITUTES FOR  
BIOMEDICAL RESEARCH, INC.**

BY       /s/ Scott Brown        
NAME: Scott Brown  
TITLE: Vice President, General Counsel

**XENCOR, INC.**

BY:       /s/ Edgardo Baracchini        
NAME: Edgardo Baracchini  
TITLE: C.B.O.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, Bassil I. Dahiyat, Ph.D., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Xencor, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in exchange act rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company is made known to us particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting; and
5. The Company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ BASSIL I. DAHIYAT

Bassil I. Dahiyat, Ph.D.

*President & Chief Executive Officer*

Date: November 2, 2016

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**CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE  
SARBANES-OXLEY ACT OF 2002**

I, John J. Kuch, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Xencor, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
4. The Company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in exchange act rules 13a-15(f) and 15d-15(F) for the Company and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company is made known to us, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the Company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter (the Company's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company's auditors and the audit committee of the Company's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company's internal control over financial reporting.

/s/ JOHN J. KUCH

John J. Kuch  
*Vice President, Finance (Principal Financial Officer)*

Date: November 2, 2016

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**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, (the “Exchange Act”) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Bassil I. Dahiyat, Chief Executive Officer of Xencor, Inc. (the “Company”), and John J. Kuch, Vice President, Finance of the Company, each hereby certifies that, to the best of his or her knowledge:

1. The Company’s Quarterly Report on Form 10-Q for the period ended September 30, 2016, to which this Certification is attached as Exhibit 32.1 (the “Periodic Report”), fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act; and
2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 2, 2016

**IN WITNESS WHEREOF** , the undersigned have set their hands hereto as of the 2nd day of November, 2016.

/s/ BASSIL I. DAHIYAT  
Bassil I. Dahiyat  
Chief Executive Officer

/s/ JOHN J. KUCH  
John J. Kuch  
Vice President, Finance

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Xencor, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

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