Xencor, Inc (XNCR)

SMALL & MID CAP RESEARCH

Rating	**OUTPERFORM* [V]**
Price (31 Jul 14, US$)	9.66
Target price (US$)	14.00[1]
52-week price range	13.90 - 7.55
Market cap. (US$ m)	302.95
Enterprise value (US$ m)	256.78

**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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Clinical Programs On-Track

Clinical updates for XmAb7195 and XmAb5871 are on track for data in H2. XNCR's bispecific lead program will be announced by year end. Q2 earnings were relatively in line with expectations. Our 2014 EPS estimate modestly decreases after our model updates following the Q2:14 earnings.

Updates expected by year end include:

- **First proof of concept for immune down regulation:** The XmAb5871 Phase IIa trial in moderate/ severe RA is expected to read out in H2:14. XNCR is expected to start a Phase IIb trial in 2015, pending positive data. (AMGN has an option to license the program after Phase IIb.)
- **Initial IgE reduction data for XmAb7195:** Preliminary data in 30+ healthy volunteers is expected by YE:14. This early data could be difficult to interpret due to technical challenges of measuring changes in low levels of IgE, as is seen in most healthy adults. A multiple ascending dose Phase Ib trial in healthy volunteers and volunteers with elevated IgE levels and a history of allergic diseases is expected to begin in 2015 and could provide a more meaningful biologic comparison to Xolair.
- **Bispecific program could drive increased investor and partnering interest:** XNCR announced that three preclinical bispecific programs in multiple myeloma (CD38), AML (CD123), and B-cell cancers CD20), are in preclinical development (primate pharmacology and initiation of cell line development for manufacturing). XNCR plans to present preclinical data from these later this year (potentially ASH), and make a decision by year-end on advancing one program to clinical development. Current investor interest in bispecifics and immuno-oncology is high and greater appreciation of XNCR's technology in this space could drive near-term value.

Financial and valuation metrics

Year	12/13A	12/14E	12/15E	12/16E
EPS (CS adj.) (US$)	-3.85	-0.69	-0.65	-0.62
Prev. EPS (US$)	—	-0.72	—	—
P/E (x)	-2.5	-14.0	-14.9	-15.7
P/E rel. (%)	-13.7	-83.2	-98.7	-115.8
Revenue (US$ m)	10.2	5.5	7.0	11.0
EBITDA (US$ m)	-9.8	-21.6	-22.7	-26.3
OCFPS (US$)	-0.24	-0.68	-0.44	-0.74
P/OCF (x)	-37.6	-14.1	-22.2	-13.1
EV/EBITDA (current)	-23.8	-10.8	-10.3	-8.9
Net debt (US$ m)	-69	-46	-123	-99
ROIC (%)	-234.14	-328.17	-335.71	-385.72

Number of shares (m)	31.36	IC (current, US$ m)	4.49
BV/share (Next Qtr., US$)	2.2	EV/IC (x)	45.5
Net debt (Next Qtr., US$ m)	-64.8	Dividend (current, US$)	—
Net debt/tot cap (Next Qtr., %)	-92.5	Dividend yield (%)	—

Bispecific program – Lead candidate decision by year end

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 three 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.
- **CD20xCD3 targets CD20**, a clinical and commercially validated target. Marketed anti-CD20 agents include Rituxan, Gazyva, and Arzerra. CD20 is found on nearly all B-cell malignancies including NHL and CLL. Another anti-CD20 bispecific antibody current in early clinical development is at REGN.

XmAb5871 – Proof of concept data in H2:15

- 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.
- A positive result would lead to a larger Phase IIb trial and an additional $12M in funding from AMGN. The Phase IIb trial would be the basis for AMGN to make a decision on its development option for this program.

XmAb7195 – Initiated Phase I trial

Clinical program initiated – proof of concept likely in H1:15

In May 2014, XNCR announced the start of a Phase I trial of XmAb7195 in both healthy volunteers and healthy subjects with a history of allergic rhinitis, conjunctivitis, and/or atopic dermatitis.

The two part Phase I trial is a 64-patient, randomized, placebo-controlled, single ascending dose study.

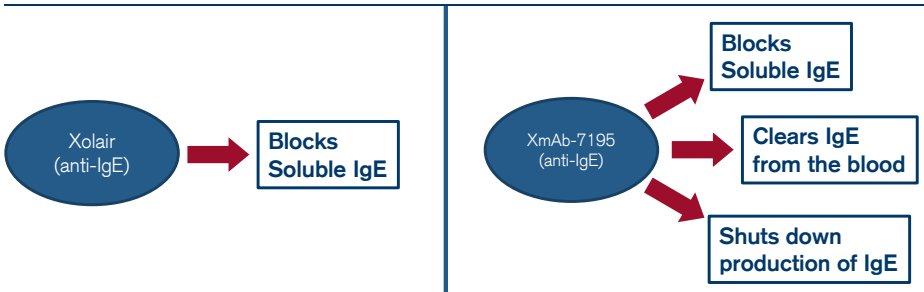
- Part A is in healthy volunteers, and
- Part B is in patients with a history of allergic diseases.

Patients will receive a single IV infusion of XmAb7195 at escalating doses. Given IgE is present in both healthy volunteers and at elevated levels in volunteers with a history of allergic diseases, it may be possible to assess the mechanism of XmAb7195 in a Phase I setting.

A Better Xolair—XmAb7195 Blocks IgE by Three Mechanisms

XmAb7195 is designed to have the same IgE binding region as Xolair, but its Fc domain has been modified for enhanced activity. While Xolair simply binds soluble IgE, XmAb7195 also shuts down the production of IgE and facilitates the clearance of IgE from the blood (See Exhibit 1). This triple mechanism of action is expected to have a greater impact on IgE levels and therefore asthma symptoms. It is also likely to overcome the dosing problems of Xolair.

Exhibit 1: Three Mechanisms for XmAb7195 vs. One for Xolair



Source: Company data, Credit Suisse Research.

Exhibit 2: Q2 Variance Table

Income Statement	2Q:14 Act.	CS 2Q:14 Est	CS Delta	Consensus 2Q:14 Est	Consensus Delta
Revenues	$ -	$ -	$ -		
Royalties on XmAb5871	$ -	$ -			
Partnering, grants, milestones	$ 0.8	$ 0.8	$ (0.0)		
Total Revenues	$ 0.8	$ 0.8	$ (0.0)	$ 1.4	$ (0.6)
Expenses	$ -	$ -	$ -		
Research and development	$ 4.3	$ 5.0	$ (0.7)		
Sales, general, administrative	$ 1.6	$ 1.8	$ (0.2)		
Total Operating Expenses	$ 5.9	$ 6.8	$ (0.9)		
					$ -
Operating income (loss)	$ (5.1)	$ (5.9)	$ 0.9	$ (7.0)	$ 2.0
Total Other Income (Expense)	$ 0.0	$ -	$ 0.0		$ 0.0
Pre Tax Income	$ (5.0)	$ (5.9)	$ 0.9		$ (5.0)
Income tax	$ -	$ -	$ -		$ -
Net Income	$ (5.0)	$ (5.9)	$ 0.9	$ (5.8)	$ 0.8
					$ -
EPS - basic (proforma)	($0.16)	($0.19)	$0.03	($0.19)	$0.03
EPS - diluted (proforma)	($0.16)	($0.19)	$0.03	($0.19)	$0.03
					$ -
Shares outstanding - basic (proforma)	31.37	31.67	-0.30		
Shares outstanding - diluted (proforma)	31.37	32.91	-1.54		

Source: Company data, Credit Suisse estimates

Exhibit 3: XNCR Newsflow

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

Source: Company data, Credit Suisse estimates

Exhibit 4: 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	AMGN has option
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 5: XNCR Model

	2012A	2013A	Q1:14A	Q2:14A	Q3:14E	Q4:14E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
Revenues													
US sales of XmAb7195													
Ex-US royalties 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	20.0	20.0
Total Revenues	**9.5**	**10.2**	**2.2**	**0.8**	**0.8**	**1.6**	**5.5**	**7.0**	**11.0**	**26.1**	**15.0**	**20.0**	**20.0**
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	40.6	42.0
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	14.6	19.0
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**	**55.2**	**61.0**
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)	(35.2)	(41.0)
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)	(35.2)	(41.0)
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)**	**(35.2)**	**(41.0)**
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)	($0.58)	($0.65)
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	60.48	63.50
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	62.27	65.39

Source: Company data, Credit Suisse estimates

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Companies Mentioned *(Price as of 31-Jul-2014)*

Xencor, Inc (XNCR.OQ, $9.66, OUTPERFORM[V], TP $14.0)

Disclosure Appendix

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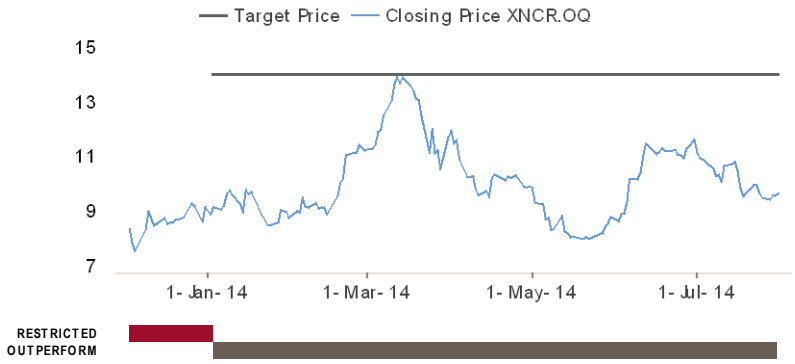
3-Year Price and Rating History for Xencor, Inc (XNCR.OQ)

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

** Asterisk signifies initiation or assumption of coverage.*



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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.

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