XBiotech Inc.
Form 10-Q
August 12, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended June 30, 2016**

**or**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**Commission File Number 001-37437**

**XBIOTECH INC.**

**(Exact name of registrant as specified in charter)**

| | |
|---|---|
| **British Columbia, Canada** | **—** |
| | **(IRS Employer** |
| **(State of Incorporation)** | **Identification No.)** |

**8201 E. Riverside Drive, Bldg. 4, Suite 100**

**Austin, TX 78744**

**(Address of principal executive offices)(Zip Code)**

**Telephone Number (512) 386-2900**

**(Registrant's telephone number, including Area Code)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

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

| | | |
|---|---|---|
| Large accelerated filer | | Accelerated filer |
| Non-accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company |

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

As of August 12, 2016, there were 32,442,865 shares of the Registrant's common stock issued and outstanding.

**XBIOTECH INC.**

**THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2016**

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SIGNATURES

**CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING STATEMENTS**

This Quarterly Report on Form 10-Q contains forward-looking statements, which reflect our current views with respect to, among other things, our operations and financial performance. All statements other than statements of historical facts contained in this Quarterly Report on Form 10-Q are forward-looking statements. You can identify forward-looking statements by terminology such as “may,” “will,” “should,” “would,” “could,” “expects,” “plans,” “contempla “anticipates,” “believes,” “estimates,” “predicts,” “projects,” “intend” or “continue” or the negative of such terms or other com terminology, although not all forward-looking statements contain these identifying words. Forward-looking statements are subject to inherent risks and uncertainties in predicting future results and conditions that could cause the actual results to differ materially from those projected in these forward-looking statements. These forward-looking statements include, but are not limited to statements about:

- our ability to obtain regulatory approval to market and sell Xilonix™ in the United States, Europe and elsewhere;
- the initiation, timing, cost, progress and success of our research and development programs, preclinical studies and clinical trials for Xilonix™ and other product candidates;
- our ability to advance product candidates into, and successfully complete, clinical trials;
- our ability to successfully commercialize the sale of Xilonix™ in the United States, Europe and elsewhere;
- our ability to recruit sufficient numbers of patients for our future clinical trials for our pharmaceutical products;
- our ability to achieve profitability;
- our ability to obtain funding for our operations, including research funding;
- our ability to identify additional new products using our True Human™ antibody discovery platform;
- the implementation of our business model and strategic plans;
- our ability to develop and commercialize product candidates for orphan and niche indications independently;
- our commercialization, marketing and manufacturing capabilities and strategy;
- our ability to protect our intellectual property and operate our business without infringing upon the intellectual property rights of others;
- our expectations regarding federal, state and foreign regulatory requirements;
- the therapeutic benefits, effectiveness and safety of our product candidates;
- the accuracy of our estimates of the size and characteristics of the markets that may be addressed by our products and product candidates;
- the rate and degree of market acceptance and clinical utility of Xilonix™ and future products, if any;
- the timing of and our collaborators’ ability to obtain and maintain regulatory approvals for our product candidates;
- our expectations regarding market risk, including interest rate changes and foreign currency fluctuations;
- our belief in the sufficiency of our cash flows to meet our needs for at least the next 12 to 24 months;

- our expectations regarding the timing during which we will be an emerging growth company under the JOBS Act;
- our ability to engage and retain the employees required to grow our business;
- our future financial performance and projected expenditures;
- developments relating to our competitors and our industry, including the success of competing therapies that are or become available; and
- estimates of our expenses, future revenue, capital requirements and our needs for additional financing.

All forward looking statements in this Quarterly Report on Form 10-Q involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. Factors that may cause actual results to differ materially from current expectations include, among other things, those under the heading “Risk Factors” included in our annual report for the year ended December 31, 2015 filed with the SEC on March 30, 2016, and elsewhere in this Quarterly Report on Form 10-Q. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in this Quarterly Report on Form 10-Q. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Except as required by law, we assume no obligation to update or revise these forward-looking statements for any reason, even if new information becomes available in the future.

This Quarterly Report on Form 10-Q also contains estimates, projections and other information concerning our industry, our business, and the markets for certain medical conditions, including data regarding the estimated size of those markets, and the incidence and prevalence of certain medical conditions. Information that is based on estimates, forecasts, projections, market research or similar methodologies is inherently subject to uncertainties and actual events or circumstances may differ materially from events and circumstances reflected in this information. Unless otherwise expressly stated, we obtained this industry, business, market and other data from reports, research surveys, studies and similar data prepared by market research firms and other third parties, industry, medical and general publications, government data and similar sources.

**XBiotech Inc.**

Consolidated Balance Sheets

(in thousands, except share data)

| | June 30, 2016 (unaudited) | December 31, 2015 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 64,798 | $ 91,051 |
| Prepaid expenses and other current assets | 1,530 | 1,990 |
| Total current assets | 66,328 | 93,041 |
| Property and equipment, net | 9,779 | 5,946 |
| Building construction in progress | 17,094 | 10,371 |
| Total assets | $ 93,201 | $ 109,358 |
| | | |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Accounts payable | $ 8,494 | $ 4,825 |
| Accrued expenses | 1,882 | 1,466 |
| Total current liabilities | 10,376 | 6,291 |
| Deferred rent | 21 | 17 |
| Total liabilities | 10,397 | 6,308 |
| | | |
| Shareholders' equity: | | |
| Preferred Stock, no par value, unlimited shares authorized, no shares outstanding | - | - |
| Common stock, no par value, unlimited shares authorized, 32,428,676 and 32,279,106 shares outstanding at June 30, 2016 and December 31, 2015, respectively | 237,523 | 233,902 |
| Accumulated other comprehensive loss | (190) | (201) |
| Accumulated deficit | (154,529) | (130,651) |
| Total shareholders' equity | 82,804 | 103,050 |
| Total liabilities and shareholders' equity | $ 93,201 | $ 109,358 |

*See accompanying notes.*

**XBiotech Inc.**

Consolidated Statements of Operations

(in thousands, except share and per share data)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 (unaudited) | 2015 (unaudited) | 2016 (unaudited) | 2015 (unaudited) |
| Operating expenses: | | | | |
| Research and development | $11,216 | $4,382 | $19,028 | $11,167 |
| General and administrative | 2,399 | 2,039 | 4,835 | 3,459 |
| Total operating expenses | 13,615 | 6,421 | 23,863 | 14,626 |
| Loss from operations | (13,615) | (6,421) | (23,863) | (14,626) |
| Other loss: | | | | |
| Foreign exchange loss | (7) | (323) | (16) | (232) |
| Total other loss | (7) | (323) | (16) | (232) |
| Net loss | $(13,622) | $(6,744) | $(23,879) | $(14,858) |
| Net loss per share—basic and diluted | $(0.42) | $(0.22) | $(0.74) | $(0.50) |
| Shares used to compute basic and diluted net loss per share | 32,378,412 | 31,287,855 | 32,333,199 | 29,474,783 |

*See accompanying notes.*

Consolidated Statements of Comprehensive Loss

(in thousands)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 (unaudited) | 2015 (unaudited) | 2016 (unaudited) | 2015 (unaudited) |
| Net loss | $ (13,622) | $ (6,744) | $ (23,879) | $ (14,858) |
| Foreign currency translation adjustment | (26) | 317 | 12 | 219 |
| Comprehensive loss | $ (13,648) | $ (6,427) | $ (23,867) | $ (14,639) |

*See accompanying notes.*

**XBiotech Inc.**

Consolidated Statements of Cash Flows

(in thousands)

| | Six Months Ended June 30, | |
|---|---|---|
| | 2016 (unaudited) | 2015 (unaudited) |
| Operating activities | | |
| Net loss | $(23,879) | $(14,858) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 350 | 341 |
| Share-based compensation expense | 2,914 | 2,469 |
| Changes in operating assets and liabilities: | | |
| Prepaid expenses and other current assets | 460 | (2,560) |
| Accounts payable | 1,536 | 144 |
| Accrued expenses | 416 | (937) |
| Deferred rent | 5 | 7 |
| Net cash used in operating activities | (18,198) | (15,394) |
| | | |
| Investing activities | | |
| Purchase of property and equipment | (3,602) | (726) |
| Expenditure on building construction | (5,172) | (1,484) |
| Net cash used in investing activities | (8,774) | (2,210) |
| | | |
| Financing activities | | |
| Issuance of common stock and warrants, net | - | 76,025 |
| Issuance of common stock under stock option plan | 707 | 678 |
| Collection of subscription receivable | - | 410 |
| Deferred offering costs | - | 325 |
| Net cash provided by financing activities | 707 | 77,438 |
| Effect of foreign exchange rate on cash and cash equivalents | 12 | 219 |
| | | |
| Net change in cash and cash equivalents | (26,253) | 60,053 |
| Cash and cash equivalents, beginning of period | 91,051 | 57,329 |
| Cash and cash equivalents, end of period | $64,798 | $117,382 |
| | | |
| Supplemental Information: | | |
| Accrued purchases of property and equipment | 581,193 | 54,241 |
| Accrued expenditure on building construction | 1,550,270 | - |

*See accompanying notes.*

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**XBiotech Inc.**

Notes to Consolidated Financial Statements (Unaudited)

**1. Organization**

XBiotech, Inc. (“XBiotech” or “the Company”) was incorporated in Canada on March 22, 2005. XBiotech USA Inc., a wholly-owned subsidiary of the Company, was incorporated in Delaware, United States (“U.S.”) in November 2007. XBiotech Schweiz AG, a wholly-owned subsidiary of the Company, was incorporated in Zug, Switzerland in August 2010. XBiotech Japan KK, a wholly-owned subsidiary of the Company, was incorporated in Tokyo, Japan in March 2013. XBiotech GmbH, a wholly-owned subsidiary of the Company, was incorporated in Germany in January 2014.

Since its inception, XBiotech has focused on advancing technology to rapidly identify and clone antibodies from individuals that have resistance to disease. At the heart of the Company is a proprietary technical knowhow to translate natural human immunity into therapeutic product candidates.

In 2005, the Company began to develop a new framework for commercial manufacturing, using technology that required less capital, fewer operators and provided greater flexibility than standard industry practices.

With the manufacturing capability to produce its True Human™ antibody therapy, in 2010 the Company began a clinical trial program. The first clinical trial program at MD Anderson Cancer Center began treating the sickest cancer patients irrespective of tumor type. Soon thereafter, the Company used the same antibody therapy in various clinical studies at treatment centers around the U.S. and abroad to investigate the antibody effect in patients that had vascular disease, leukemia, type 2 diabetes, psoriasis or acne.

The Company’s headquarters are located in Austin, Texas.

The Company continues to be subject to a number of risks common to companies in similar stages of development. Principal among these risks are the uncertainties of technological innovations, dependence on key individuals, development of the same or similar technological innovations by the Company’s competitors and protection of proprietary technology. The Company’s ability to fund its planned clinical operations, including completion of its planned trials, is expected to depend on the amount and timing of cash receipts from future collaboration or product sales and/or financing transactions.

**2. Significant Accounting Policies**

**Basis of Presentation**

These consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States, or US GAAP.

These interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP, and Securities and Exchange Commission, or SEC, requirements for interim financial statements. In the Company's opinion, the accompanying unaudited consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, consisting of normal, recurring adjustments, necessary for a fair presentation. Certain information and disclosures normally included in the notes to the annual consolidated financial statements prepared in accordance with GAAP have been omitted from these interim unaudited consolidated financial statements pursuant to the rules and regulations of the SEC. Accordingly, these interim unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the accompanying notes for the fiscal year ended December 31, 2015, which are included in the Company's Annual Report on Form 10-K, filed with the SEC on March 30, 2016. The results of operations for the three month and six month periods ended June 30, 2016 are not necessarily indicative of the results to be expected for the year ending December 31, 2016 or for any other period.

**Basis of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated upon consolidation.

**Use of Estimates**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported values of amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

Prior to the completion of its initial public offering in April 2015, the Company utilized significant estimates and assumptions in determining the fair value of its common stock. The board of directors determined the estimated fair value of the Company's common stock based on a number of objective and subjective factors, including the prices at which the Company sold shares of its common stock to third parties and external market conditions affecting the biotechnology industry sector.

**Research and Development Costs**

All research and development costs are charged to expense as incurred. Research and development costs include salaries and personnel-related costs, consulting fees, fees paid for contract research services, the costs of laboratory equipment and facilities, license fees and other external costs. Costs incurred to acquire licenses for intellectual property to be used in research and development activities with no alternative future use are expensed as incurred as research and development.

Nonrefundable advance payments for goods or services to be received in the future for use in research and development activities are deferred and capitalized. The capitalized amounts are expensed as the related goods are delivered or the services are performed.

**Income Taxes**

The Company makes estimates and judgments in determining the need for a provision for income taxes, including the estimation of its taxable income or loss for the each full fiscal year. The Company has accumulated significant deferred tax assets that reflect the tax effects of net operating loss and tax credit carryovers and temporary difference between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Realization of certain deferred tax assets is dependent upon future earnings. The Company is uncertain about the timing and amount of any future earnings. Accordingly, the Company offsets these deferred tax assets with a valuation allowance. The Company may in the future determine that certain deferred tax assets will likely be realized, in which case the Company will reduce its valuation allowance in the period in which such determination is made. If the valuation allowance is reduced, the Company may recognize a benefit from income taxes in its statement of operations in that period. The Company classifies interest recognized pursuant to its deferred tax assets as interest expense, when appropriate.

**Share-Based Compensation**

The Company accounts for its share-based compensation awards in accordance with ASC Topic 718, *Compensation-Stock Compensation* (“ASC 718”). ASC 718 requires all share-based payments to employees, including grants of employee stock options, to be recognized in the statements of operations based on their grant date fair values. For stock options granted to employees and to members of the board of directors for their services on the board of directors, the Company estimates the grant date fair value of each option award using the Black-Scholes option-pricing model. The use of the Black-Scholes option-pricing model requires management to make assumptions with respect to the expected term of the option, the expected volatility of the common stock consistent with the expected life of the option, risk-free interest rates and expected dividend yields of the common stock. For awards subject to service-based vesting conditions, the Company recognizes share-based compensation expense, equal to the grant date fair value of stock options on a straight-line basis over the requisite service period.

Share-based compensation expense recognized for the three months and six months ended June 30, 2016 and 2015 was included in the following line items on the Consolidated Statement of Operations (in thousands).

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Research and development | $587 | $521 | $1,184 | $976 |
| General and administrative | $511 | $726 | $1,730 | $1,493 |
| Total share-based compensation expense | $1,097 | $1,247 | $2,914 | $2,469 |

The fair value of each option is estimated on the date of grant using the Black-Scholes method with the following assumptions:

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2016 | | 2015 | | 2016 | | 2015 | |
| Dividend yield | - | - | - | - | - | - | - | - |
| Expected volatility | 65% | 70% | 71% | | 65% | 70% | 68% | 71% |
| Risk-free interest rate | 1.16% | 1.51% | 1.07% | 2.42% | 1.16% | 1.82% | 1.07% | 2.42% |
| Expected life (in years) | 5.25 | 6.25 | 3 | 10 | 5 | 10 | 3 | 10 |
| Weighted-average grant date fair value per share | $8.17 | | $13.01 | | $6.64 | | $11.49 | |

No related tax benefits were recognized for the three months and six months ended June 30, 2016 and 2015.

**Cash and Cash Equivalents**

The Company considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consisted primarily of cash on deposit in U.S., German, Swiss and Canadian banks. Cash and cash equivalents are stated at cost which approximates fair value.

**Concentrations of Credit Risk**

Financial instruments that potentially subject the Company to credit risk consist primarily of cash and cash equivalents. The Company holds these investments in highly-rated financial institutions, and limits the amounts of credit exposure to any one financial institution. These amounts at times may exceed federally insured limits. The Company has not experienced any credit losses in such accounts and does not believe it is exposed to any significant credit risk on these funds. The Company has no off-balance sheet concentrations of credit risk, such as foreign currency exchange contracts, option contracts or other hedging arrangements.

**Fair Value Measurements**

The Company follows ASC Topic 820, *Fair Value Measurements and Disclosures*, which establishes a fair value hierarchy for those instruments measured at fair value that distinguishes between assumptions based on market date (observable inputs) and the Company's own assumptions (unobservable inputs). The hierarchy consists of three levels:

- Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

- Level 3—Unobservable inputs that reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability in which there is little, if any, market activity for the asset or liability at the measurement date.

At June 30, 2016 and December 31, 2015, the Company did not have any assets or liabilities that are measured at fair value on a recurring basis. The carrying amounts reflected in the balance sheets for cash and cash equivalents, prepaid expenses and other current assets, accounts payable, and accrued expenses approximate their fair values at June 30, 2016 and December 31, 2015, due to their short-term nature.

**Property and Equipment**

Property and equipment, which consists of land, construction in process, furniture and fixtures, computers and office equipment, scientific equipment, leasehold improvements and vehicles are stated at cost and depreciated over the estimated useful lives of the assets, with the exception of land and construction in process which are not depreciated, using the straight line method. The useful lives are as follows:

- Furniture and fixtures (in years) 7
- Office equipment (in years) 5
- Leasehold improvements Shorter of asset's useful life or remaining lease term
- Scientific equipment (in years) 5
- Vehicles (in years) 5

Costs of major additions and betterments are capitalized; maintenance and repairs, which do not improve or extend the life of the respective assets, are charged to expense as incurred. Upon retirement or sale, the cost of the disposed asset and the related accumulated depreciation are removed from the accounts and the resulting gain or loss is recognized.

**Building Construction in Progress**

Building construction in progress consists of the accumulated expenditures to build the new XBiotech manufacturing facility located in Austin, Texas, which includes the cost for land clearing, architecture design, engineering services, city permits, installation of utilities, construction materials and labor and construction management. Once the building is completed and placed into service, the Company will commence depreciation over its estimated useful life. As of June 30, 2016, the Company plans to spend $2.2 million more on construction and $6.7 million more on equipment, based on the forecast.

**Impairment of Long-Lived Assets**

The Company periodically evaluates its long-lived assets for potential impairment in accordance with ASC Topic 360, *Property, Plant and Equipment*. Potential impairment is assessed when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. Recoverability of these assets is assessed based on undiscounted expected future cash flows from the assets, considering a number of factors, including past operating results, budgets and economic projections, market trends and product development cycles. If impairments are identified, assets are written down to their estimated fair value. The Company has not recognized any impairment through June 30, 2016.

**Foreign Currency Transactions**

Certain transactions are denominated in a currency other than the Company's functional currency of the U.S. dollar, and the Company generates assets and liabilities that are fixed in terms of the amount of foreign currency that will be received or paid. At each balance sheet, the Company adjusts the assets and liabilities to reflect the current exchange rate, resulting in a translation gain or loss. Transaction gains and losses are also realized upon a settlement of a foreign currency transaction in determining net loss for the period in which the transaction is settled.

**Comprehensive Income (Loss)**

ASC Topic 220, *Comprehensive Income*, requires that all components of comprehensive income (loss), including net income (loss), be reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources, including unrealized gains and losses on investments and foreign currency translation adjustments.

**Segment and Geographic Information**

Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions on how to allocate resources and assess performance. The Company's chief operating decision maker is the Chief Executive Officer. The Company and the chief operating decision maker view the Company's operations and manage its business as one operating segment. Substantially all of the Company's operations are in the U.S. geographic segment.

**Net Loss Per Share**

Net loss per share ("EPS") is computed by dividing net loss by the weighted average number of common shares outstanding during each period. Diluted EPS is computed by dividing net loss by the weighted average number of common shares and common share equivalents outstanding (if dilutive) during each period. The number of common share equivalents, which include stock options, is computed using the treasury stock method.

**Subsequent Events**

The Company considered events or transactions occurring after the balance sheet date but prior to the date the consolidated financial statements are available to be issued for potential recognition or disclosure in its consolidated financial statements. The Company has evaluated subsequent events through the date the consolidated financial statements were available for issuance for potential recognition or disclosure in its consolidated financial statements.

**Recent Accounting Pronouncements**

In August 2014, the FASB issued ASU 2014-15*, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The ASU is intended to define management's responsibility to evaluate whether there is substantial doubt about an organization's ability to continue as a going concern and to provide related footnote disclosures. For all entities, the ASU is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. The Company is currently evaluating the effect that the adoption of ASU 2014-15 will have on its financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The core change with ASU 2016-2 is the requirement for the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The new standard is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is currently evaluating the effect that the adoption of ASU 2016-02 will have on its financial statements.

In March 2016, the FASB issued ASU No. 2016-09, "Improvements to Employee Share-Based Payment Accounting," or ASU 2016-09, which amends ASC Topic 718, "Compensation – Stock Compensation." ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard is effective for fiscal years beginning after December 31, 2016, and interim periods within those years and early adoption is permitted. The Company is currently evaluating how the adoption of this standard will impact its consolidated financial statements.

**3. Income Taxes**

The Company did not provide for income taxes in 2016 because the Company has projected net loss for all jurisdictions for the full year 2016. The Company has recorded a full valuation allowance for its net deferred tax assets in 2016 and 2015.

**4. Common Stock**

Pursuant to its Articles, the Company has an unlimited number of shares available for issuance with no par value.

From January to March 2015, warrants to purchase a total of 164,999 shares of common stock were exercised at $15.00 per share for a total of $2.4 million in proceeds. Also, the Company received approximately $8,000 in January 2015 from 15,000 exercised stock options at $0.55 per share.

On April 17, 2015, the Company sold 4.0 million shares of common stock at $19.00 per share in its Initial Public Offering (“IPO”) resulting in net proceeds of $70.6 million.

From April to June 2015, excluding the IPO, the Company issued 208,333 shares of common stock for total proceeds of approximately $3.1 million from the exercise of warrants by common stock shareholders. Also, the Company received $0.7 million from 106,000 exercised stock options.

In July 2015, 12,000 stock options were exercised at a price of $2.50 for total proceeds of $30,000.

From October through December 31, 2015, 226,141 shares of common stock were issued upon the exercise of stock option at the price $ 0.53 to $10 per share for a total of $639,253.

In January 2016, 13,000 stock options were exercised at a price of $2.50 for total proceeds of $32,500 on January 28th.

From April to June 2016, 136,570 shares of common stock were issued upon the exercise of stock options at a price of $ 2.50 to $15 per share for a total of $674,758.

**5. Common Stock Options**

On each of November 11, 2005 and March 13, 2015, the board of directors of the Company adopted a stock option plan (collectively, “the Plans”) pursuant to which the Company may grant stock options to directors, officers, employees or consultants of the Company or an affiliate or other persons as the Compensation Committee may approve.

All options will be non-transferable and may be exercised only by the participant, or in the event of the death of the participant, a legal representative until the earlier of the options’ expiry date or the first anniversary of the participant’s death, or such other date as may be specified by the Compensation Committee.

The term of the options is at the discretion of the Compensation Committee, but may not exceed 10 years from the grant date. The options expire on the earlier of the expiration date or the date three months following the day on which the participant ceases to be a director, officer or employee of or consultant to the Company, or in the event of the termination of the participant with cause, the date of such termination.

The number of common shares reserved for issuance to any one person pursuant to the Plans shall not, in aggregate, exceed 5% of the total number of outstanding common shares. The exercise price per common share under each option will be the fair market value of such shares at the time of the grant. Upon stock option exercise, the Company issues new shares of common stock.

A summary of changes in common stock options issued under the Plan is as follows:

| | Options | Exercise Price | Weighted-Average Exercise Price |
|---|---|---|---|
| Options outstanding at December 31, 2015 | 4,786,577 | $0.53 - $21.99 | $8.56 |
| Granted | 357,833 | 7.71 - 9.45 | 8.01 |
| Exercised | (13,000) | 2.50 | 2.50 |
| Forfeitures | (48,250) | 0.55 - 16.91 | 11.50 |
| Options outstanding at March 31, 2016 | 5,083,160 | $0.55 - $21.99 | $ 8.00 |
| Granted | 398,500 | 10.00 - 19.10 | 13.43 |
| Exercised | (136,570) | 2.50 - 15.00 | 4.96 |
| Forfeitures | (63,375) | 7.71 - 16.97 | 8.87 |
| Options outstanding at June 30, 2016 | 5,281,715 | $0.77 - $21.99 | 8.48 |

As of June 30, 2016, there was approximately $6.4 million of unrecognized compensation cost, related to stock options granted under the Plan which will be amortized to stock compensation expense over the next 2.96 years.

**6. Net Loss Per Share**

The following summarizes the computation of basic and diluted net loss per share for the three months and six months ended June 30, 2016 and 2015 (in thousands, except share and per share data):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Net loss | $(13,622) | $(6,744) | $(23,879) | $(14,858) |
| Weighted-average number of common shares—basic and diluted | 32,378,412 | 31,287,855 | 32,333,199 | 29,474,783 |
| Net loss per share—basic and diluted | $(0.42) | $(0.22) | $(0.74) | $(0.50) |

The following potentially dilutive securities outstanding, prior to the use of the treasury stock method or if-converted method, have been excluded from the computation of diluted weighted-average common shares outstanding, because including them would have had an anti-dilutive effect due to the losses reported.

| | Six Months ended June 30, | |
|---|---|---|
| | 2016 | 2015 |
| Stock options | 5,281,715 | 4,952,068 |
| Total | 5,281,715 | 4,952,068 |

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**7. Commitment and Contingencies**

On December 1, 2015, a purported securities class action complaint captioned *Yogina Rezko v. XBiotech Inc., John Simard, Queena Han and WR Hambrecht & Co., LLC* was filed against us, certain of our officers and directors and the underwriter for our initial public offering in the Superior Court for the State of California, Los Angeles County. On December 2, 2015, a purported securities class action complaint captioned *Linh Tran v. XBiotech Inc., John Simard and Queena Han* was filed against us and certain of our officers and directors in U.S. District Court for the Western District of Texas. The lawsuits are based on substantially similar factual allegations and purport to be class actions brought on behalf of purchasers of the Company's securities during the period from April 15, 2015 through November 23, 2015. The complaint filed in California state court alleges that the defendants violated the Securities Act of 1933, as amended (the "Securities Act"), and the complaint filed in federal court alleges that the defendants violated the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in each case by making materially false and misleading statements concerning the Company's Phase III clinical trial conducted in Europe to assess Xilonix™ as a treatment for colorectal cancer. The California complaint purports to assert claims for violations of Sections 11, 12(a)(2) and 15 of the Securities Act, and the federal complaint purports to assert claims for violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. Both complaints seek, on behalf of the purported class, an unspecified amount of monetary damages, interest, fees and expenses of attorneys and experts, and other relief.

In February 24, 2016, following a proceeding to select a lead plaintiff in the federal case, the court issued an order appointing Mr. Kresimir Corak as lead plaintiff. The plaintiff filed an amended complaint in the federal case on April 8, 2016. We filed a motion to dismiss brief with the court on May 23, 2016, while plaintiffs filed a response brief on July 7, 2016. In the California case, the plaintiffs filed an amended complaint on June 7, 2016. We responded with a demurrer in August 2016. No trial or other dates have been set in either case. We are unable to estimate the outcome of this matter or resulting financial impact to us, if any.

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

**Overview**

XBiotech is a clinical-stage biopharmaceutical company engaged in discovering and developing True Human™ monoclonal antibodies for treating a variety of different diseases. True Human™ monoclonal antibodies are those which occur naturally in human beings—as opposed to being derived from animal immunization technologies or otherwise engineered. We believe that naturally occurring monoclonal antibodies have the potential to be safer and more effective than their non-naturally occurring counterparts. While primarily focused on bringing our lead product candidate to market, we have also developed a proprietary True Human™ monoclonal antibody discovery platform and manufacturing system.

We have never been profitable and, as of June 30, 2016, we had an accumulated deficit of $154.5 million. We had net losses of $13.6 million and $23.9 million for three months and six months ended June 30, 2016, respectively, compared to $6.7 million and $14.9 million for three months and six months ended June 30, 2015, respectively. We expect to incur significant and increasing operating losses for the foreseeable future as we advance our drug candidates from discovery through preclinical testing and clinical trials and seek regulatory approval and eventual commercialization. In addition to these increasing research and development expenses, we expect general and administrative costs to increase as we add personnel and begin to operate as a public company. We will need to generate significant revenues to achieve profitability, and we may never do so. As of June 30, 2016, we had 88 employees.

**Recent Events:**

During the second quarter, XBiotech presented pivotal trial data for Xilonix™ for the treatment of advanced colorectal cancer (CRC) at European Society of Medical Oncology (ESMO) World Congress in Barcelona, Spain.

XBiotech's marketing authorization application for Xilonix™ for the treatment of colorectal cancer remains on schedule to possibly achieve a decision in 2016 by the European Medicines Agency Committee for Medicinal Products for Human Use (CHMP).

Construction continued during Q2 2016 on the new manufacturing facility located in Austin, Texas. During the quarter, the build out of the interior administrative and lab spaces continued on schedule. XBiotech anticipates final building completion in August 2016 with plant shakedown and validation starting immediately thereafter.

**Revenues**

To date, we have not generated any revenue. Our ability to generate revenue and become profitable depends on our ability to successfully commercialize our lead product candidate, Xilonix™, or any other product candidate we may advance in the future.

**Research and Development Expenses**

Research and development expense consists of expenses incurred in connection with identifying and developing our drug candidates. These expenses consist primarily of salaries and related expenses, stock-based compensation, the purchase of equipment, laboratory and manufacturing supplies, facility costs, costs for preclinical and clinical research, development of quality control systems, quality assurance programs and manufacturing processes. We charge all research and development expenses to operations as incurred.

Clinical development timelines, likelihood of success and total costs vary widely. We do not currently track our internal research and development costs or our personnel and related costs on an individual drug candidate basis. We use our research and development resources, including employees and our drug discovery technology, across multiple drug development programs. As a result, we cannot state precisely the costs incurred for each of our research and development programs or our clinical and preclinical drug candidates. From inception through June 30, 2016, we have recorded total research and development expenses, including share-based compensation, of $120.1 million. Our total research and development expenses for the three months and six months ended June 30, 2016 were $11.2 million and $19.0 million, respectively, compared to $4.4 million and $11.2 million for the three months and six months ended June 30, 2015, respectively. Share-based compensation accounted for $0.6 million and $1.2 million for the three months and six months ended June 30, 2016, respectively, compared to $0.5 million and $1.0 million for the three months and six months ended June 30, 2015, respectively.

Research and development expenses, as a percentage of total operating expenses for the three months and six months ended June 30, 2016 were 82% and 80%, respectively, compared to 68% and 76% for the three months and six months ended June 30, 2015, respectively. The percentages, *excluding* stock-based compensation, for the three months and six months ended June 30, 2016 were 88% and 87%, respectively, compared to 75% and 84% for the three months and six months ended June 30, 2015, respectively.

Based on the results of our preclinical studies, we anticipate that we will select drug candidates and research projects for further development on an ongoing basis in response to their preclinical and clinical success as well as commercial potential. For R&D candidates in early stages of development, it is premature to estimate when material net cash inflows from these projects might occur.

Increased research and development costs were anticipated and primarily due to Phase II and Phase III studies related to XBiotech's wholly-owned R&D programs in Xilonix™ and 514G3.

Due to the fact that our drug candidates are in the early stage of development, we cannot estimate anticipated completion dates and when we might receive material net cash inflows from our research and development projects.

**General and Administrative Expenses**

General and administrative expense consists primarily of salaries and related expenses for personnel in administrative, finance, business development and human resource functions, as well as the legal costs of pursuing patent protection of our intellectual property and patent filing and maintenance expenses, stock–based compensation, and professional fees for legal services. Our total general and administration expenses for the three months and six months ended June 30, 2016 were $2.4 million and $4.8 million, respectively, compared to $2.0 million and $3.5 million for the three months and six months ended June 30, 2015, respectively. Share-based compensation accounted for $0.5 million and $1.7 million for the three months and six months ended June 30, 2016, respectively, compared to $0.7 million and $1.5 million for the three months and six months ended June 30, 2015, respectively.

**Critical Accounting Policies**

Our Management's Discussion and Analysis of our Financial Condition and Results of Operations is based on our financial statements, which have been prepared in conformity with generally accepted accounting principles in the United States, or US GAAP. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and expenses incurred during the reported periods.

We base estimates on our historical experience, known trends and various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in the notes to our financial statements appearing in this prospectus, we believe that the following accounting policies are the most critical to understanding and evaluating our reported financial results.

***Stock-Based Compensation***

Stock-based awards are measured at fair value at each grant date. We recognize stock-based compensation expenses ratably over the requisite service period of the option award.

***Determination of the Fair Value of Stock-Based Compensation Grants***

The determination of the fair value of stock-based compensation arrangements is affected by a number of variables, including estimates of the fair value of our common stock, expected stock price volatility, risk-free interest rate and the expected life of the award. We value stock options using the Black-Scholes option-pricing model, which was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Black-Scholes and other option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. If we made different assumptions, our stock-based compensation expenses, net loss, and net loss per common share could be significantly different. Prior to our IPO in April 2015, we issued common stock for cash consideration to new investors. We believe that such transactions represent the best evidence of fair value of our common stock. Therefore, we used the sales price of our common stock during the three months and six months ended June 30, 2015 as the fair value of our common stock.

The following summarizes the assumptions used for estimating the fair value of stock options granted during the periods indicated:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Dividend yield | - | - | | |
| Expected volatility | 65%-70% | 71 % | 65%-70% | 68%-71% |
| Risk-free interest rate | 1.16%-1.51% | 1.07%-2.42% | 1.16%-1.82% | 1.07%-2.42% |
| Expected life (in years) | 5.25-6.25 | 3-10 | 5-10 | 3-10 |
| Weighted-average grant date fair value per share | $8.17 | $13.01 | $6.64 | $11.49 |

We have assumed no dividend yield because we do not expect to pay dividends in the foreseeable future, which is consistent with our past practice. The risk-free interest rate assumption is based on observed interest rates for U.S. Treasury securities with maturities consistent with the expected life of our stock options. The expected life represents the period of time the stock options are expected to be outstanding and is based on the simplified method when the stock option includes “plain vanilla” terms. Under the simplified method, the expected life of an option is presumed to be the midpoint between the vesting date and the end of the agreement term. We used the simplified method due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to otherwise estimate the expected life of the stock options. For stock options that did not include “plain vanilla” terms we used the contractual life of the stock option as the expected life. Such stock options consisted primarily of options issued to our board of directors that were immediately vested at issuance. Due to the lack of sufficient trading history for our common stock, expected volatility is based on historical volatilities for publicly traded stock of comparable companies over the estimated expected life of the stock options.

We based our estimate of pre-vesting forfeitures, or forfeiture rate, on historical forfeiture rates. We apply the estimated forfeiture rate to the total estimated fair value of the awards, as derived from the Black-Scholes model, to compute the stock-based compensation expenses, net of pre-vesting forfeitures, to be recognized in our consolidated statements of operations.

**Results of Operations**

***Revenue***

We did not record any revenue during the three months and six months ended June 30, 2016 and 2015.

***Expenses***

*Research and Development*

Research and Development costs are summarized as follows (in thousands):

| | Three Months Ended June 30, | | Increase | % Increase |
|---|---|---|---|---|
| | 2016 | 2015 | (Decrease) | (Decrease) |
| Salaries and related expenses | $ 1,980 | $ 1,546 | $ 434 | 28 % |
| Laboratory and manufacturing supplies | 2,762 | 704 | 2,058 | 292 % |
| Clinical trials and sponsored research | 4,657 | 715 | 3,942 | 551 % |
| Stock-based compensation | 587 | 521 | 66 | 13 % |
| Other | 1,230 | 896 | 334 | 37 % |
| Total | $ 11,216 | $ 4,382 | $ 6,834 | 156 % |

| | Six Months Ended June 30, | | Increase | % Increase |
|---|---|---|---|---|
| | 2016 | 2015 | (Decrease) | (Decrease) |
| Salaries and related expenses | $ 3,837 | $ 2,976 | 861 | 29 % |
| Laboratory and manufacturing supplies | 3,538 | 2,039 | 1,499 | 74 % |
| Clinical trials and sponsored research | 8,313 | 3,405 | 4,908 | 144 % |
| Stock-based compensation | 1,184 | 976 | 208 | 21 % |
| Other | 2,156 | 1,771 | 385 | 22 % |
| Total | 19,028 | 11,167 | 7,861 | 70 % |

We do not currently track our internal research and development costs or our personnel and related costs on an individual drug candidate basis. We use our research and development resources, including employees and our drug discovery technology, across multiple drug development programs. As a result, we cannot state precisely the costs incurred for each of our research and development programs or our clinical and preclinical drug candidates.

Research and development expenses increased by 156% to $11.2 million for the three months ended June 30, 2016 compared to $4.4 million for the three months ended June 30, 2015 Research and development expenses increased by 70% to $19.0 million for the six months ended June 30, 2016 compared to $11.2 million for the six months ended June 30, 2015.

The three month increase in research and development expenses was mainly due to a $3.9 million increase in clinical trial activities, related to a trial expanded from a U.S. trial to a global trial. In addition there was a continued increase in laboratory and manufacturing supplies expense due to the increase of the manufacturing activities as well as

preparation for new building supplies. Salaries and related expenses continued to increase related to the growing size of the workforce.

Compared to the six months ended June 30, 2015, the research and development expense increase in the six months ended June 30, 2016 was primarily caused by a substantial growth in the clinical trial activity, mainly in Europe, the US and Asia. The laboratory and manufacturing supplies increase was principally due to the manufacturing activities as well as the research activities. Labor costs also increased due to an increase of current employee’s salaries and an increase in the size of the Research and Development workforce from 40 to 77.

*General and Administrative*

General and administrative costs are summarized as follows (in thousands):

| | Three Months Ended June 30, | | Increase | % Increase |
|---|---|---|---|---|
| | 2016 | 2015 | (Decrease) | (Decrease) |
| Salaries and related expenses | $ 386 | $ 410 | $ (24) | (6 %) |
| Patent filing expense | 207 | 256 | (49) | (19 %) |
| Stock-based compensation | 511 | 726 | (215) | (30 %) |
| Professional fees | 768 | 290 | 478 | 165 % |
| Other | 527 | 357 | 170 | 48 % |
| Total | $ 2,399 | $ 2,039 | $ 360 | 18 % |

| | Six Months Ended June 30, | | Increase | % Increase |
|---|---|---|---|---|
| | 2016 | 2015 | (Decrease) | (Decrease) |
| Salaries and related expenses | $ 913 | $ 609 | $ 304 | 50 % |
| Patent filing expense | 353 | 483 | (130) | (27 %) |
| Stock-based compensation | 1,730 | 1,493 | 237 | 16 % |
| Professional fees | 860 | 422 | 438 | 104 % |
| Other | 979 | 452 | 527 | 117 % |
| Total | $ 4,835 | $ 3,459 | $ 1,376 | 40 % |

General and administrative expenses increased 18% to $2.4 million for the three months ended June 30, 2016 compared to $2.0 million for the three months ended June 30, 2015. General and administrative expenses increased 40% to $4.8 million for the six months ended June 30, 2015 compared to $3.5 million for the six months ended June 30, 2015.

The three months increase was primarily related to a $0.5 million increase in public relations fees. The decrease in stock–based compensation expenses of $0.2 million due to the grant of stock options to new employees by the Company from April 1, 2015 to June 30, 2016, which offset the total increase. Other expenses also increased including the increase in insurance and recruiting activities.

The six months increase was principally due to the growing of our workforce, an increase in stock-based compensation and the $0.5 million increase in public relations fees. The increase in salaries and related expenses was due to new employees in the general and administrative department, including the Chief Financial Officer. Stock-based compensation also increased due to the grant of stock options to board members in Q1 2016 that were immediately vested. Other reasons for increases included insurance, travel expense and recruiting activities.

***Other income***

The following table summarizes other income (in thousands):

| | Three months Ended June 30, | | Six months Ended June 30, | |
|---|---|---|---|---|
| | 2016 | 2015 | 2016 | 2015 |
| Foreign exchange gain (loss) | $ (7) | $ (323) | $ (16) | $ (232) |
| Total | $ (7) | $ (323) | $ (16) | $ (232) |

Other income consists primarily of a $7 thousand foreign exchange loss for the three months ended June 30, 2016, compared to a $323 thousand loss for the three months ended June 30, 2015. Also, foreign exchange loss for the six months ended June 30, 2016 was $16 thousand, compared to $232 thousand for the six months ended June 30, 2015.

**Liquidity and Capital Resources**

Our cash requirements could change materially as a result of the progress of our research and development and clinical programs, licensing activities, acquisitions, divestitures or other corporate developments.

Since our inception on March 22, 2005 through June 30, 2016, we have funded our operations principally through the sales of equity securities in private and public transactions, which have provided aggregate cash proceeds of approximately $221.7 million. The following table summarizes our sources and uses of cash (in thousands):

| | Six Months Ended June 30, | |
|---|---|---|
| Net cash (used in) provided by: | 2016 | 2015 |
| Operating activities | $(18,198) | $(15,394) |
| Investing activities | (8,774) | (2,210) |
| Financing activities | 707 | 77,438 |
| Effect of foreign exchange rate on cash and cash equivalents | 12 | 219 |
| Net change in cash and cash equivalents | $(26,253) | $60,053 |

During the six months ended June 30, 2016 and 2015, our operating activities used net cash of $18.2 million and $15.4 million, respectively. The use of net cash in each of these periods primarily resulted from our net losses. The increase in net loss from operations for the six months ended June 30, 2016 as compared to the six months ended June 30, 2015 was mainly due to increases in clinical trial activities, labor cost and manufacturing supplies.

During the six months ended June 30, 2016 and 2015, our investing activities used net cash of $8.7 million and $2.2 million, respectively. We spent approximately $3.4 million more on the construction of new facilities during the six months ended June 30, 2016 compared to the six months ended June 30, 2015.

During the six months ended June 30, 2016 and 2015, our financing activities provided net cash proceeds of $0.7 million and $77.4 million, respectively. During the six months ended June 30, 2016, employees exercised stock options to purchase a total of 149,570 shares of common stock. In April 2015, we sold an aggregate of 4,000,000 shares of our common stock at a price of $19.00 per share and received IPO proceeds of $76.0 million and incurred offering costs of $5.4 million, which consisted of underwriters' commission direct incremental legal, accounting and other professional service fees related to our IPO.

**Contractual Obligations and Commitments**

On January 12, 2008, we entered a lease agreement to lease our facility in Austin, Texas. On September 15, 2010, we entered into a second lease agreement to lease additional space in Austin, Texas. On March 20, 2014, we extended the lease for an additional 21 months on the same terms and rental rates as the current lease. Rent expense was $180 thousand and $197 thousand for the three months ended June 30, 2016 and 2015, respectively. On February 28, 2015, we extended the lease for another 4 years. The future minimum lease payments are as follows as of June 30, 2016 (in thousands):

| Contractual Obligations | Total | Less than 1 Year | 1 - 3 Years | More than 3 years |
|---|---|---|---|---|
| Operating facility leases | $1,235 | $ 455 | $ 780 | $ — |
| Total contractual obligations | $1,235 | $ 455 | $ 780 | $ — |

New building construction was set to complete at the end of August, 2016, per our contract. The construction is now set to be completed at the end of September 2016. The total estimated future payment to our general contractor is $8.9 million. The last payment is expected to occur in Q3 2016.

**Off-Balance Sheet Arrangements**

Since inception, we have not engaged in any off-balance sheet activities, including the use of structured finance, special purpose entities or variable interest entities.

**Item 3. Quantitative and Qualitative Disclosure of Market Risks**

The Company is not currently exposed to material market risk arising from financial instruments, changes in interest rates or commodity prices, or fluctuations in foreign currencies. The Company currently engages in no hedging activities.

**Item 4. Controls and Procedures**

**Management's Evaluation of our Disclosure Controls and Procedures**

As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out by the Company’s management, with the participation of the Chief Executive Officer and Principal Financial Officer, of the effectiveness of the Company’s disclosure controls and procedures, as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on such evaluation, the Chief Executive Officer and Principal Financial Officer concluded that the Company’s disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports the Company files or furnishes under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and regulations, and are operating in an effective manner.

**Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on Effectiveness of Controls and Procedures**

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply judgment in evaluating the benefits of possible controls and procedures relative to their costs.

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**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

On December 1, 2015, a purported securities class action complaint captioned *Yogina Rezko v. XBiotech Inc., John Simard, Queena Han and WR Hambrecht & Co., LLC* was filed against us, certain of our officers and directors and the underwriter for our initial public offering in the Superior Court for the State of California, Los Angeles County. On December 2, 2015, a purported securities class action complaint captioned *Linh Tran v. XBiotech Inc., John Simard and Queena Han* was filed against us and certain of our officers and directors in U.S. District Court for the Western District of Texas. The lawsuits are based on substantially similar factual allegations and purport to be class actions brought on behalf of purchasers of the Company's securities during the period from April 15, 2015 through November 23, 2015. The complaint filed in California state court alleges that the defendants violated the Securities Act of 1933, as amended (the "Securities Act"), and the complaint filed in federal court alleges that the defendants violated the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in each case by making materially false and misleading statements concerning the Company's Phase III clinical trial conducted in Europe to assess Xilonix™ as a treatment for colorectal cancer. The California complaint purports to assert claims for violations of Sections 11, 12(a)(2) and 15 of the Securities Act, and the federal complaint purports to assert claims for violation of Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder. Both complaints seek, on behalf of the purported class, an unspecified amount of monetary damages, interest, fees and expenses of attorneys and experts, and other relief.

In February 24, 2016, following a proceeding to select a lead plaintiff in the federal case, the court issued an order appointing Mr. Kresimir Corak as lead plaintiff. The plaintiff filed an amended complaint in the federal case on April 8, 2016. We filed a motion to dismiss brief with the court on May 23, 2016, while plaintiffs filed a response brief on July 7, 2016. In the California case, the plaintiffs filed an amended complaint on June 7, 2016. We responded with a demurrer in August 2016. No trial or other dates have been set in either case.

**Item 1A. Risk Factors**

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2015. Please carefully consider the information set forth in this Quarterly Report on Form 10-Q and the risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K, as well as other risks and uncertainties, could materially and adversely affect our business, results of operations and financial condition, which in turn could materially and adversely affect the trading price of shares of our Common Stock. Additional risks not currently known or currently material to us may also harm our business.

**Item 2. Unregistered Sale of Equity Securities and Use of Proceeds**

Not Applicable.

**Item 3. Defaults upon Senior Securities**

Not Applicable.

**Item 4. Mine Safety Disclosures**

Not Applicable.

**Item 5. Other Information.**

On August 11th, the Company's Chief Financial Officer Scott Whitehurst announced that due to health reasons he was retiring. His resignation from his position at XBiotech was effective immediately.

**Item 6. Exhibits.**

| | |
|---|---|
| 31.1 | Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 31.2 | Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended. |
| 32.1 | Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350. |
| 101 | The following financial statements from the XBiotech Inc. Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, formatted in Extensive Business Reporting Language (XBRL): (i) condensed consolidated balance sheets, (ii) condensed consolidated statements of operations, (iii) condensed consolidated statements of comprehensive loss, (iv) condensed consolidated statements of cash flows and (v) notes to condensed consolidated financial statements (detail tagged). |

**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.

**XBIOTECH INC.**

Date: August 12, 2016

By: /S/ John Simard
John Simard
President, Chief Executive Officer and Director (*Principal Executive Officer*)

Date: August 12, 2016

By: /S/ Queena Han
Queena Han
Vice President, Finance and Human Resources, and Secretary (*Principal Financial Officer and Principal Accounting Officer*)