Xencor, Inc (XNCR)

Rating	OUTPERFORM* [V]
Price (28 Oct 14, US$)	10.60
Target price (US$)	14.00[1]
52-week price range	13.90 - 7.55
Market cap. (US$ m)	332.79
Enterprise value (US$ m)	277.23

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.
[V] = Stock considered volatile (see Disclosure Appendix).

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SMALL & MID CAP RESEARCH

Good Strategic Move Taking XmAb5871 Into Rare Autoimmune Diseases

XNCR regained full development rights to XmAb5871 and all associated materials from AMGN. Previously part of an option deal with AMGN that tied XNCR to a development path in RA, the new arrangement gives XNCR full rights to pursue less competitive orphan diseases, while AMGN retains only a right of first negotiation. AMGN's work developing a subcutaneous formulation will be transferred to XNCR, and may be incorporated in future studies.

- **XNCR regains the full rights to a promising internally developed asset:** XmAb5871 is a CD19 targeted antibody that uses XNCR's proprietary Fc technology to down-regulate B-cells. This may have broad applicability in certain autoimmune diseases. XNCR expects to report the initial data from its Phase IIa trial of XmAb5871 in RA by year-end 2014.
- **Rare autoimmune diseases the focus:** XNCR now intends to focus development of XmAb5871 on a relatively rare autoimmune condition known as IgG4-related disease and will start the first clinical study in 2015. XNCR plans to provide an update on the clinical strategy and possible endpoints at a later date. XNCR is also weighing other autoimmune diseases to pursue and will provide an update on those indications in the future.
- **Upcoming catalysts:** We are expecting several early stage proof of concept readouts over the next nine months including (1) Phase IIa proof of concept data for XmAb5871 in RA by year-end 2014, (2) updated Phase II data for MOR208 in ALL and NHL potentially at ASH in December 2014, and (3) XmAb7195 Phase I data including IgE reduction in healthy volunteers in January 2015.

Financial and valuation metrics

Year	12/13A	12/14E	12/15E	12/16E
EPS (CS adj.) (US$)	-3.85	-0.69	-0.65	-0.62
Prev. EPS (US$)	—	—	—	—
P/E (x)	-2.8	-15.4	-16.3	-17.2
P/E rel. (%)	-16.0	-96.5	-113.9	-134.2
Revenue (US$ m)	10.2	5.5	7.0	11.0
EBITDA (US$ m)	-9.8	-21.6	-22.7	-26.3
OCFPS (US$)	-0.24	-0.68	-0.44	-0.74
P/OCF (x)	-37.6	-15.5	-24.3	-14.4
EV/EBITDA (current)	-27.2	-12.3	-11.8	-10.1
Net debt (US$ m)	-78	-56	-138	-107
ROIC (%)	236.83	813.99	273.89	7,471.78

Number of shares (m)	31.40	IC (current, US$ m)	-4.44
BV/share (Next Qtr., US$)	1.8	EV/IC (x)	-116.5
Net debt (Next Qtr., US$ m)	-61.4	Dividend (current, US$)	—
Net debt/tot cap (Next Qtr., %)	-103.9	Dividend yield (%)	—

Three important catalysts for internal programs (two by YE:14)

- **First proof of concept for immune down regulation:** The XmAb5871 Phase IIa trial in RA is fully enrolled and expected to read out in Q4:14. While the trial is relatively small (30 patients), it should give some initial indication of how well B-cell down regulation compares to other biologic approaches, including B-cell depletion. TA positive result could also have a halo effect on the XmAb7195 program, which also relies in part on immune down regulation.
- **Initial IgE reduction data:** The primary value driver for XNCR is its proprietary anti-IgE antibody XmAb7195. This drug works by three mechanisms (1) binding free IgE, (2) reducing total IgE by increasing clearance, and (3) down regulating the production of IgE. The ongoing two-part Phase I trial should provide initial proof of concept in H1:15 in subjects with elevated baseline IgE.
- **Bispecific program could drive increased investor and partnering interest:** XNCR has two preclinical bispecific programs in multiple myeloma (CD38xCD3) and acute myeloid leukemia (CD123xCD3). XNCR plans to present preclinical data from both at ASH in December. While an IND is not expected until H2:15, the areas of bispecifics and immune-oncology a particularly "hot" at the moment, and greater appreciation of XNCR's technology in this space could drive near-term value.

Positive thesis on broad antibody platform

We continue to believe that XNCR's engineered antibody platform is one of the most diverse in the industry, enabling higher potency antibodies (MOR208 and multiple partnered programs), immune down regulating antibodies (XmAb5871 and XmAb7195), enhanced target clearance (XmAb7195), and longer half-life (Merck program). In total, there are now seven drugs in the clinic using XNCR's antibody technology.

- The emerging bispecific platform provides extra upside beyond the disclosed programs, and could be a major source of future partnerships.
- The most exciting clinical-stage program in our view, is the proprietary anti-IgE antibody (XmAb7195), which could be a much better version of Xolair.

XmAb5871 – Proof of concept trial

XmAb5871 is a CD19 targeted immune modulating antibody that is designed to down regulate activated B-cells (rather than killing them). The initial proof of concept trial is in patients with active RA who are on a stable dose of non-biologic DMARDs (e.g. methotrexate).

XNCR completed enrollment in this 30-patient Phase IIa trial in H1:14 and expects to have data released in Q4:14.

The trial includes 12 weeks of treatment (6 doses every other week), with standard RA endpoints at 12 and 24 weeks.

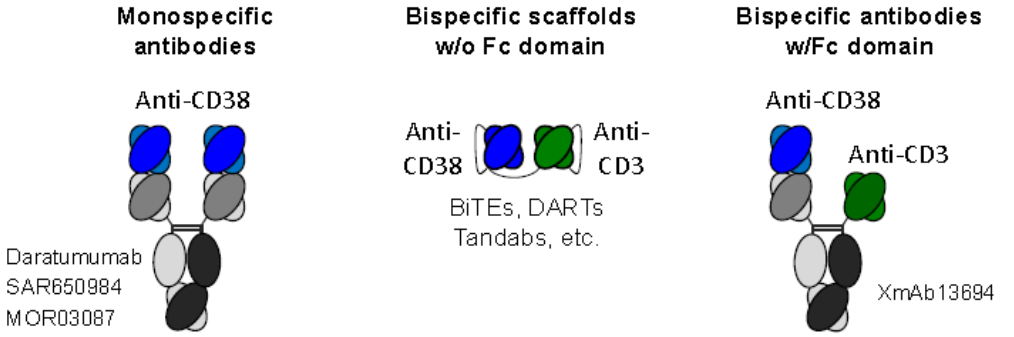
Emerging bispecific program

XNCR is developing a bispecific format that uses a full length Fc, which differentiates it from many of the other bispecifics including AMGN's BiTEs and MGNX's DARTs. REGN is also working on full-length bispecifics.

XNCR has two preclinical candidates.

- **XmAb13694 (CD38xCD3) targets CD38**, a clinically validated antibody target in multiple myeloma. Several "naked" antibodies are advancing in development including daratumumab (Genmab/JNJ), SAR650984 (Sanofi/IMGN), and MOR03087 (Morphosys/CELG).
- **CD123xCD3 targets CD123**, a validated target in AML. CD123 is found on AML cells and on tumor stem cells. Toxin fusions targeting CD123 have shown some evidence of anti-tumor activity.

Exhibit 1: XNCR's bispecific format for its anti-CD38



Source: Company data, Credit Suisse estimates

MOR208 – Three ongoing Phase II trials

There are currently three ongoing Phase II trials of MOR208 (Fc engineered anti-CD19 antibody) for a variety of B-cell malignancies. Data from a prior CLL trial was reported in 2013, and we expect data from the NHL and/or ALL trial(s) at ASH in December.

- **Acute lymphoblastic leukemia (ALL):** This Phase II trial is expected to recruit up to 30 relapsed/refractory patients. The study is still recruiting patients.
- **Non-Hodgkin lymphoma (NHL):** This trial is expected to recruit up to 120 relapsed/refractory patients in each of several disease specific cohorts, including follicular lymphoma (FL), mantle cell lymphoma (MCL), diffuse large B-cell lymphoma (DLBCL), and other indolent lymphomas (iNHL).
- **Chronic lymphocytic leukemia (CLL):** This investigator sponsored trial combines MOR208 with Revlimid in both relapsed/refractory and treatment naïve CLL. This trial is being conducted at Ohio State University. This trial was announced and initiated after XNCR's IPO.

Exhibit 2: XNCR pipeline

Drug	Target	Technology	Indication	Stage	Partner
XmAb5574/MOR208	CD19	High ADCC	CLL, NHL, ALL	Phase II	Morphosys
XmAb5871	CD19	Immune inhibitory	Autoimmune	Phase I/II	Proprietary
XmAb7195	IgE	Immune inhibitory	Asthma/Allergy	Phase I	Proprietary
BI 836826	CD37	High ADCC	CLL, NHL	Phase I	Boehringer Ingelheim
BI 836858	CD33	High ADCC	AML	Phase I	Boehringer Ingelheim
CSL362	CD123 (IL3R)	High ADCC	AML	Phase I	CSL/Janssen
ND	ND	Stability	Autoimmune	Phase I	Merck
Xtend-TNF	TNF	Long half-life	Autoimmune	Preclinical	Proprietary
CD3 X CD38	CD38	Bispecific	Oncology	Preclinical	Proprietary
CD3 X CD123	CD123	Bispecific	Oncology	Preclinical	Proprietary
CD3 X CD20	CD20	Bispecific	Lymphoma	Preclinical	Proprietary
Xtend-CTLA4	CTLA4	Long half-life	Autoimmune	Preclinical	Proprietary
Anti-X/ CD32b	ND	Immune inhibitory	TBD	Discovery Lead	Proprietary
ND	ND	Long half-life	Hematology	Preclinical	CSL
ND	ND	Long half-life	Autoimmune	Preclinical	Janssen
ND	ND	Long half-life	Undisclosed	Discovery Lead	Alexion

Source: Company data, Credit Suisse estimates

Exhibit 3: XNCR newsflow

Product/Event	Indication	Catalyst	Expected Date
XmAb5871	RA	Phase IIa results	YE:14
MOR208	ALL	Complete enrollment in ALL cohort	Q4:14
MOR208	fNHL, MCL, DLBCL, iNHL	Potential Phase II data at ASH	Dec. 2014
Bispecific	N/A	Presentation of preclinical data at ASH	Dec. 2014
XmAb5871	RA	Start Phase IIb (150-250 pts)	Q1:15
XmAb7195	Asthma	Phase Ia data in patients with asthma and allergic disease (includes high IgE cohort)	H1:15
Bispecific	N/A	IND for proprietary program	H2:15
XmAb7195	Asthma	Phase Ib start	Q1:15
XmAb7195	Asthma	Start Phase II in poorly controlled	late 15/ early 16
MOR208	CLL	IST to complete enrollment of CLL study	H2:15
XmAb5871	RA	Phase IIb data/ AMGN option	late 16/ early 17

Source: Company data, Credit Suisse estimates

Exhibit 4: XNCR Model

	2012A	2013A	Q1:14A	Q2:14A	Q3:14E	Q4:14E	2014E	2015E	2016E	2017E	2018E
Revenues											
US sales of XmAb7195											
Ex-US royalies on XmAb7195											
Royalties on XmAb5871											
Partnering, grants, milestones	**9.5**	**10.2**	2.2	0.8	0.8	1.6	5.5	7.0	11.0	26.1	15.0
Total Revenues	**9.5**	**10.2**	**2.2**	**0.8**	**0.8**	**1.6**	**5.5**	**7.0**	**11.0**	**26.1**	**15.0**
Expenses											
Cost of goods											
Research and development	**12.7**	**17.0**	4.2	4.3	5.6	6.3	20.5	21.7	28.5	31.4	39.3
Sales, general, administrative	**3.1**	**3.7**	1.7	1.6	1.8	1.9	7.0	7.9	8.7	9.9	14.3
Total Operating Expenses	**15.8**	**20.7**	**6.0**	**5.9**	**7.4**	**8.2**	**27.4**	**29.6**	**37.2**	**41.3**	**53.6**
Operating income (loss)	**(6.2)**	**(10.5)**	(3.8)	(5.1)	(6.6)	(6.6)	(22.0)	(22.7)	(26.3)	(15.2)	(38.6)
Total Other Income (Expense)	**(2.4)**	**(49.7)**	0.0	0.0			0.0				
Pre Tax Income	**(8.6)**	**(60.3)**	(3.8)	(5.0)	(6.6)	(6.6)	(21.9)	(22.7)	(26.3)	(15.2)	(38.6)
Income tax											
Net Income	**(8.6)**	**(60.3)**	**(3.8)**	**(5.0)**	**(6.6)**	**(6.6)**	**(21.9)**	**(22.7)**	**(26.3)**	**(15.2)**	**(38.6)**
EPS - diluted (proforma)	**($38.31)**	**($3.85)**	**($0.12)**	($0.16)	($0.21)	($0.20)	($0.69)	($0.65)	($0.62)	($0.33)	($0.77)
Shares outstanding - basic (proforma)	**0.22**	**15.65**	**31.36**	31.37	31.99	32.31	31.83	34.88	42.70	46.21	49.98
Shares outstanding - diluted (proforma)	**0.22**	**15.65**	**31.36**	31.37	33.25	33.60	33.08	36.23	44.16	47.80	51.69

Source: Company data, Credit Suisse estimates

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Companies Mentioned *(Price as of 28-Oct-2014)*

Amgen Inc. (AMGN.OQ, $157.19, NEUTRAL, TP $160.0)
Xencor, Inc (XNCR.OQ, $10.6, OUTPERFORM[V], TP $14.0)

Disclosure Appendix

Important Global Disclosures

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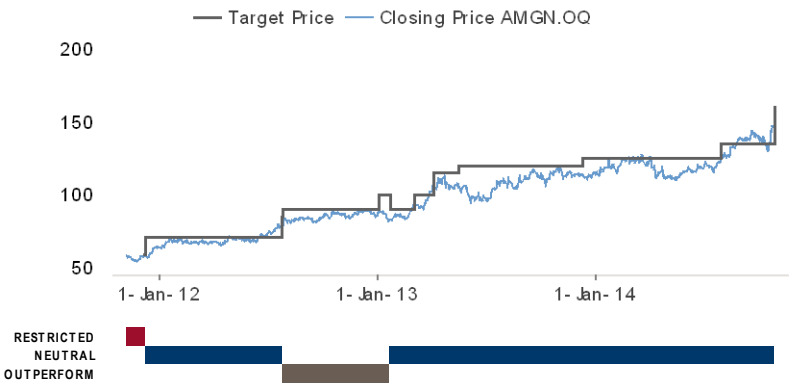
3-Year Price and Rating History for Amgen Inc. (AMGN.OQ)

AMGN.OQ Date	Closing Price (US$)	Target Price (US$)	Rating
07-Nov-11	58.43		R
08-Dec-11	58.41	59.00	N
09-Dec-11	58.59	71.00	
25-Jul-12	77.96	85.00	O
26-Jul-12	79.30	90.00	
03-Jan-13	88.59	100.00	
22-Jan-13	83.29	90.00	N
04-Mar-13	92.73	100.00	
04-Apr-13	105.90	115.00	
17-May-13	105.63	120.00	
10-Dec-13	114.10	125.00	
30-Jul-14	130.01	135.00	
28-Oct-14	157.19	160.00	

** Asterisk signifies initiation or assumption of coverage.*



3-Year Price and Rating History for Xencor, Inc (XNCR.OQ)

XNCR.OQ Date	Closing Price (US$)	Target Price (US$)	Rating
03-Dec-13	8.34		R
03-Jan-14	9.15	14.00	O *

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ratings were based on (1) a stock's absolute total return potential to its current share price and (2) the relative attractiveness of a stock's total return potential within an analyst's coverage universe. For Australian and New Zealand stocks, 12-month rolling yield is incorporated in the absolute total return calculation and a 15% and a 7.5% threshold replace the 10-15% level in the Outperform and Underperform stock rating definitions, respectively. The 15% and 7.5% thresholds replace the +10-15% and -10-15% levels in the Neutral stock rating definition, respectively. Prior to 10th December 2012, Japanese ratings were based on a stock's total return relative to the average total return of the relevant country or regional benchmark.

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Price Target: (12 months) for Xencor, Inc (XNCR.OQ)

Method: Our $14 target for XNCR is derived using a probability-adjusted DCF (discounted cash flow), including $9 for XmAb7195 (40% POS), $3 for XmAb5871 (25% POS), and $1 each for MOR208 and the technology licensees. We us a 12% discount rate and model through the products' entire lifecycle.

Risk: Risks to our $14 target price for Xencor, Inc include: 1) unexpected negative result for proprietary or partnered clinical programs, 2) financing risk from expected future equity raises, 3) competition in the CD19 and asthma programs, and 4) significant delay in one or more clinical programs that pushes potential approval timeline(s) out.

Price Target: (12 months) for Amgen Inc. (AMGN.OQ)

Method: Our $160 target price for AMGN implies a 10% premium to the S&P 500 2015 PE multiple on our 2015 non-GAAP ex-option EPS estimate

Risk: We see several risks to AMGN's achievement of our $160 target price. (1) More or less biosimilar competition relative to our model. (2) Denosumab could exceed or miss our expectations. (3) Erythropoietin safety concerns could be more or less than our model. (4) Pipeline exceeds expectations. (5) Share buyback could be less aggressive than our model.

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