November 10, 2014

OUTPERFORM

Reason for report:

EARNINGS

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XENCOR, INC.

3Q Recap – Lead Bispecific mAb Selected; ALXN Advances Xtend mAb into Phase I

• **Bottom Line:** XNCR reported 3Q14 financial results and provided an update on its pipeline programs. XNCR still expects XmAb5871 Phase IIa RA data in 4Q14. XmAb7195 data in healthy volunteers are still expected in January 2015. Full MOR208 data are being presented at ASH (Dec. 6-9). XNCR disclosed selection of a lead preclinical development candidate XmAb14045 from its bispecific antibody platform. In addition, licensee ALXN (OP) has selected a first product using XNCR's half-life prolonging Xtend Fc-domain into Phase I. We are updating our estimates to reflect 3Q14 results. **Reiterate $17 PT and Outperform rating.**

• **An undisclosed ALXN antibody using Xencor's Xtend Fc-domain technology entered a Phase I clinical trial** and represents the first use of the XNCR's half-life extension technology in humans. We would view positive data as validating for XNCR's platform. Recall under the R&D license, XNCR could receive up to $67M in milestones per target and a low single-digit royalty on WW sales, should ALXN exercise the option.

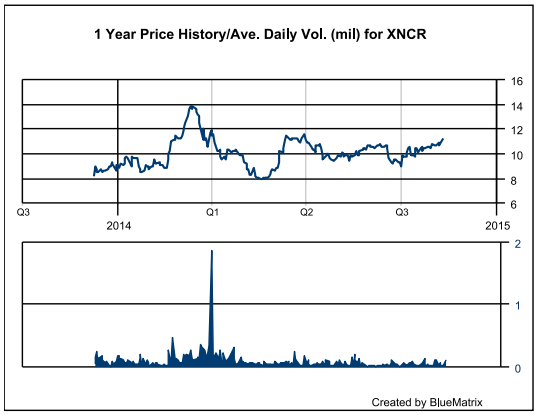
• **XNCR announced that it selected a lead preclinical bispecific antibody candidate,** XmAb14045, an anti-CD123 x CD3 bispecific antibody, for IND-enabling studies. XNCR plans to begin clinical trials by mid-2016. Other T cell engagers in development for acute lymphoblastic leukemia (ALL) include MGNX's (OP) MGD006 (CD123, in Phase I), blinatumomab (CD19, BLA pending, AMGN [MP]), AMG330 (CD33, preclinical, AMGN [MP]), and AFM11 (CD19, Phase I, AFMD [OP]). Cellectis (ALCLS [NR]) has UCART123, a CAR-T approach in preclinical development.

• **Full MOR208 (Non-Hodgkin's Lymphoma, MorphoSys) Phase II data expected at ASH.** The full presentation will likely include data from stage 2 of the trial for pts with diffuse large B-cell lymphoma (DLBCL) and follicular lymphoma (FL) (up to 20 addl pts per cohort). Although single agent activity in the abstract looks moderate, it is clearly active, and we believe unlike other CD19-targeted agents, MOR208 holds the promise to be easily combinable with current standard of care in NHL, given its safety profile.

• **Updates for XmAb5871 (autoimmune disease) and XmAb7195 (asthma) are expected in 4Q14 and January 2015, respectively.** Please see our more detailed preview here (LINK). Recall, XNCR recently announced it has regained all development and commercial rights to XmAb5871 from AMGN and that it plans to pursue future clinical development in IgG4-related disease (IgG4-RD). An update on clinical plans is expected in the coming months, and XNCR plans initiation of Phase II trials in 2015.

Key Stats:	**(NASDAQ:XNCR)**
S&P 600 Health Care Index:	**1,360.47**
Price:	**$11.22**
Price Target:	$17.00
Methodology:	Sum-of-the-parts discounted sales multiple
52 Week High:	$14.41
52 Week Low:	$5.75
Shares Outstanding (mil):	31.4
Market Capitalization (mil):	$352.3
Cash Per Share:	$1.74
Dividend (ann):	$0.00
Dividend Yield:	0.0%

Shares Outstanding (mil): Total accounts for IPO, which closed 12.06.13.



Dec Yr	1Q	2Q	3Q	4Q	FY Rev	1Q	2Q	3Q	4Q	FY EPS	PE
2013A	--	--	$8.4	$1.7	$10.2	--	--	($4.10)	($0.12)	($3.85)	NM
2014E - New	**$2.2A**	**$0.8A**	**$0.8A**	**$0.8**	**$4.7**	**($0.12)A**	**($0.16)A**	**($0.20)A**	**($0.27)**	**($0.75)**	**NM**
2014E - Old	$2.2A	$0.8A	$1.3	$1.3	$5.5	($0.12)A	($0.16)A	($0.24)	($0.25)	($0.77)	NM
2015E	--	--	--	--	$10.0	--	--	--	--	($0.89)	NM

Source: Company Information and Leerink Partners LLC Research
Revenues in MM.
Diluted GAAP EPS; 3Q13 represents 1Q-3Q13, pre-IPO; quarterly EPS may not sum to annual total due to change in shares out.

INVESTMENT THESIS

We rate XNCR Outperform. XNCR has used its proprietary "XmAb" platform to develop an antibody pipeline focused on asthma, autoimmune diseases, and cancer and also to generate incremental near-term revenue and long-term upside in the form of technology licenses and partnerships. We believe XNCR's key value drivers are its two proprietary lead product candidates XmAb7195 and XmAb5871, both addressing large market opportunities in allergic asthma and autoimmune diseases, respectively. Both programs have clinical catalysts approaching in 4Q14/1Q15 that could serve as early clinical validation for those agents, thus driving XNCR shares higher. In addition to that, we believe advances by XNCR's partners and licensees could provide additional incremental cash flows while new licenses could further validate XNCR's Fc-platform as a value driver.

Phase I IgE data in 1Q15 could provide early validation for XmAb7195 as potential "biosuperior" of Xolair (Roche) for allergic asthma. We believe XmAb7195 addresses a validated target, and preclinical data have been promising thus far. Similar to Xolair, XmAb7195 is an anti-IgE mAb, but in contrast to Xolair it uses XNCR's proprietary immune-inhibitor Fc domain, which makes it a more potent inhibitor of IgE. We believe XmAb7195 could potentially be more efficacious in patients eligible for Xolair and potentially efficacious in 20% of patients who are currently ineligible for Xolair therapy due to body weight/IgE level limitations. We believe XmAb7195 could potentially address a patient population that is 20% larger than that of Xolair, which generated $1.3Bn in global sales in 2012.

XmAb5871 is a unique B-Cell inhibitor with first Phase IIa rheumatoid arthritis (RA) data in 2H14. XmAb5871 simultaneously targets the B-cell proteins CD19 and FcgRIIb -- which could have potential advantages over rituximab (anti-CD20), which has only limited utility in treating autoimmune diseases. XmAb5871 Phase Ia data show immunosuppression with only transient B-cell reduction and Phase IIa disease activity data in RA in 2H14 should provide further proof-of-concept for XmAb5871. We believe XmAb5871 could potentially be developed for a wide range of autoimmune diseases, including RA, lupus, or Sjögren syndrome, among others. Positive Phase IIa data in 2H14, in our view, also increase the likelihood of partner AMGN to license the product following a larger controlled Phase IIb trial.

MOR208 is an antibody targeting CD19 -- which contains XNCR's high antibody-dependent cell cytotoxicity (ADCC) Fc domain -- outlicensed to MorphoSys (MOR), which is currently conducting two Phase II trials in acute lymphoblastic leukemia (ALL) and Non Hodgkin's Lymphoma (NHL). An investigator-sponsored study in chronic lymphocytic leukemia (CLL) is ongoing, and data from all three studies potentially in 2015 could validate MOR208's activity.

VALUATION

We estimate a $17 per share price target in 12 months for XNCR based on a discounted sales multiple analysis. We apply a 12% discount rate to probability of success-weighted 2025E XmAb7195 (20%), XmAb5871 (20%), MOR208 (30%), CD3XCD38 (15%), and CD3XCD123 (15%) derived revenues. Our probability of success rates are higher than the industry average of 9% for Phase I stage therapeutics, given our higher conviction of the respective programs' success rates. We apply a 6X multiple to XmAb7195 sales, reflecting current trailing Midcap ($1-$10Bn) biotech industry average and a 10X multiple to royalty streams for XmAb 5871, MOR208, CD3XCD38, and CD3XCD123. We also value XNCR's XmAb platform at $150MM. Based on our sum-of-parts analysis, we attribute ~$4/share to XmAb7195, ~$3/share to XmAb 5871, ~$2/share to MOR208, ~$2/share to the bispecific antibodies. We also attribute ~$5/share to the XmAb platform and ~$2/share to expected cash in 12 months.

RISKS TO VALUATION

Early stage developmental pipeline agents face high clinical and regulatory development risk, as well as commercial and competitive risks. As a small-cap biotech company, XNCR also faces execution risk and financial risk. We estimate that XNCR's current cash will be sufficient to fund operations through 2016 assuming continued development of XmAb8195 and XmAb5871, and the company may have additional financing needs before turning cash flow positive.

XNCR P&L (in $ MMs)	2011	2012	2013	1Q14	2Q14	3Q14	4Q14E	2014E	2015E	2016E	2017E	2018E
Collaboration and licensing revenue	6.8	9.5	10.2	2.2	0.8	0.8	0.8	4.7	10.0	10.0	20.0	25.0
Product sales	-	-	-	-	-	-	-	-	-	-	-	-
Royalty revenue	-	-	-	-	-	-	-	-	-	-	-	-
Total revenue	**6.8**	**9.5**	**10.2**	**2.2**	**0.8**	**0.8**	**0.8**	**4.7**	**10.0**	**10.0**	**20.0**	**25.0**
COGS	-	-	-	-	-	-	-	-	-	-	-	-
R&D	12.7	12.7	17.0	4.2	4.3	5.0	7.2	20.7	30.0	36.0	39.6	43.6
SG&A	3.6	3.1	3.7	1.7	1.6	2.2	2.0	7.5	8.0	8.8	9.7	10.6
Operating expenses	16.3	15.8	20.7	6.0	5.9	7.1	9.2	28.2	38.0	44.8	49.3	54.2
Operating income	(9.5)	(6.2)	(10.5)	(3.8)	(5.1)	(6.3)	(8.4)	(23.5)	(28.0)	(34.8)	(29.3)	(29.2)
Total other income (expense)	(1.8)	(2.4)	(49.7)	0.0	0.0	0.0	-	0.0	-	-	-	-
EBT	(11.2)	(8.6)	(60.3)	(3.8)	(5.0)	(6.3)	(8.4)	(23.5)	(28.0)	(34.8)	(29.3)	(29.2)
Income tax expense	-	-	-	-	-	-	-	-	-	-	-	-
Net income (loss)	(11.2)	(8.6)	(60.3)	(3.8)	(5.0)	(6.3)	(8.4)	(23.5)	(28.0)	(34.8)	(29.3)	(29.2)
Diluted EPS	(154.95)	(118.86)	(3.85)	(0.12)	(0.16)	(0.20)	(0.27)	(0.75)	(0.89)	(0.84)	(0.71)	(0.71)
Diluted shares outstanding	0.1	0.1	15.6	31.4	31.4	31.4	31.4	31.4	31.4	41.4	41.4	41.4

BS & CFS	2011	2012	2013	1Q14	2Q14	3Q14	4Q14E	2014E	2015E	2016E	2017E	2018E
Cash and STI	14.5	2.3	78.0	72.5	66.2	60.9	53.3	54.5	30.3	100.0	75.6	51.8
Debt	18.5	20.9	-	-	-	-	-	-	-	-	-	-

Source: Leerink Partners Estimates and Company Filings

	Valuation ($MM)	Per Share
XmAb7195 (20% p/w)	113	$ 3.61
XmAb5871 (20% p/w)	80	$ 2.55
MOR208 royalty (30% p/w)	57	$ 1.81
CD3XCD38 (15% p/w)	46	$ 1.48
CD3XCD123 (15% p/w)	23	$ 0.73
XmAb Platform	150	$ 4.78
Total EV	469	$ 14.95
Cash (2014E)	54	$ 1.74
Price Target	**523**	**$ 17**
Diluted shares outstanding (2014E)	31	

Source: Leerink Partners Estimates and Company Filings

Agent	Target	Platform	Indication	Status	Event	Timing
XmAb5871	CD19	Immune-inhibitory FcγRIIb domain	Autoimmune	Phase Ib/IIa	Phase IIa RA data	4Q14
					Initiate Phase I IgG4-RD trial	2015
XmAb7195	IgE	Immune-inhibitory FcγRIIb domain	Asthma	Phase I	Phase I data (part 1)	Jan-15
					Phase I data (part 2)	2015
MOR208 /XmAb5574	CD19	ADCC enhancing FcγRIIIa domain	Hematological Cancers	Phase II	Initiate Phase II POC	1H16
					Phase II data NHL	ASH Dec 2014

Source: Leerink Partners Estimates and Company Filings

Disclosures Appendix

Analyst Certification

I, Michael Schmidt, Ph.D., certify that the views expressed in this report accurately reflect my views and that no part of my compensation was, is, or will be directly related to the specific recommendation or views contained in this report.

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Distribution of Ratings/Investment Banking Services (IB) as of 09/30/14				
			IB Serv./Past 12 Mos.	
Rating	Count	Percent	Count	Percent
BUY [OP]	138	69.30	51	37.00
HOLD [MP]	61	30.70	2	3.30
SELL [UP]	0	0.00	0	0.00

Explanation of Ratings

Outperform (Buy): We expect this stock to outperform its benchmark over the next 12 months.
Market Perform (Hold/Neutral): We expect this stock to perform in line with its benchmark over the next 12 months.
Underperform (Sell): We expect this stock to underperform its benchmark over the next 12 months.The degree of outperformance or underperformance required to warrant an Outperform or an Underperform rating should be commensurate with the risk profile of the company.
For the purposes of these definitions the relevant benchmark will be the S&P 600® Health Care Index for issuers with a market capitalization of less than $2 billion and the S&P 500® Health Care Index for issuers with a market capitalization over $2 billion.

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