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

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, 2019**

or

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

Commission file number: **001-36182**

Xencor, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(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)

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

Title of each class:	Trading Symbol	Name of each exchange on which registered:
Common Stock, par value \$0.01 per share	XNCR	NASDAQ

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

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

If an emerging growth company, indicate by checkmark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13 (a) of the Exchange Act.

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 31, 2019
Common stock, \$0.01 par value	56,721,172

Xencor, Inc.

Quarterly Report on FORM 10-Q for the quarter ended September 30, 2019

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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 research, 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, 2018 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 1. Financial Statements

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

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
	<u>(unaudited)</u>	
Assets		
Current assets		
Cash and cash equivalents	\$ 51,189	\$ 26,246
Marketable securities	495,292	268,115
Accounts receivable	4,349	10,187
Income tax receivable	402	804
Contract asset	15,000	—
Prepaid expenses and other current assets	7,533	10,375
Total current assets	<u>573,765</u>	<u>315,727</u>
Property and equipment, net	13,868	11,813
Patents, licenses, and other intangible assets, net	14,027	11,969
Marketable securities - long term	73,995	236,108
Income tax receivable	402	804
Other assets	10,187	311
Total assets	<u>\$ 686,244</u>	<u>\$ 576,732</u>
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable	\$ 8,304	\$ 3,797
Accrued expenses	7,832	9,662
Deferred rent	—	315
Lease liabilities	2,197	—
Deferred revenue	45,579	40,079
Income tax payable	400	—
Total current liabilities	<u>64,312</u>	<u>53,853</u>
Deferred rent, net of current portion	—	1,198
Lease liabilities, net of current portion	9,082	—
Deferred revenue, net of current portion	2,613	—
Total liabilities	<u>76,007</u>	<u>55,051</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, 2019 and December 31, 2018	—	—
Common stock, \$0.01 par value: 200,000,000 authorized shares at September 30, 2019 and December 31, 2018; 56,714,788 issued and outstanding at September 30, 2019 and 56,279,542 issued and outstanding at December 31, 2018	567	563
Additional paid-in capital	877,724	845,366
Accumulated other comprehensive income (loss)	1,436	(971)
Accumulated deficit	<u>(269,490)</u>	<u>(323,277)</u>
Total stockholders' equity	<u>610,237</u>	<u>521,681</u>
Total liabilities and stockholders' equity	<u>\$ 686,244</u>	<u>\$ 576,732</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,	
	2019	2018	2019	2018
Revenue				
Collaborations, licenses, milestones, and royalties	\$ 21,760	\$ 29,039	\$ 153,184	\$ 29,039
Operating expenses				
Research and development	29,770	20,953	91,250	70,371
General and administrative	6,266	7,435	17,537	16,955
Total operating expenses	36,036	28,388	108,787	87,326
Income (loss) from operations	(14,276)	651	44,397	(58,287)
Other income (expenses)				
Interest income, net	3,699	2,642	10,201	6,279
Other income (expense), net	3	(143)	(211)	(202)
Total other income, net	3,702	2,499	9,990	6,077
Net income (loss) before income tax expense (benefit)	(10,574)	3,150	54,387	(52,210)
Income tax expense (benefit)	(350)	—	600	—
Net income (loss)	(10,224)	3,150	53,787	(52,210)
Other comprehensive income (loss)				
Net unrealized gain (loss) on marketable securities	(193)	(330)	2,407	(530)
Comprehensive income (loss)	\$ (10,417)	\$ 2,820	\$ 56,194	\$ (52,740)
Basic net income (loss) per common share	\$ (0.18)	\$ 0.06	\$ 0.95	\$ (0.98)
Diluted net income (loss) per common share	\$ (0.18)	\$ 0.05	\$ 0.92	\$ (0.98)
Basic weighted average common shares outstanding	56,643,075	55,974,080	56,449,678	53,165,774
Diluted weighted average common shares outstanding	56,643,075	58,313,002	58,365,158	53,165,774

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 Income (Loss)	Accumulated Deficit	
Balance, December 31, 2018	56,279,542	563	845,366	(971)	(323,277)	521,681
Issuance of common stock upon exercise of stock awards	58,536	1	666	—	—	667
Issuance of restricted stock units	11,311	—	—	—	—	—
Comprehensive income	—	—	—	1,316	80,045	81,361
Stock-based compensation	—	—	5,856	—	—	5,856
Balance, March 31, 2019	56,349,389	\$ 564	\$ 851,888	\$ 345	\$ (243,232)	\$ 609,565
Issuance of common stock upon exercise of stock awards	143,504	1	3,238	—	—	3,239
Issuance of common stock under the Employee Stock Purchase Plan	36,505	—	734	—	—	734
Comprehensive income (loss)	—	—	—	1,284	(16,034)	(14,750)
Stock-based compensation	—	—	9,303	—	—	9,303
Balance, June 30, 2019	56,529,398	\$ 565	\$ 865,163	\$ 1,629	\$ (259,266)	\$ 608,091
Issuance of common stock upon exercise of stock awards	185,390	2	3,047	—	—	3,049
Comprehensive loss	—	—	—	(193)	(10,224)	(10,417)
Stock-based compensation	—	—	9,514	—	—	9,514
Balance, September 30, 2019 (unaudited)	56,714,788	\$ 567	\$ 877,724	\$ 1,436	\$ (269,490)	\$ 610,237

Stockholders' Equity	Common Stock		Additional Paid in-Capital	Accumulated		Total Stockholders' Equity
	Shares	Amount		Other Comprehensive Income (Loss)	Accumulated Deficit	
Balance, December 31, 2017	47,002,488	470	570,670	(1,808)	(287,286)	282,046
Adoption of ASC 606	—	—	—	—	34,418	34,418
Balance December 31, 2017 as revised	47,002,488	470	570,670	(1,808)	(252,868)	316,464
Sale of common stock, net of issuance cost	8,395,000	84	245,421	—	—	245,505
Issuance of common stock upon exercise of stock awards	219,387	2	1,108	—	—	1,110
Comprehensive loss	—	—	—	(393)	(29,493)	(29,886)
Stock-based compensation	—	—	4,471	—	—	4,471
Balance, March 31, 2018	55,616,875	\$ 556	\$ 821,670	\$ (2,201)	\$ (282,361)	\$ 537,664
Sale of common stock, net of issuance cost	—	—	(1)	—	—	(1)
Issuance of common stock upon exercise of stock awards	177,883	2	1,803	—	—	1,805
Issuance of common stock under the Employee Stock Purchase Plan	26,552	—	504	—	—	504
Comprehensive income (loss)	—	—	—	193	(25,869)	(25,676)
Stock-based compensation	—	—	4,882	—	—	4,882
Balance, June 30, 2018	55,821,310	\$ 558	\$ 828,858	\$ (2,008)	\$ (308,230)	\$ 519,178
Issuance of common stock upon exercise of stock awards	391,139	4	4,150	—	—	4,154
Comprehensive income (loss)	—	—	—	(330)	3,150	2,820
Stock-based compensation	—	—	6,120	—	—	6,120
Balance, September 30, 2018	56,212,449	\$ 562	\$ 839,128	\$ (2,338)	\$ (305,080)	\$ 532,272

See accompanying notes.

Xencor, Inc.
Statements of Cash Flows
(unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities		
Net income (loss)	\$ 53,787	\$ (52,210)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,073	2,368
Amortization of premium and accretion of discount on marketable securities	(3,333)	68
Stock-based compensation	24,673	15,473
Abandonment of capitalized intangible assets	115	118
Loss on disposal of assets	8	110
Changes in operating assets and liabilities:		
Accounts receivable	5,903	(1,320)
Interest receivable	(3)	(624)
Contract asset	(15,000)	—
Prepaid expenses and other assets	2,843	(6,535)
Accounts payable	4,508	(886)
Accrued expenses	(1,830)	192
Income taxes	1,204	(156)
Deferred rent	(1,513)	466
Lease liabilities and ROU assets	1,403	—
Deferred revenue	8,113	(20,039)
Net cash provided by (used in) operating activities	<u>83,951</u>	<u>(62,975)</u>
Cash flows from investing activities		
Purchase of marketable securities	(352,174)	(331,126)
Purchase of intangible assets	(2,932)	(1,302)
Purchase of property and equipment	(4,443)	(4,425)
Proceeds from maturities of marketable securities	292,852	165,134
Repayment of loan	—	86
Net cash used in investing activities	<u>(66,697)</u>	<u>(171,633)</u>
Cash flows from financing activities		
Proceeds from issuance of common stock upon exercise of stock awards	6,955	7,068
Proceeds from issuance of common stock under the Employee Stock Purchase Plan	734	504
Proceeds from issuance of common stock	—	260,245
Common stock issuance costs	—	(14,741)
Net cash provided by financing activities	<u>7,689</u>	<u>253,076</u>
Net increase in cash and cash equivalents	<u>24,943</u>	<u>18,468</u>
Cash and cash equivalents, beginning of period	<u>26,246</u>	<u>16,528</u>
Cash and cash equivalents, end of period	<u>\$ 51,189</u>	<u>\$ 34,996</u>
Supplemental disclosure of cash flow information		
Cash paid during the period for:		
Interest	\$ 11	\$ 9
Income taxes	\$ 200	\$ 170
Supplemental disclosures of non-cash investing activities		
Unrealized gain (loss) on marketable securities, net of tax	\$ 2,407	\$ (530)

See accompanying notes.

Xencor, Inc.

**Notes to Financial Statements
(unaudited)**

September 30, 2019

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim financial statements for Xencor, Inc. (the Company, Xencor, we or us) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. Certain amounts in the prior period financial statements have been revised to conform to the presentation of the current period financial statements. 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 2018 Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on February 26, 2019.

Use of Estimates

The preparation of interim financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, other comprehensive gain (loss) and the related disclosures. On an ongoing basis, management evaluates its estimates, including estimates related to its accrued clinical trial and manufacturing development expenses, stock-based compensation expense, intangible assets and related amortization. Significant estimates in these interim financial statements include estimates made for royalties and accrued research and development expenses, stock-based compensation expenses, intangible assets and related amortization, estimated standalone selling price of performance obligations, the likelihood of recognizing variable consideration, and recoverability of deferred tax assets.

Intangible Assets

The Company maintains definite-lived intangible assets related to certain capitalized costs of acquired licenses and third-party costs incurred in establishing and maintaining its intellectual property rights to its platform technologies and development candidates. These assets are amortized over their useful lives, which are estimated to be the remaining patent life or the contractual term of the license. The straight-line method is used to record amortization expense. The Company assesses its intangible assets for impairment if indicators are present or changes in circumstances suggest that impairment may exist. There were no impairment charges recorded for the nine months ended September 30, 2019 and 2018.

The Company capitalizes certain in-process intangible assets that are abandoned when they are no longer pursued or used in current research activities. There was no material abandonment of in-process intangible assets during the nine months ended September 30, 2019 or 2018.

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 debt securities issued by investment grade institutions.

The Company considers its marketable debt 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 debt securities is included in marketable securities. If a decline in the value of a marketable debt 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 debt securities, using both quantitative and qualitative factors, to determine if declines in fair value below cost are other-than-temporary.

Recent Accounting Pronouncements

Pronouncements Adopted in 2019

Effective January 1, 2019, the Company adopted Accounting Standards Codification Topic 842 (ASC 842), *Leases*, which requires lessees to recognize a right-of-use (ROU) asset and a lease liability for leases with terms greater than 12 months and also requires disclosures about the amount, timing and uncertainty of cash flows arising from such leases. The Company adopted ASC 842 using the optional transition method provided under ASU 2018-11, which did not require adjustments to comparative periods nor require modified disclosures in those comparative periods. Under this method, the Company adjusted its financial statements for the cumulative effect of the adoption of ASC 842 at the beginning of January 1, 2019.

At inception of an arrangement, the Company determines whether the arrangement is or contains a lease based on the unique facts and circumstances. For leases with a term of one year or longer where the Company is the lessee, ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent an obligation to make lease payments arising from the lease. ROU assets and lease liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. The interest rate implicit with such leases is typically not readily determined. The Company has determined the appropriate incremental borrowing rate by reference to an estimate of the current market borrowing rate for a collateralized asset over a similar term as the lease term.

The new standard impacts our reporting on the leases on our facilities in Monrovia and San Diego. Under ASC 842, tenant allowances under such operating leases are no longer tracked separately as a deferred rent liability; instead, it is integrated as part of the ROU asset. As a result, we recorded an adjustment to the beginning balance for deferred rent liability and adopted the use of ROU asset and lease liability. We recorded lease liabilities of \$12.7 million and ROU assets of \$11.4 million for lease agreements in effect as of January 1, 2019. The ROU asset is included in Other assets on the balance sheet as of September 30, 2019. This resulted in an increase to the beginning balance on both assets and liabilities after the adjustment of \$11.2 million, with no impact on our retained earnings.

Effective January 1, 2019, the Company adopted ASU No. 2018-07, *Compensation – Stock Compensation* (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of Topic 718 to include share-based payments issued to nonemployees for goods and services. The standard requires a modified retrospective transition approach, with a cumulative adjustment to retained earnings as of adoption date, for all liability-classified awards that have not been settled as of the adoption date and equity-classified nonemployee awards for which a measurement date has not been established. The adoption of this standard did not have any impact on the Company's financial statements.

There have been no other material changes to the significant accounting policies previously disclosed in the Company's 2018 Annual Report on Form 10-K.

2. Fair Value of Financial Instruments

Financial instruments included in the financial statements include cash equivalents, marketable securities, 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-term 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). 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.

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, 2019			December 31, 2018		
	Total Fair Value	Level 1	Level 2	Total Fair Value	Level 1	Level 2
Money Market Funds	\$ 30,603	\$ 30,603	\$ —	\$ 18,270	\$ 18,270	\$ —
Corporate Securities	217,702	—	217,702	104,967	—	104,967
Government Securities	351,585	—	351,585	399,256	—	399,256
	<u>\$ 599,890</u>	<u>\$ 30,603</u>	<u>\$ 569,287</u>	<u>\$ 522,493</u>	<u>\$ 18,270</u>	<u>\$ 504,223</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, 2019 and 2018, 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 basic 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 net 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, employee stock purchase plan (ESPP) and restricted stock units (RSUs). Potentially dilutive securities consisting of stock issuable under options, ESPP and RSUs are not included in the per common share calculation in periods where there is a net loss where the inclusion of such shares would have had an antidilutive effect.

Basic and diluted net 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,	
	2019	2018	2019	2018
(in thousands, except share and per share data)				
Numerator:				
Net income (loss) attributable to common stockholders	\$ (10,224)	\$ 3,150	\$ 53,787	\$ (52,210)
Denominator:				
Weighted-average common shares outstanding used in computing basic net income (loss)	56,643,075	55,974,080	56,449,678	53,165,774
Weighted-average common shares outstanding used in computing diluted net income (loss)	56,643,075	58,313,002	58,365,158	53,165,774
Basic net income (loss) per common share	\$ (0.18)	\$ 0.06	\$ 0.95	\$ (0.98)
Diluted net income (loss) per common share	\$ (0.18)	\$ 0.05	\$ 0.92	\$ (0.98)

For the three months ended September 30, 2019 and the nine months ended September 30, 2018, 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 three months ended September 30, 2018 and the nine months ended September 30, 2019, potentially dilutive securities were included in the diluted net income per common share calculation.

The numbers of common stock equivalents that were included in the calculation of the weighted-average common shares outstanding used in computing diluted net income per common share are as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
(in thousands)				
Employee stock purchase plan shares	—	—	20	—
Options to purchase common stock and RSU grants	—	2,339	1,895	—
	—	2,339	1,915	—

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The table below summarizes the number of common stock equivalents that were excluded in the calculation of the weighted-average common shares outstanding used in computing diluted net income (loss) because the inclusion of such shares would have had an antidilutive effect as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
	(in thousands)		(in thousands)	
Employee stock purchase plan shares	6	—	—	—
Options to purchase common stock and RSU grants	2,261	—	—	1,884
	<u>2,267</u>	<u>—</u>	<u>—</u>	<u>1,884</u>

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, 2019 and 2018, the only component of other comprehensive income (loss) is net unrealized gain (loss) on marketable securities. There were no material reclassifications out of accumulated other comprehensive income (loss) during the three and nine months ended September 30, 2019 and 2018.

5. Marketable Securities

The Company's marketable debt securities held as of September 30, 2019 and December 31, 2018 are summarized below:

<u>September 30, 2019</u> (in thousands)	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Money Market Funds	\$ 30,603	\$ —	\$ —	\$ 30,603
Corporate Securities	217,484	228	(10)	217,702
Government Securities	350,358	1,227	—	351,585
	<u>\$ 598,445</u>	<u>\$ 1,455</u>	<u>\$ (10)</u>	<u>\$ 599,890</u>

Reported as				
Cash and cash equivalents				\$ 30,603
Marketable securities				569,287
Total investments				<u>\$ 599,890</u>

<u>December 31, 2018</u> (in thousands)	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Money Market Funds	\$ 18,270	\$ —	\$ —	\$ 18,270
Corporate Securities	105,311	1	(345)	104,967
Government Securities	399,873	187	(804)	399,256
	<u>\$ 523,454</u>	<u>\$ 188</u>	<u>\$ (1,149)</u>	<u>\$ 522,493</u>

Reported as				
Cash and cash equivalents				\$ 18,270
Marketable securities				504,223
Total investments				<u>\$ 522,493</u>

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

<u>September 30, 2019</u> (in thousands)	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Mature in one year or less	\$ 494,248	\$ 495,292
Mature within two years	73,594	73,995
	<u>\$ 567,842</u>	<u>\$ 569,287</u>

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The unrealized losses on available-for-sale investments and their related fair values as of September 30, 2019 and December 31, 2018 are as follows:

	<u>Less than 12 months</u>		<u>12 months or greater</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
<u>September 30, 2019</u>				
(in thousands)				
Corporate Securities	\$ 3,037	\$ (1)	\$ 21,409	\$ (9)
Government Securities	15,606	(1)	—	—
	<u>\$ 18,643</u>	<u>\$ (2)</u>	<u>\$ 21,409</u>	<u>\$ (9)</u>

	<u>Less than 12 months</u>		<u>12 months or greater</u>	
	<u>Fair value</u>	<u>Unrealized losses</u>	<u>Fair value</u>	<u>Unrealized losses</u>
<u>December 31, 2018</u>				
(in thousands)				
Corporate Securities	\$ 84,666	\$ (310)	\$ 17,805	\$ (35)
Government Securities	176,225	(672)	116,830	(132)
	<u>\$ 260,891</u>	<u>\$ (982)</u>	<u>\$ 134,635</u>	<u>\$ (167)</u>

The unrealized losses from the listed securities are due to a change in the interest rate environment and not a change in the credit quality of the securities.

The Company does not intend to sell these securities, and it is not more likely than not that the Company will be required to sell the securities before recovery of the amortized cost basis. Therefore, the Company did not consider these securities to be other-than-temporarily impaired as of September 30, 2019 or December 31, 2018.

6. Sale of Additional Common Stock

In March 2018, we completed the sale of 8,395,000 shares of common stock which included shares issued pursuant to our underwriters' exercise of their over-allotment option pursuant to a follow-on financing. We received net proceeds of \$245.5 million after underwriting discounts, commissions and offering expenses.

7. Stock Based Compensation

Our Board of Directors (the Board) and the requisite stockholders previously approved the 2010 Equity Incentive Plan (the 2010 Plan). In October 2013, the Board approved the 2013 Equity Incentive Plan (the 2013 Plan) and in November 2013 our stockholders approved the 2013 Plan which became effective as of December 3, 2013. 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.

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As of September 30, 2019, the total number of shares of common stock available for issuance under the 2013 Plan is 11,434,273, which includes 2,684,456 shares 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 the Board on January 1, 2019, the total number of shares of common stock available for issuance under the 2013 Plan was increased by 2,251,181 shares. As of September 30, 2019, a total of 8,669,662 options have been granted under the 2013 Plan.

In November 2013, the Board and our 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 the 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 of Directors, there was no increase in the number of authorized shares in the ESPP in 2019. As of September 30, 2019, we have issued a total of 386,221 shares of common stock under the ESPP.

During the nine months ended September 30, 2019, the Company awarded 39,666 Restricted Stock Units (RSUs) to certain employees. Vesting of these awards is in three equal annual installments and is contingent on continued service to the Company. The fair value of these awards is determined based on the intrinsic value of the stock on the date of grant and will be recognized as stock-based compensation expense over the requisite service period. As of September 30, 2019, we have granted a total of 73,599 shares of common stock subject to RSUs.

Total employee, director and non-employee stock-based compensation expense recognized for the three and nine months ended September 30, 2019 and 2018 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
General and administrative	\$ 2,474	\$ 2,732	\$ 6,337	\$ 6,037
Research and development	7,040	3,388	18,336	9,436
	<u>\$ 9,514</u>	<u>\$ 6,120</u>	<u>\$ 24,673</u>	<u>\$ 15,473</u>

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Stock options	\$ 9,117	\$ 5,832	\$ 23,588	\$ 14,723
ESPP	217	209	630	562
Restricted stock units	180	79	455	188
	<u>\$ 9,514</u>	<u>\$ 6,120</u>	<u>\$ 24,673</u>	<u>\$ 15,473</u>

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

	Number of Shares subject to outstanding options	Weighted Average Exercise Price (Per Share)	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Balances at December 31, 2018	5,966,928	\$ 19.71	7.51	
Options granted	1,918,375	\$ 35.76		
Options forfeited	(266,780)	\$ 31.36		
Options exercised	(387,430)	\$ 17.95		
Balances at September 30, 2019	<u>7,231,093</u>	<u>\$ 23.63</u>	7.47	\$ 78,789
Exercisable	3,831,677	\$ 17.25	6.28	\$ 63,736

We calculate the intrinsic value as the difference between the exercise price of the options and the closing price of common stock of \$33.73 per share as of September 30, 2019.

Weighted average fair value of options granted during the nine-month periods ended September 30, 2019 and 2018 were \$20.71 and \$17.57 per share, respectively. There were 1,679,400 options granted during the nine-month period ended September 30, 2018. 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, 2019 and 2018:

	Options		Options	
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Expected term (years)	6.0	6.1	6.0	6.1
Expected volatility	60.8 %	72.8 %	61.2 %	73.1 %
Risk-free interest rate	1.52 %	2.87 %	2.33 %	2.56 %
Expected dividend yield	— %	— %	— %	— %

	ESPP		ESPP	
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Expected term (years)	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0	0.5 - 2.0
Expected volatility	55.0 - 71.4 %	61.2 - 71.4 %	55.0 - 71.4 %	61.2 - 71.4 %
Risk-free interest rate	1.47 - 2.70 %	1.47 - 2.41 %	1.47 - 2.70 %	1.47 - 2.41 %
Expected dividend yield	— %	— %	— %	— %

As of September 30, 2019, the unamortized compensation expense related to unvested stock options was \$6.6 million. The remaining unamortized compensation expense will be recognized over the next 2.45 years. As of September 30, 2019, the unamortized compensation expense under our ESPP was \$0.1 million. The remaining unamortized expense will be recognized over the next 0.2 years.

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The following table summarizes the RSU activity for the nine-month period ended September 30, 2019:

	Restricted Stock Units	Weighted Average Grant Date Fair Value (Per unit)
Unvested at December 31, 2018	33,933	\$ 27.64
Granted	39,666	35.94
Vested	(11,311)	27.64
Forfeited	(4,182)	31.12
Unvested at September 30, 2019	<u>58,106</u>	<u>\$ 33.05</u>

As of September 30, 2019, the unamortized compensation expense related to unvested restricted stock units was \$1.5 million. The remaining unamortized expense will be recognized over the next 2.2 years.

8. Leases

The Company leases office and laboratory space in Monrovia, CA under a lease that continues through June 2020, with an option to renew for an additional five years. In July 2017, the Company entered into an amended lease agreement for additional space in the same building with a lease that continues through September 2022, also with an option to renew for an additional five years. The Company assesses that it is likely to exercise both options of the lease term extensions.

The Company also leases office space in San Diego, CA through July 2020 which includes an option to renew for an additional five years. The Company assesses that it is unlikely to exercise the option to extend this lease.

The Company leases additional office space in San Diego, CA through August 2022, with an option to extend for an additional five years. The Company assesses that it is unlikely to exercise the option to extend the lease term.

The Company's lease agreements do not contain any residual value guarantees or restrictive covenants. As of September 30, 2019, the Company did not have additional operating leases that have not yet commenced.

The following table reconciles the undiscounted cash flows for the operating leases at September 30, 2019 to the operating lease liabilities recorded on the balance sheet (in thousands):

Years ending December 31,	
For the remainder of 2019	\$ 698
2020	2,703
2021	2,587
2022	2,208
2023	1,352
2024	1,371
Thereafter	2,282
Total undiscounted lease payments	<u>13,201</u>
Less: Imputed interest	(1,922)
Present value of lease payments	<u>\$ 11,279</u>
Lease liabilities - short-term	\$ 2,197
Lease liabilities - long-term	9,082
Total lease liabilities	<u>\$ 11,279</u>

Our operating lease cost and the cash payments for operating leases for the nine months ended September 30, 2019 were \$2.0 million and \$1.9 million, respectively. Rent expense for the nine months ended September 30, 2018 was \$1.9 million.

At September 30, 2019, the weighted-average remaining lease term for operating leases was 5.7 years, and the weighted average discount rate for operating leases is 5.5%.

9. Commitments and 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.

We are obligated to make future payments to third parties under in-license agreements, including sublicense fees, royalties, and payments that become due and payable on the achievement of certain development and commercialization milestones. As the amount and timing of sublicense fees and the achievement and timing of these milestones are not probable and estimable, such commitments have not been included on our balance sheet. We have also entered into agreements with third-party vendors which will require us to make future payments upon the delivery of goods and services in future periods.

10. Collaboration and Licensing Agreements

The following is a summary description of the material revenue arrangements, including arrangements that generated revenue in the nine months ended September 30, 2019 and 2018.

Genentech

In February 2019, the Company entered into a collaboration and license agreement (the Genentech Agreement) with Genentech, Inc. and F. Hoffman-La Roche Ltd (collectively, Genentech) for the development and commercialization of novel IL-15 collaboration products (Collaboration Products), including XmAb24306, the Company's IL-15/IL-15Ra candidate. The Genentech Agreement became effective March 8, 2019.

Under the terms of the Genentech Agreement, Genentech received an exclusive worldwide license to XmAb24306 and other Collaboration Products, including any new IL-15 programs identified during the joint research collaboration. Genentech and Xencor will jointly collaborate on worldwide development of XmAb24306 and other Collaboration Products with Genentech maintaining all worldwide commercialization rights, subject to Xencor having an option to co-promote in the United States. Xencor has the right to perform clinical studies of Collaboration Products in combination with other therapeutic agents at its own cost, subject to certain requirements.

The term of the Genentech Agreement will continue on a program-by-program and country-by-country basis until there are no remaining payment obligations from Genentech to Xencor with respect to Collaboration Products. Genentech may terminate the Genentech Agreement in its entirety or on a Collaboration Product-by-Collaboration Product basis by providing prior written notice. Xencor may terminate the Agreement on a Collaboration Product-by-Collaboration Product basis if Genentech fails to spend a defined minimum amount on research, development, or commercialization activities for that Collaboration Product. In the event of a termination of any individual Collaboration Product or the Genentech Agreement in its entirety, the relevant rights revert to Xencor.

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The Company received a \$120.0 million upfront payment and is eligible to receive up to an aggregate of \$160.0 million in clinical milestone payments for each Collaboration Product that advances to Phase 3 clinical trials. The Company is also eligible to receive 45% share of net profits for sales of XmAb24306 and other Collaboration Products, while also sharing in net losses at the same percentage rate. The parties will jointly share in development and commercialization costs for all programs designated as a development program under the Genentech Agreement at the same percentage rate, while Genentech will bear launch costs entirely. The initial 45% profit-cost share percent is subject to ratchet down at the Company's discretion and convertible to a royalty under certain circumstances.

Pursuant to the Genentech Agreement, XmAb24306 is designated as a development program and all costs incurred for developing XmAb24306 from the effective date of the Genentech Agreement are being shared with Genentech under the initial cost-sharing percentage.

Under the Genentech Agreement, the Company and Genentech will conduct joint research activities for a two-year period to identify and discover additional IL-15 candidates developed from the Company's cytokine and bispecific technologies. The two-year research term may be extended an additional year if both parties agree. The Company and Genentech are each responsible for their own costs in conducting the research activities. The Company will receive a \$20.0 million development milestone for each new Collaboration Product that is identified from the research efforts and advances into a Phase 1 clinical trial.

The Company evaluated the Genentech Agreement under the provisions of ASU No. 2014-09, *Revenue from Contracts with Customers* and all related amendments (collectively, ASC 606) and also ASC 808, *Collaborative Arrangements*. Certain provisions of the Genentech Agreement including the cost-sharing of development programs are governed by ASC 808. We have determined that Genentech is a customer for purposes of the delivery of specific performance obligations under the Genentech Agreement and applied the provisions of ASC 606 to the transaction.

The Company identified the following performance obligations under the Genentech Agreement: (i) the license of XmAb24306 and (ii) research services during a two-year period to identify up to potentially nine additional IL-15 candidates, each a separate research program and a separate performance obligation. The Company determined that the license and each of the potential research programs are separate performance obligations because they are capable of being distinct and are distinct in the context of the Genentech Agreement. The license to XmAb24306 has standalone functionality as Genentech has exclusive worldwide rights to the program, including the right to sublicense to third parties. Genentech has significant experience and capabilities in developing and commercializing drug candidates similar to XmAb24306, and Genentech is capable of performing these activities without the Company's involvement. Upon the transfer of the license of XmAb24306, Genentech could develop and commercialize XmAb24306 without further assistance from the Company. The Company determined that the research services for each potential additional IL-15 candidate and research program were separate standalone performance obligations. The Genentech Agreement provides an outline of an integrated research plan for the programs to be conducted by the two companies, and the research activities are separate and distinct from the license to XmAb24306.

The Company determined the standalone selling price of the license to be \$14.4 million using the adjusted market assessment approach considering similar collaboration and license agreements and transactions. The standalone selling price for the research activities for all nine of the potential IL-15 programs to be performed during the research term was determined to be \$8.5 million using the expected cost approach which was derived from the Company's experience and information from providing similar research activities to other parties.

The Company determined that the transaction price of the Genentech Agreement at inception was \$20.0 million consisting of the upfront payment. The potential milestones are not included in the transaction price as these are contingent on future events and the Company would not recognize these in revenue until it is not probable that these would not result in significant reversal of revenue amounts in future periods. The Company will re-assess the transaction price at each reporting period and when event outcomes are resolved or changes in circumstances occur.

The Company allocated the transaction price to each of the separate performance obligation using the relative standalone selling price with \$11.7 million allocated to the license to XmAb24306 and \$8.3 million allocated to the research services.

The Company recognized the \$111.7 million allocated to the license when it satisfied its performance obligation and transferred the license to Genentech in March 2019. The license was transferred upon the effective date of the Genentech Agreement and when the Company subsequently transferred certain data related to the program to Genentech. The \$8.3 million allocated to the research activities is being recognized over a period of time through the end of the research term that services are rendered as we determine that the input method is the appropriate approach to recognize income for such services. A total of \$1.6 million of revenue related to the research activities was recognized in the nine-month period ended September 30, 2019.

For the three and nine months ended September 30, 2019, we recognized \$0.7 million and \$113.2 million of income, respectively, from the Genentech Agreement. As of September 30, 2019, there is a \$0.5 million payable related to cost-sharing development activities during the third quarter of 2019 for the XmAb24306 program. There is \$6.8 million in deferred revenue as of September 30, 2019 which reflects our obligation to perform research services during the research term.

Astellas

Effective March 29, 2019, the Company entered into a Research and License Agreement (Astellas Agreement) with Astellas Pharma Inc. (Astellas) pursuant to which the Company and Astellas will conduct a discovery program to characterize compounds and products for development and commercialization. Under the Astellas Agreement, Astellas was granted a worldwide exclusive license, with the right to sublicense products in the field created by the research activities.

Pursuant to the Astellas Agreement, the Company will apply its bispecific Fc technology to research antibodies provided by Astellas to generate bispecific antibody candidates and will conduct limited testing and characterization of the bispecific candidates and return the candidates to Astellas for development and commercialization. The activities will be conducted under a research plan agreed to by both parties to the Astellas Agreement. Astellas will assume full responsibility for development and commercialization of the antibody candidate. Pursuant to the Astellas Agreement, the Company received an upfront payment of \$15.0 million and is eligible to receive up to \$240.0 million in milestones which include \$32.5 million in development milestones, \$57.5 million in regulatory milestones and \$150.0 million in sales milestones. If commercialized, the Company is eligible to receive royalties on net sales that range from the high-single to low-double digit percentages.

We evaluated the Astellas Agreement under ASC 606 and identified the performance obligations under the Agreement to be (i) delivery of bispecific antibodies to Astellas from the antigen provided by Astellas and (ii) research activities against the bispecific antibodies as outlined in the research plan. The Company determined that the license to the bispecific antibodies is not a separate performance obligation because it is not capable of being distinct, the license to the antibodies cannot be separated from the underlying antibodies.

Astellas will control and benefit from the antibodies that are delivered. The Astellas Agreement provides Astellas the right to sublicense the antibody to third parties and Astellas has significant experience and capabilities in developing and commercializing clinical candidates and is capable of performing these activities from the delivered antibodies without the Company's involvement.

The Company determined the standalone selling price of the bispecific deliverable to be \$17.1 million using the income approach by calculating a risk adjusted net present value of the potential revenue that could be earned from the arrangement. The standalone selling price for the research activities to be performed was determined to be \$1.4 million using the expected cost approach which was derived from the Company's experience and information from providing similar research activities to other customers.

The Company determined that the transaction price of the Astellas Agreement at inception was \$15.0 million consisting of the upfront payment. The potential milestones are not included in the transaction price as these are contingent on future events and the Company would not recognize these in revenue until it is not probable that these would not result in significant reversal of revenue amounts in future periods. The Company will re-assess the transaction price at each reporting period and when event outcomes are resolved or changes in circumstances occur.

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The Company allocated the transaction price to each of the separate performance obligations using the relative standalone selling price with \$13.6 million allocated to delivery of the bispecific antibodies and \$1.4 million allocated to the research activities.

The Company recognized the \$13.6 million allocated to the bispecific antibodies when it satisfied its performance obligation and transferred the bispecific antibodies to Astellas in June 2019. Astellas transferred the research antibodies to the Company and the Company applied its bispecific technologies to and transferred the completed antibodies to Astellas. The \$1.4 million allocated to the research activities is being recognized as the research services are being completed over the period of time the Company expects to complete the activities under the research plan.

No revenue was recognized under this arrangement for the three months ended September 30, 2019. For the nine months ended September 30, 2019, we recognized \$13.8 million related to the arrangement and there is \$1.2 million in deferred revenue as of September 30, 2019 related to our obligation to complete research activities under the Astellas Agreement.

Novartis

In June 2016, the Company entered into a Collaboration and License Agreement (Novartis Agreement) with Novartis Institutes for BioMedical Research, Inc. (Novartis), to develop and commercialize bispecific and other Fc engineered antibody drug candidates using the Company's proprietary XmAb technologies and drug candidates. The Company received an upfront payment of \$150.0 million and is eligible to receive additional development, regulatory and sales milestones.

Pursuant to the Novartis 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 determined that the transaction price of the Novartis Agreement at inception was the \$50.0 million upfront payment. The potential milestones were not included in the transaction price as these are contingent on future events, and the Company will not recognize these potential milestones in revenue until it is not probable that these would not result in significant reversal of revenue amounts in future periods. The Company will re-assess the transaction price at each reporting period and when event outcomes are resolved or changes in circumstances occur.

Under the Novartis Agreement, the Company and Novartis are co-developing XmAb14045 worldwide and sharing development costs.

In December 2018, Novartis notified us that they were returning their rights to the XmAb13676 program. Pursuant to the terms of the Novartis Agreement, the rights to the XmAb13676 program reverted to us in June 2019 and Novartis' obligation to fund its share of XmAb13676 development costs will continue through June 2020.

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We completed delivery of a Global Discovery Program in 2017 and delivery of a second Global Discovery Program in 2018. Under the Novartis Agreement, Novartis will assume full responsibility for development and commercialization of each Global Discovery product candidate that is delivered. Assuming successful development and commercialization of a Global Discovery Program, we are eligible to receive \$50.0 million in development milestones, \$100.0 million in regulatory milestones and \$100.0 million in sales milestones for each program. Pursuant to ASC 606, the potential milestone payments are considered variable consideration and were not included in determining the transaction price at inception of the Novartis Agreement. The Company has elected the most-likely-amount method for recognizing variable consideration.

Under ASC 606, revenue is recognized at the time that the Company's performance obligation for each Global Discovery is completed upon delivery of each discovery program to Novartis.

In the third quarter ended September 30, 2019, Novartis notified the Company that the United States Food and Drug Administration (FDA) had allowed its Investigational New Drug application (IND) that was submitted for a Global Discovery bispecific antibody candidate, and Novartis intends to initiate a Phase 1 clinical trial for the candidate. Based on the expectation of a patient being dosed in the study, the Company recognized \$10.0 million of revenue related to the expected Phase 1 milestone in the three-month period ended September 30, 2019. This amount was also recorded as a contract asset on the balance sheet at September 30, 2019.

The Company recognized \$10.0 million of revenue during the three and nine months ended September 30, 2019 in connection with the Novartis arrangement. The Company recognized \$20.0 million of revenue in the three and nine months ended September 30, 2018. As of September 30, 2019 there is a receivable of \$1.7 million related to cost-sharing of development activities for the third quarter of 2019 for the XmAb14045 and XmAb13676 programs, and \$40.1 million in deferred revenue related to our obligation to deliver two additional Global Discovery Programs to Novartis under 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 bispecific technology. Under the Amgen Agreement, the Company licensed the rights to its internally developed, preclinical CD38 x CD3 bispecific antibody candidate to Amgen and also agreed to apply our bispecific technology to five previously identified Amgen targets (each a Discovery Program). The Company has received a total of \$55.0 million in upfront payments and milestone payments and is eligible to receive up to an additional \$600.0 million in milestone payments and royalties on approved products. Pursuant to ASC 606, the milestone payments are considered variable consideration and were not included in determining the transaction price at inception of the Amgen Agreement.

Pursuant to the Amgen Agreement, the Company applied its bispecific technology to five Discovery Programs antibody molecules provided by Amgen that bind Discovery Program targets and returned the bispecific product candidates to Amgen for further testing, development and commercialization. The initial research term was three years from the date of the Amgen Agreement, but Amgen, at its option, could request an extension of one year. In May 2018, Amgen elected to extend the term of the research term for one year. During the extended research term, the Company provided additional research activities to Amgen and received research funding for such activities. The extended research term expired in May 2019.

In the third quarter ended September 30, 2019, Amgen notified the Company that the FDA had allowed the IND that was submitted for AMG 509, a STEAP1 x CD3 bispecific antibody developed under the Amgen Agreement. Amgen indicated that it intends to initiate a Phase 1 clinical trial for AMG 509. Based on the expectation of a patient being dosed in the study, we recognized \$5.0 million of revenue related to the expected Phase 1 milestone for the three months ended September 30, 2019. This amount was also recorded as a contract asset on the balance sheet at September 30, 2019.

We recognized \$5.0 million of revenue under this arrangement during the three and nine months ended September 30 2019. No revenue was recognized under the arrangement during the same periods in 2018. As of September 30, 2019, there was no deferred revenue related to the arrangement.

MorphoSys AG

In June 2010, the Company entered into a Collaboration and License Agreement with MorphoSys AG (MorphoSys) for a worldwide license to the Company's patents and know-how to research, develop and commercialize our drug candidate XmAb5574 (subsequently renamed MOR208 and tafasitamab) with the right to sublicense under certain conditions. Under the agreement, the Company agreed to collaborate with MorphoSys to develop and commercialize tafasitamab. If certain developmental, regulatory and sales milestones are achieved, the Company is eligible to receive future milestone payments and royalties.

In June 2017, MorphoSys initiated a Phase 3 clinical trial under the arrangement for which the Company received a milestone payment of \$12.5 million. The Company recognized the payment as revenue in the period that the milestone event occurred.

There were no revenues recognized under this arrangement for the three and nine months ended September 30, 2019 and 2018. As of September 30, 2019, the Company has no deferred revenue related to this agreement.

Alexion Pharmaceuticals, Inc.

In January 2013, the Company entered into an option and license agreement with Alexion Pharmaceuticals, Inc. (Alexion). Under the terms of the agreement, the Company 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. Alexion exercised its option to take a commercial license for our technology against a target that was developed as ALXN1210 and is currently marketed as Ultomiris®.

The Company is eligible to receive contractual milestones for certain regulatory and commercial achievements and is also entitled to receive royalties based on a percentage of net sales of Ultomiris sold by Alexion, its affiliates or its sub licensees, which percentage is in the low single digits. Alexion's royalty obligations continue on a product-by-product and country-by-country basis until the expiration of the last-to-expire valid claim in a licensed patent covering the applicable product in such country.

In the third quarter of 2018, Alexion completed certain regulatory submission filings for ALXN1210, and the Company received \$9.0 million in milestone payments. In the fourth quarter of 2018, Alexion completed certain regulatory submission filings and also received FDA marketing approval, and the Company received \$11.0 million in milestone payments.

In the second quarter of 2019, Alexion received marketing authorization from Japan's Ministry of Health, Labour and Welfare, and the Company received a \$4.0 million milestone.

In the third quarter of 2019, Alexion received marketing authorization from the European Commission, and the Company received a \$4.0 million milestone.

Under ASC 606, we recognize revenue for sales-based royalties upon the subsequent sale of the product. We began earning royalty revenue from the sale of Ultomiris in 2019. For the three and nine months ended September 30, 2019, we have estimated royalty revenue of \$1.4 million and \$2.5 million, respectively, related to sales of Ultomiris.

We recognized \$4.0 million and \$8.0 million of milestone revenue under the arrangement for the three and nine months ended September 30, 2019. We also recognized \$1.4 million and \$2.5 million of royalty revenue under this arrangement for the three and nine months ended September 30, 2019. There was \$9.0 million of revenue recognized under this arrangement for the three and nine months ended September 30, 2018. As of September 30, 2019, there is no deferred revenue related to this agreement.

Boehringer Ingelheim International GmbH

In 2007, the Company entered into a Research License and Collaboration Agreement with Boehringer Ingelheim International GmbH (BI). Under the agreement, the Company provided BI with a three-year research license to one of the Company's technologies and commercial options. BI elected to exercise two commercial licenses from the compounds identified during the research term and one compound was in clinical development. In the third quarter of 2019, BI discontinued development of the compound and terminated the agreement. No revenue related to this arrangement was recognized for the three and nine months ended September 30, 2019 and 2018 and there is no deferred revenue related to this agreement at September 30, 2019.

INmune Bio, Inc.

In October 2017, the Company entered into a License Agreement with INmune Bio, Inc. (INmune). Under the terms of the agreement, the Company provided INmune with an exclusive license to certain rights to a proprietary protein, XPRO1595. Under the agreement the Company received an upfront payment of \$100,000, an equity interest in INmune and an option to acquire additional shares of INmune. The Company is eligible to receive a percentage of sublicensing revenue received for XPRO1595 and also royalties in the mid-single digit percentages on the sale of approved products.

The equity interest in INmune constituted of 1,585,000 shares of common stock and the option is to purchase up to an additional 10% of the fully diluted outstanding share of INmune for \$10.0 million. We have recorded our equity interest in INmune at cost pursuant to ASC 323. We did not record our share of the net loss from INmune during the nine months ended September 30, 2019 or 2018, respectively, as the carrying value of this investment has been reduced to zero.

In 2018, INmune filed a registration statement on Form S-1 with the Securities and Exchange Commission (SEC) which was declared effective by the SEC as of December 19, 2018.

The Company did not recognize any revenue related to the agreement for the three and nine months ended September 30, 2019 and 2018. There is no deferred revenue as of September 30, 2019 related to this agreement.

VIR Biotechnology, Inc.

In the third quarter of 2019, the Company entered into a Patent License Agreement (the VirBio Agreement) with VIR Biotechnology (VirBio) pursuant to which the Company provided a non-exclusive license to its Xtend technology for up to two targets. Under the terms of the VirBio Agreement, the Company received an upfront payment and is eligible to receive total milestones of \$155.5 million which include \$5.5 million of development milestones, \$30.0 million of regulatory milestones and \$120.0 million of sales milestones. In addition, the Company is eligible to receive royalties on the net sales of approved products in the low single digits.

The Company evaluated the VirBio Agreement and determined that the single performance obligation was access to a non-exclusive license to certain patents of the Company which were transferred to VirBio upon execution of the VirBio Agreement in July 2019.

The Company recognized \$0.7 million of license and milestone revenue related to the agreement for the three and nine months ended September 30, 2019. There is no deferred revenue as of September 30, 2019 related to this agreement.

Revenue earned

The revenues recorded for the three and nine months ended September 30, 2019 were earned principally from the following licensees (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Alexion	\$ 5.4	\$ 9.0	\$ 10.5	\$ 9.0
Amgen	5.0	—	5.0	—
Astellas	—	—	13.8	—
Genentech	0.7	—	113.2	—
Novartis	10.0	20.0	10.0	20.0
Vir Biotechnology	0.7	—	0.7	—
Total	\$ 21.8	\$ 29.0	\$ 153.2	\$ 29.0

The table below summarizes the disaggregation of revenue recorded for the three and nine months ended September 30, 2019 (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Research collaboration	\$ 0.6	\$ 20.0	\$ 15.2	\$ 20.0
Milestone	19.3	9.0	23.3	9.0
Licensing	0.5	—	112.2	—
Royalties	1.4	—	2.5	—
Total	\$ 21.8	\$ 29.0	\$ 153.2	\$ 29.0

Remaining Performance Obligations and Deferred Revenue

Our remaining performance obligations are delivery of two Global Discovery Programs under the Novartis Agreement and the conduct of research activities pursuant to research plans under the Genentech and Astellas Agreements. As of September 30, 2019 and 2018, we have deferred revenue of \$48.2 million and \$40.1 million, respectively. As of September 30, 2019, \$45.6 million was classified as current liabilities as our obligations to perform services are due on demand when requested by Novartis and Astellas under the Novartis Agreement and Astellas Agreement, respectively; \$2.6 million of the deferred revenue liability is classified as long-term for the obligation to perform research services to Genentech after one year.

11. Income taxes

The provision for income taxes of \$0.6 million for the nine months ended September 30, 2019 represents the interim period tax allocation of the state alternative minimum tax based on the Company's projected year-end effective income tax rates which cannot be offset by the Company's net operating loss carryforwards. The Company has a federal income tax receivable of \$0.8 million at September 30, 2019 related to refundable alternative minimum tax credits. As of September 30, 2019, the Company's deferred income tax assets, consisting primarily of net operating loss and tax credit carryforwards, 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, 2018 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, 2018. See also "Special Note Regarding Forward-Looking Statements" included in this Quarterly Report on Form 10-Q.

Company Overview

We are a clinical-stage biopharmaceutical company focused on discovering and developing engineered monoclonal antibody and other protein therapeutics to treat severe and life-threatening diseases with unmet medical needs. We are developing a suite of clinical-stage drug candidates from our proprietary XmAb® technology platforms that are designed to treat cancer, autoimmune and allergic diseases, and other conditions. In contrast to conventional approaches to antibody design, which focus on the portion of antibodies that interact with target antigens, our protein engineering efforts and the XmAb technologies are focused on the portion of the antibody that interacts with multiple segments of the immune system and controls antibody structure. 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 to pharmaceutical or biotechnology companies to use in developing their own proprietary antibodies with improved properties.

There are currently 14 antibody product candidates that are being advanced in clinical trials by us or by our partners that have been engineered with our XmAb technologies. The most recent expansion of our platform is the XmAb bispecific Fc domains, which enable the rapid design and simplified development of antibodies, and other protein structures, that bind two or more different targets simultaneously using an engineered heterodimer Fc domain. These bispecific Fc domains are used to generate a broad array of novel drug candidates.

The initial bispecific antibody candidates that we designed contain an anti-tumor associated antigen binding domain and a second binding domain targeted to CD3, an activating receptor on T cells. We are advancing three CD3 bispecific candidates through clinical development: XmAb14045, XmAb13676, and XmAb18087.

- XmAb14045 is a bispecific antibody that targets CD123, an antigen on acute myeloid leukemia (AML) cells and leukemic stem cells, and CD3, a cytotoxic T-cell binding domain. It is being developed in collaboration with Novartis and is being evaluated in a Phase 1 study. In September 2016, we dosed the first patient in an open-label, multiple-dose, dose escalation study to assess the safety, tolerability, and preliminary anti-tumor activity of XmAb14045 in patients with relapsed or refractory AML and other CD123-expressing hematologic malignancies. We presented initial data from the study in December 2018 at the American Society of Hematology (ASH) Annual Meeting. The data presented indicated multiple complete remissions had been achieved with weekly dosing of XmAb14045 in this heavily-pretreated patient population.

In April 2019, the FDA lifted the partial clinical hold that had been placed on the Phase 1 study of XmAb14045 in February 2019, when we received notice from the FDA placing the XmAb14045 study on partial clinical hold due to safety issues of cytokine release syndrome and pulmonary toxicities. The FDA's decision to lift the hold followed discussion and agreement on amendments to the study protocol, including guidance on the monitoring and clinical management of cytokine release syndrome. In July 2019, we resumed enrolling patients in the trial based on the amended protocol. In 2020, we plan to initiate additional clinical studies evaluating XmAb14045.

- XmAb13676 is a bispecific antibody that targets CD20, an antigen on B-cell tumors, and CD3 for the treatment of B-cell malignancies. In February 2017, we dosed the first patient in an open-label, Phase 1, multiple-dose, dose escalation study to assess the safety, tolerability, and preliminary anti-tumor activity of XmAb13676 in patients with B-cell malignancies. This program was also partnered with Novartis pursuant to the Novartis Agreement. In December 2018, as part of a strategic realignment of its pipeline, Novartis notified us of its decision to return its rights to XmAb13676. The Novartis rights to XmAb13676 reverted to us in June 2019. We continue to develop XmAb13676 as planned and expect to present initial data from the Phase 1 study at the ASH Annual Meeting in December 2019.
- XmAb18087 is a bispecific antibody that targets somatostatin receptor 2 (SSTR2) and the cytotoxic T-cell binding domain CD3 for the treatment of neuroendocrine tumors (NET) and gastrointestinal stromal tumors (GIST). In February 2018, we dosed the first patient in a Phase 1 study. XmAb18087 is our first CD3 bispecific antibody to be evaluated in solid tumors. We expect to provide initial data from this study in the first half of 2020.

We are also advancing a suite of tumor microenvironment (TME) activators that have been designed to promote tumor-selective T-cell activation by targeting multiple checkpoint or co-stimulatory receptors. We are advancing three TME activator candidates through clinical development: XmAb20717, XmAb22841, and XmAb23104:

- * XmAb20717 simultaneously targets PD-1 and CTLA-4, both immune checkpoint receptors, and is being developed in broad oncology indications including solid tumors. In July 2018, we dosed the first patient in an open label, Phase 1 dose-escalation study to assess the safety, tolerability, and preliminary anti-tumor activity of XmAb20717 in patients with selected solid tumors. We expect to provide initial data from this study in the first half of 2020.
- * XmAb23104 targets PD-1 and ICOS, an immune co-stimulatory receptor, and is being developed for multiple oncology indications. In May 2019, we dosed the first patient in an open-label, Phase 1, dose-escalation study to assess the safety, tolerability and preliminary anti-tumor activity of XmAb23104 in patients with selected solid tumors.
- * XmAb22841 targets CTLA-4 and LAG-3, also an immune checkpoint receptor, and is being developed for multiple indications. We intend to advance XmAb22841 in combination with an anti-PD-1 drug to create a triple checkpoint blockade. In May 2019, we dosed the first patient in an open-label, Phase 1, dose-escalation study to assess the safety, tolerability and preliminary anti-tumor activity of XmAb22841 in patients with selected solid tumors.

In 2018, we expanded our bispecific Fc platform with the design of our novel cytokine candidates. These cytokines are built on our bispecific Fc domain and have potency tuned to improve therapeutic index. These candidates also incorporate our Xtend technology for longer duration of action.

- * Our first cytokine candidate is XmAb24306, an IL15/IL15-receptor alpha complex fused to a bispecific Fc domain (IL15/IL15Ra-Fc). We believe a broad combination development strategy will be critical to realize the potential of IL-15 cytokines like XmAb24306. In February 2019, we entered into the Genentech Agreement to develop and commercialize novel IL-15 cytokine therapeutics, whereby the companies will co-develop XmAb24306 and other potential IL-15 programs. We will support Genentech's efforts to submit an IND for XmAb24306, which is expected by year-end.

XmAb24306 is currently in Investigational New Drug application (IND)-enabling studies, and we are supporting Genentech's efforts to submit an IND for this candidate, which is currently expected in the second half of 2019.

We have also created a suite of wholly-owned compounds using our Immune Inhibitor Fc Domain.

- * XmAb5871 uses our XmAb Immune Inhibitor Fc Domain and targets CD19 with its variable domain, which is designed to inhibit the function of B cells, an important component of the immune system. We have completed Phase 2 clinical trials for XmAb5871 in three autoimmune diseases: Systemic Lupus Erythematosus (SLE), IgG4-Related Disease (IgG4-RD), and Rheumatoid Arthritis (RA).

We have also completed an additional Phase 1 trial for a subcutaneous formulation of XmAb5871.

We believe that the data from the studies of XmAb5871 in patients with SLE and IgG4-RD support further development in these indications and show the potential of XmAb5871 in other B-cell mediated autoimmune indications. We are seeking to partner XmAb5871 with a partner that has the infrastructure and resources to continue late-stage development of XmAb5871 and maximize the potential of this candidate for a broad set of patient populations.

- * XmAb7195 uses our Immune Inhibitor Fc Domain and is being developed for the treatment of severe asthma and allergic diseases. In May 2016, we reported complete data from the Phase 1a trial with XmAb7195 treating patients with high baseline IgE levels. In 2017, we announced data from a Phase 1b trial for XmAb7195 with a subcutaneous formulation. The data from the trial showed that subcutaneous administration of XmAb7195 was well tolerated and effective at reducing free and total IgE levels in patients in the study. The results support subcutaneous delivery for future development. We are seeking a development partner for XmAb7195.

Licensing partnerships: We have nine partnerships for the licensing of our XmAb technologies and XmAb candidates. These arrangements provide upfront payments, annual licensing fees, potential milestone payments and royalties as our partners advance compounds that incorporate our technology through clinical development. These payments provide us with multiple revenue streams that help fund development of our product candidates and usually require limited resources or efforts from us. Where possible, we structure such transactions to retain long-term value in the drug candidates through profit-split arrangements or retaining commercial rights to geographic areas. In 2019, we entered into collaborations and licensing transactions with Genentech and Astellas for which we received upfront payments of \$120.0 million and \$15.0 million, respectively.

The most advanced program where we have licensed our technology is Alexion's Ultomiris®, formerly ALXN1210. Alexion has received marketing authorizations from regulatory agencies in the U.S., Europe, and Japan for the treatment of adult patients with paroxysmal nocturnal hemoglobinuria (PNH). In October 2019, Alexion announced that it received marketing authorization in the U.S. for the treatment of atypical hemolytic uremic syndrome (aHUS) to inhibit complement-mediated thrombotic microangiopathy (TMA).

Examples of other partnership and collaborations in which we have licensed antibodies to other pharmaceutical and biotechnology companies for further development include our MorphoSys, Amgen and Novartis collaborations:

- * *MorphoSys:* In 2010 we licensed tafasitamab (MOR208) to MorphoSys. In 2017, MorphoSys advanced tafasitamab into a Phase 3 clinical trial, and MorphoSys has indicated plans to submit a Biologics License Application (BLA) to the FDA by year-end and to the European authorities in 2020.
- * *Amgen:* In 2015 we licensed our preclinical CD38 x CD3 bispecific antibody, now AMG 424, to Amgen, and Amgen is enrolling a Phase 1 study for AMG 424. As part of our research collaboration, we also created and licensed to Amgen, AMG 509, a STEAP1 x CD3 bispecific antibody. In the third quarter of 2019, Amgen indicated to us that an IND has been allowed by the FDA, and they expect to dose the first patient in a Phase 1 study.
- * *Novartis:* In connection with our 2016 Novartis collaboration, we created and licensed to Novartis undisclosed bispecific antibodies. In the third quarter of 2019, Novartis indicated to us that an IND for one of the bispecific candidates has been allowed by the FDA, and they expect to dose the first patient in a Phase 1 study for this drug candidate.

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We have over 750 issued and pending patents worldwide to protect our XmAb technology platform and XmAb drug candidates.

Since we commenced active operations in 1998, we have devoted substantially all 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 from payments generated from our product development partnerships and licensing arrangements.

As of September 30, 2019, we had an accumulated deficit of \$269.5 million. Substantially all of the 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.

Results of Operations

Comparison of the Three Months Ended September 30, 2019 and 2018

The following table summarizes our results of operations for the three months ended September 30, 2019 and 2018 (in millions):

	Three Months Ended		
	September 30,		
	2019	2018	Change
Revenues:			
Research collaboration	\$ 0.6	\$ 20.0	\$ (19.4)
Milestone	19.3	9.0	10.3
Licensing	0.5	—	0.5
Royalties	1.4	—	1.4
Total revenues	21.8	29.0	(7.2)
Operating expenses:			
Research and development	29.8	21.0	8.8
General and administrative	6.2	7.4	(1.2)
Total operating expenses	36.0	28.4	7.6
Other income, net	3.7	2.5	1.2
Income (loss) before income tax expense (benefit)	(10.5)	3.1	(13.6)
Income tax expense (benefit)	(0.3)	—	(0.3)
Net income (loss)	<u>\$ (10.2)</u>	<u>\$ 3.1</u>	<u>\$ (13.3)</u>

Revenues

Revenues for the three months ended September 30, 2019 are primarily from milestone revenue recognized from our Alexion, Amgen and Novartis collaborations. Revenue recognized for the three months ended September 30, 2018 is primarily from our research collaboration with Novartis and milestone revenue from our Alexion collaboration.

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Research and Development Expenses

The following table summarizes our research and development expenses for the three months ended September 30, 2019 and 2018 (in millions):

	Three Months Ended September 30,		
	2019	2018	Change
Product programs:			
XmAb5871 programs	\$ 2.4	\$ 5.6	\$ (3.2)
XmAb7195 programs	—	0.3	(0.3)
Bispecific programs:			
CD3*	9.7	5.1	4.6
Tumor micro environment (TME) activators	7.7	6.4	1.3
Cytokines*	6.1	1.3	4.8
Subtotal Bispecific programs	23.5	12.8	10.7
Other, research and early stage programs	3.9	2.3	1.6
Total research and development expenses	\$ 29.8	\$ 21.0	\$ 8.8

*Includes net payments to, and reimbursements from our partners pursuant to agreements that include cost-sharing arrangements.

Research and development expenses increased by \$8.8 million for the three months ended September 30, 2019 over the same period in 2018 due to increases in stock-based compensation charges of \$3.7 million and additional spending on our pipeline of bispecific candidates. Increased spending in development activities for our bispecific cytokines, CD3 and TME activators candidates and technologies were partially offset by decreased spending in our XmAb5871 program.

General and Administrative Expenses

The following table summarizes our general and administrative expenses for the three months ended September 30, 2019 and 2018 (in millions):

	Three Months Ended September 30,		
	2019	2018	Change
General and administrative	\$ 6.2	\$ 7.4	\$ (1.2)

General and administrative expenses decreased by \$1.2 million for the three months ended September 30, 2019 over the same period in 2018 primarily due to decreased spending on expenses related to personnel.

Other Income, Net

Other income was \$3.7 million and \$2.5 million for the three months ended September 30, 2019 and 2018, respectively. The increase in other income was primarily from higher interest income earned from our investments in 2019.

Comparison of the Nine Months Ended September 30, 2019 and 2018

The following table summarizes our results of operations for the nine months ended September 30, 2019 and 2018 (in millions):

	Nine Months Ended September 30,		
	2019	2018	Change
Revenues:			
Research collaboration	\$ 15.2	\$ 20.0	\$ (4.8)
Milestone	23.3	9.0	14.3
Licensing	112.2	—	112.2
Royalties	2.5	—	2.5
Total revenues	153.2	29.0	124.2
Operating expenses:			
Research and development	91.3	70.3	21.0
General and administrative	17.5	17.0	0.5
Total operating expenses	108.8	87.3	21.5
Other income, net	10.0	6.1	3.9
Income (loss) before income tax expense	54.4	(52.2)	106.6
Income tax expense	0.6	—	0.6
Net income (loss)	\$ 53.8	\$ (52.2)	\$ 106.0

Revenues

Revenues recognized for the nine months ended September 30, 2019 are primarily from licensing and collaboration revenue recognized under the Genentech and Astellas Agreements, as well as milestone revenue recognized from the Alexion, Amgen and Novartis collaborations. Revenue for the same period in 2018 was primarily from our Novartis collaboration and milestone revenue from our Alexion collaboration.

Research and Development Expenses

The following table summarizes our research and development expenses for the nine months ended September 30, 2019 and 2018 (in millions):

	Nine Months Ended September 30,		
	2019	2018	Change
Product programs:			
XmAb5871 programs	\$ 14.4	\$ 17.4	\$ (3.0)
XmAb7195 programs	0.4	0.5	(0.1)
Bispecific programs:			
CD3*	27.0	15.9	11.1
Tumor micro environment (TME) activators	22.1	25.8	(3.7)
Cytokines*	17.0	3.8	13.2
Subtotal Bispecific programs	66.1	45.5	20.6
Other, research and early stage programs	10.4	6.9	3.5
Total research and development expenses	\$ 91.3	\$ 70.3	\$ 21.0

*Net of reimbursements from our partners pursuant to agreements that include cost-sharing arrangements.

Research and development expenses increased by \$21.0 million for the nine months ended September 30, 2019 over the same period in 2018 due to increased stock-based compensation charges of \$9.0 million and additional spending on our pipeline of bispecific candidates. Increased spending in development activities for our bispecific cytokines and CD3 candidates and technologies were offset by decreased spending in XmAb5871 and our TME activator candidates.

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General and Administrative Expenses

The following table summarizes our general and administrative expenses for the nine months ended September 30, 2019 and 2018 (in millions):

	Nine Months Ended September 30,		
	2019	2018	Change
General and administrative	\$ 17.5	\$ 17.0	\$ 0.5

General and administrative expenses increased by \$0.5 million for the nine months ended September 30, 2019 over the same period in 2018 primarily due to additional spending on intellectual property including patents and licenses and expenses related to professional services.

Other Income, Net

Other income was \$10.0 million and \$6.1 million for the nine months ended September 30, 2019 and 2018, respectively. The increase in other income was primarily from higher interest income earned from our investments in 2019.

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,		
	2019	2018	Change
Net cash (used in) provided by:			
Operating activities	\$ 83,951	\$ (62,975)	\$ 146,926
Investing activities	(66,697)	(171,633)	104,936
Financing activities	7,689	253,076	(245,387)
Net increase in cash	\$ 24,943	\$ 18,468	\$ 6,475

Operating Activities

Cash provided by operating activities for the nine months ended September 30, 2019 increased by \$146.9 million over amounts reported for the nine months ended September 30, 2018 primarily due to upfront payments received from collaborations in the nine-month period ended September 30, 2019.

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.

Financing Activities

Net cash provided by financing activities for the nine months ended September 30, 2019 decreased by \$245.4 million over the same period in 2018 which reflects proceeds received from our financing in March 2018 and additional proceeds received from the exercise of stock options.

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.

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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.

We have not sold any shares under the Distribution Agreement and the Distribution Agreement terminated October 7, 2019.

In March 2018, we completed the sale of 8,395,000 shares of common stock which included shares issued pursuant to our underwriters' exercise of their over-allotment option pursuant to a follow-on financing. We received net proceeds of \$245.5 million after underwriting discounts, commissions and offering expenses.

As of September 30, 2019, we had \$620.5 million of cash, cash equivalents and marketable securities compared to \$530.5 million at December 31, 2018. The investments in marketable securities are further described above in footnote 5 to the notes to the financial statements. We expect to continue to receive additional payments from our collaborators for research and development services rendered, additional milestone, opt-in, contingent payments and royalties. 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.

Funding Requirements

We have not generated any revenue from product sales to date and do not expect to do so until we obtain regulatory approval of and commercialize one or more of our product candidates. As we are currently in the 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, based upon our current operating plan, we expect that our existing cash, cash equivalents and marketable securities and certain potential milestone payments will fund our operating expenses and capital expenditure requirements beyond 2024. 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.

Off-Balance Sheet Arrangements

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

Contractual Obligations and Commitments

There were no material changes outside of the ordinary course of business to our specific contractual obligations during the nine months ended September 30, 2019.

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 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 low risk profile of our investments, an immediate 10% decrease in interest rates would not have a material effect on the fair market value of our portfolio. Accordingly, we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our investment portfolio.

We do not believe that our cash and cash equivalents have significant risk of default or illiquidity. While we believe our cash and cash equivalents do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits.

Inflation generally affects us by increasing our cost of labor and clinical trial costs. We do not believe that inflation has had a material effect on our results of operations during the periods presented.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the supervision of our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2019. 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, 2019.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. Accordingly, our disclosure controls and procedures are designed to provide reasonable assurance, not absolute assurance, that the objectives of our disclosure control system are met and, as set forth above, our principal executive officer and principal financial officer have concluded, that based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective to provide reasonable assurance that the objective of our disclosure control system were met.

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.

None.

ITEM 1A. Risk Factors

For information regarding certain factors that could materially affect our business, results of operations, financial condition and liquidity, see the risk factor discussion provided under “Risk Factors” in item 1A of our Annual Report on Form 10-K for the year ended December 31, 2018. 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, 2018, 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.

ITEM 6. Exhibits

Exhibit Number	Description of Document
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 June 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*	Xencor, Inc. Amended and Restated Non-Employee Director Compensation Policy.
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	Inline XBRL Instance Document – The instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the inline XBRL document.
101.SCH	Inline XBRL Schema Document
101.CAL	Inline XBRL Calculation Linkbase Document
101.DEF	Inline XBRL Definition Linkbase Document
101.LAB	Inline XBRL Labels Linkbase Document
101.PRE	Inline XBRL Presentation Linkbase Document
104	104 Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)
*	Indicates management contract or compensatory plan

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
Chief Financial Officer
(Principal Financial Officer)

Dated: November 5, 2019

**XENCOR, INC.
AMENDED AND RESTATED NON-EMPLOYEE DIRECTOR COMPENSATION POLICY**

Each member of the Board of Directors (the “*Board*”) who is a member as of September 5, 2019 (the “*Effective Date*”) and who is not also serving as an employee of Xencor, Inc. (“*Xencor*”) or any of its subsidiaries (each such member, an “*Eligible Director*”) will receive the compensation described in this Amended and Restated Non-Employee Director Compensation Policy for his or her Board service. This policy is effective as of the Effective Date and may be amended at any time in the sole discretion of the Board.

Annual Cash Compensation

Eligible Directors will be paid the following annual cash compensation amounts, payable in equal quarterly installments, payable in arrears on the last day of each fiscal quarter in which the service occurred. If an Eligible Director joins a committee of the Board or the Board at a time other than effective as of the first day of a fiscal quarter, each annual retainer set forth below will be pro-rated based on days served in the applicable fiscal year, with the pro-rated amount paid for the first fiscal quarter in which the Eligible Director provides the service, and regular full quarterly payments thereafter. All cash fees are vested upon payment.

1. Annual Board Service Retainer:
 - a. Eligible Directors other than the Chairman: \$40,000
 - b. Chairman: \$70,000
2. Annual Committee Chair Service Retainer:
 - a. Chairman of the Audit Committee: \$20,000
 - b. Chairman of the Compensation Committee: \$15,000
 - c. Chairman of the Nominating & Corporate Governance Committee: \$10,000
3. Annual Committee Member (other than Committee Chair) Service Retainer:
 - a. Member of the Audit Committee: \$10,000
 - b. Member of the Compensation Committee: \$7,500
 - c. Member of the Nominating & Corporate Governance Committee: \$5,000

Equity Compensation

The equity compensation set forth below will be granted under the Xencor, Inc. 2013 Equity Incentive Plan (the “*Plan*”) as may be amended from time to time. All stock options granted under this policy will be nonstatutory stock options, with an exercise price per share equal to 100% of the Fair Market Value (as defined in the Plan) of the underlying Common Stock on the date of grant, and a term of ten years from the date of grant (subject to earlier termination in connection with a termination of service as provided in the Plan).

1 . Initial Grant: On the date of the Eligible Director's initial election to the Board, for each Eligible Director who is first elected to the Board following the Effective Date (or, if such date is not a market trading day, the first market trading day thereafter), the Eligible Director will be automatically, and without further action by the Board or Compensation Committee of the Board, granted a stock option to purchase shares of Common Stock with an aggregate Black Scholes option value of \$400,000. For the avoidance of doubt, Eligible Directors who are serving on the Board at the Effective Date will not be awarded an initial grant. One-third of the shares subject to each stock option will vest on the one year anniversary of the date of grant and the balance of the shares will vest in a series of 24 equal monthly installments thereafter, such that the option is fully vested on the third anniversary of the date of grant, subject to the Eligible Director's Continuous Service (as defined in the Plan) through each such vesting date and will vest in full upon a Change in Control (as defined in the Plan).

2 . Annual Grant: On the date of each of Xencor's annual stockholder meeting held after the Effective Date, each Eligible Director who continues to serve as a non-employee member of the Board (or who is first elected to the Board at such annual stockholder meeting) will be automatically, and without further action by the Board or Compensation Committee of the Board, granted a stock option to purchase shares of Common Stock with an aggregate Black Scholes option value of \$300,000. The shares subject to the stock option will vest in a series of 12 equal monthly installments, such that the option is fully vested on the one anniversary of the date of grant, subject to the Eligible Director's Continuous Service (as defined in the Plan) through each such vesting date and will vest in full upon a Change in Control (as defined in the Plan).

Exhibit 31.2

**CERTIFICATION OF THE PRINCIPAL 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., (the "Company");
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, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the 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/ JOHN J. KUCH

John J. Kuch

Chief Financial Officer (Principal Financial Officer)

Date: November 5, 2019

Exhibit 31.1

**CERTIFICATION OF CHIEF PRINCIPAL 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., (the "Company");
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, including its consolidated subsidiaries, is made known to us by others within those entities particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the 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 5, 2019

Exhibit 32.1

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, Chief Financial Officer 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, 2019, 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 5, 2019

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 5th day of November 2019.

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

/s/ JOHN J. KUCH
John J. Kuch
Chief Financial Officer

This certification accompanies the Periodic Report 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.
