

Edgar Filing: Xenon Pharmaceuticals Inc. - Form 10-Q

Xenon Pharmaceuticals Inc.
Form 10-Q
August 13, 2015

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, 2015

OR

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

For the transition period from _____ to _____

Commission file number: 001-36687

XENON PHARMACEUTICALS INC.

(Exact name of registrant as specified in its charter)

Canada 98-0661854
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification Number)

200-3650 Gilmore Way

Burnaby, British Columbia V5G 4W8

Canada

(Address of principal executive offices)

(604) 484-3300

(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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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. (Check one):

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

The number of registrant's common shares outstanding as of August 7, 2015 was 14,286,858

XENON PHARMACEUTICALS INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2015

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

XENON PHARMACEUTICALS INC.

Balance Sheets

(Unaudited)

(Expressed in thousands of U.S. dollars except share data)

	June 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$64,346	\$72,026
Marketable securities	9,354	12,015
Accounts receivable	188	215
Prepaid expenses and other current assets	465	686
	74,353	84,942
Property, plant and equipment, net	2,174	2,476
Total assets	\$76,527	\$87,418
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued expenses (note 7)	2,278	2,664
Deferred revenue	5,635	11,622
Fair value of liability classified stock options (note 3 and 6)	4,103	—
	12,016	14,286
Deferred revenue, less current portion	—	157
Deferred tenant inducements	164	196
	\$12,180	\$14,639
Shareholders' equity:		
Common shares, without par value; unlimited shares authorized; issued and		
outstanding: 14,267,174 (December 31, 2014 - 14,181,333)	147,824	147,157
Additional paid-in capital	29,314	30,346
Accumulated deficit	(111,801)	(103,734)
Accumulated other comprehensive loss	(990)	(990)
	\$64,347	\$72,779
Total liabilities and shareholders' equity	\$76,527	\$87,418
Collaboration agreements (note 9)		
Commitments and contingencies (note 10)		
Subsequent event (note 11)		

The accompanying notes are an integral part of these financial statements.

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XENON PHARMACEUTICALS INC.

Statements of Operations and Comprehensive Income (Loss)

(Unaudited)

(Expressed in thousands of U.S. dollars except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenue:				
Collaboration revenue (note 9)	\$4,044	\$5,296	\$8,054	\$10,297
Royalties	2	2	2	2
	4,046	5,298	8,056	10,299
Operating expenses:				
Research and development	3,669	2,566	7,096	5,099
General and administrative	2,058	1,213	3,629	2,513
General and administrative - stock based compensation (note 3 and 6)	(1,880)	141	3,269	277
	3,847	3,920	13,994	7,889
Income (loss) from operations	199	1,378	(5,938)	2,410
Other income (expense):				
Interest income	163	137	315	278
Foreign exchange gain (loss)	806	(285)	(2,365)	(85)
Net income (loss)	1,168	1,230	(7,988)	2,603
Net income attributable to participating securities	—	1,230	—	2,603
Net income (loss) attributable to common shareholders	\$1,168	\$—	\$(7,988)	\$—
Net income (loss) per common share (note 5):				
Basic	\$0.08	\$—	\$(0.56)	\$—
Diluted	\$(0.07)	\$—	\$(0.56)	\$—
Weighted-average shares outstanding (note 5):				
Basic	14,241,827	1,347,237	14,227,203	1,346,274
Diluted	15,129,978	1,347,237	14,227,203	1,346,274
Other comprehensive income (loss):				
Foreign currency translation adjustment	—	919	—	10
Comprehensive income (loss)	\$1,168	\$2,149	\$(7,988)	\$2,613

The accompanying notes are an integral part of these financial statements.

XENON PHARMACEUTICALS INC.

Statement of Shareholders' Equity (Deficit)

(Unaudited)

(Expressed in thousands of U.S. dollars except per share data)

Series A convertible preferred shares		Series B convertible preferred shares		Series E convertible preferred shares		Common shares		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income (deficit)	Total shareholders' equity (deficit)
Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
1,151,468	\$2,939	994,885	\$8,683	4,322,126	\$90,866	1,344,627	\$6,147	\$29,722	\$(116,752)	\$2,511	\$(78,372)

Impact on Existing Stockholders who Participate in the Offering

An existing stockholder of the Company who participates in an offering by the Company below NAV per share or who buys additional shares of the Company in the secondary market at the same or lower price as obtained by the Company in the offering (after expenses and any underwriting discounts and commissions) will experience the same types of NAV dilution as the nonparticipating stockholders, albeit at a lower level, to the extent they purchase less than the same percentage of the discounted offering as their interest in the Company's common stock immediately prior to the offering. The level of NAV dilution on an aggregate basis will decrease as the number of shares of the Company's common stock that such stockholder purchases increases. Existing stockholders of the Company who buy more than such percentage will experience NAV dilution, but will, in contrast to existing stockholders of the Company who purchase less than their proportionate share of the offering, experience an increase (often called accretion) in NAV per share over their investment per share and will also experience a disproportionately greater increase in their participation in the Company's earnings and assets and their voting power than the Company's increase in assets, potential earning power and voting interests due to the offering. The level of accretion will increase as the excess number of shares of the Company's common stock that such stockholder purchases increases. Even a stockholder who over-participates will, however, be subject to the risk that the Company may make additional

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discounted offerings in which such stockholder does not participate, in which case such a stockholder will experience NAV dilution as described above in such subsequent offerings. These stockholders may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in NAV per share. This decrease could be more pronounced as the size of the Company's offering and level of discount to NAV increases.

The examples assume that Company XYZ has 1,000,000 shares of common stock outstanding, \$15,000,000 in total assets and \$5,000,000 in total liabilities. The current NAV and NAV per share are thus \$10,000,000 and \$10.00, respectively. The table below illustrates the dilutive and accretive effect in the hypothetical 20% discount offering from the prior table (Example 3) for a stockholder that acquires shares equal to (1) 50% of its proportionate share of the offering (i.e., 1,000 shares, which is 0.50% of an offering of 200,000 shares) rather than its 1.00% proportionate share and (2) 150% of its proportionate share of the offering (i.e., 3,000 shares, which is 1.50% of an offering of 200,000 shares) rather than its 1.00% proportionate share. The Company's prospectus or prospectus supplement pursuant to which any discounted offering is made will include a table for these examples based on the actual number of shares in such offering and the actual discount from the most recently determined NAV per share.

	Prior to Sale Below NAV	50% Participation Following Sale	% Change	150% Participation Following Sale	% Change
Offering Price					
Price per share to public		\$8.42		\$8.42	
Net proceeds per share to issuer		\$8.00		\$8.00	
Decrease/Increase to NAV					
Total shares outstanding	1,000,000	1,200,000	20.00%	1,200,000	20.00%
NAV per share	\$10.00	\$9.67	(3.33)%	\$9.67	(3.33)%
(Dilution)/Accretion to Participating Stockholder A					
Shares held by Stockholder A	10,000	11,000	10.00%	13,000	30.00%
Percentage held by Stockholder A	1.00%	0.92%	(8.33)%	1.08%	8.33%
Total Asset Values					
Total NAV held by Stockholder A	\$100,000	\$106,333	6.33%	\$125,662	25.67%
Total investment by Stockholder A (assumed to be \$10.00 per share on shares held prior to sale)	\$100,000	\$108,421	8.42%	\$125,263	25.26%
Total (dilution)/accretion to Stockholder A (total NAV less total investment)		(2,088)		\$404	
Per Share Amounts					
NAV per share held by Stockholder A	\$10.00	\$9.67		\$9.67	
Investment per share held by Stockholder A (assumed to be \$10.00 per share on shares held prior to sale)	\$10.00	\$9.86	(1.40)%	\$9.64	(3.60)%
(Dilution)/accretion per share held by Stockholder A (NAV per share less investment per share)		\$(0.19)		\$0.03	
Percentage (dilution)/accretion to Stockholder A (dilution/accretion per share divided by investment per share)			(1.93)%		0.32%

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Impact on New Investors

The following table illustrates the level of NAV dilution or accretion that would be experienced by a new stockholder in the Company in four different hypothetical common stock offerings of different sizes and levels of discount from NAV per share, although it is not possible to predict the level of market price decline that may occur. Actual sales prices and discounts may differ from the presentation below.

Investors who are not currently stockholders of the Company, but who participate in an offering by the Company below NAV and whose investment per share is greater than the resulting NAV per share due to expenses and any underwriting discounts and commissions paid by the Company will experience an immediate decrease, albeit small, in the NAV of their shares of the Company's common stock and their NAV per share compared to the price they pay for their shares. Investors who are not currently stockholders of the Company and who participate in an offering by the Company below NAV per share and whose investment per share is also less than the resulting NAV per share due to expenses and any underwriting discounts and commissions paid by the Company being significantly less than the discount per share, will experience an immediate increase in the NAV of their shares of the Company's common stock and their NAV per share compared to the price they pay for their shares. These investors will experience a disproportionately greater participation in the Company's earnings and assets and their voting power than the Company's increase in assets, potential earning power and voting interests. These investors will, however, be subject to the risk that the Company may make additional discounted offerings in which such new stockholder does not participate, in which case such new stockholder will experience dilution as described above in such subsequent offerings by the Company. These investors may also experience a decline in the market price of their shares, which often reflects to some degree announced or potential increases and decreases in NAV per share. This decrease could be more pronounced as the size of the offering and level of discounts increases.

The following examples illustrate the level of NAV dilution or accretion that would be experienced by a new stockholder who purchases the same percentage (1.00%) of the shares in the four different hypothetical offerings of common stock of different sizes and levels of discount from NAV per share. The examples assume that Company XYZ has 1,000,000 shares of common stock outstanding, \$15,000,000 in total assets and \$5,000,000 in total liabilities. The current NAV and NAV per share are thus \$10,000,000 and \$10.00, respectively. The table below illustrates the dilutive and accretive effects on Stockholder A at (1) an offering of 50,000 shares (5% of the outstanding shares) at \$9.50 per share after offering expenses and any underwriting discounts and commissions (a 5% discount from NAV); (2) an offering of 100,000 shares (10% of the outstanding shares) at \$9.00 per share after offering expenses and any underwriting discounts and commissions (a 10% discount from NAV); (3) an offering of 200,000 shares (20% of the outstanding shares) at \$8.00 per share after offering expenses and any underwriting discounts and commissions (a 20% discount from NAV); and (4) an offering of 330,000 shares (33% of the outstanding shares) at \$0.01 per share after offering expenses and any underwriting discounts and commissions (effectively a 100% discount from NAV).

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The discount to NAV is a result of market perception that moves the share price and thus NAV is only one determinant of market value.

The Company expects the market price of shares of its common stock will incorporate a discount or premium factor based on the market assessment of future earnings and the likelihood of those earnings supporting growth in our dividend yield.

Notwithstanding the dilutive effect of any equity financing on the Company's NAV, the Board of Directors has considered the Company's need to obtain additional capital for investment and other factors discussed in this Proxy Statement. With more capital to invest, the Board of Directors believes that the Company would be able to make investments with more significant earnings and growth potential. The Board of Directors further believes that over time the value of the incremental assets available for investment, taken together with the other factors previously discussed, may be reflected positively in the market price of the Company's shares and that such increases may exceed the initial dilutive effects that the Company is likely to experience in its NAV due to offerings of shares of common stock in accordance with this Proposal No. 2. In our view, the secondary market price of our common stock is an important gauge of the true economic impact on stockholders of any equity offering.

Other Considerations

In reaching its recommendation to stockholders to approve this Proposal No. 2, the Board of Directors considered a possible source of conflict of interest due to the fact that, once invested, proceeds from the issuance of additional shares of the Company's common stock will increase the management fees that the Company pays to MC Advisors as such fees are partially based on the amount of the Company's gross assets, excluding cash. The Board of Directors, including the independent directors, concluded that the benefits to the Company's stockholders from increasing the Company's capital base outweighed any detriment from increased management fees, especially considering that the management fees would increase regardless of whether the Company offers shares of common stock below NAV or above NAV. The Board of Directors also considered the effect of the following factors:

the costs and benefits of a common stock offering below NAV compared to other possible means for raising capital or concluding not to raise capital;

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the size of a common stock offering in relation to the number of shares outstanding;
the general conditions of the securities markets; and
any impact on operating expenses associated with an increase in capital.

Potential Investors

The Company has not solicited any potential buyers of the shares that it may elect to issue in any future offering to comply with the federal securities laws. No shares are earmarked for management or other affiliated persons of the Company. However, members of our management and other affiliated persons may participate in a common stock offering by the Company on the same terms as others.

Required Vote

Approval of this proposal requires the affirmative vote of (1) a majority of the outstanding shares of common stock entitled to vote at the Annual Meeting; and (2) a majority of the outstanding shares of common stock entitled to vote at the Annual Meeting which are not held by affiliated persons of the Company.

For purposes of this proposal, the 1940 Act defines a majority of the outstanding shares as: (1) 67% or more of the voting securities present at the Annual Meeting if the holders of more than 50% of the outstanding voting securities of the Company are present or represented by proxy; or (2) 50% of the outstanding voting securities of the Company, whichever is less. Abstentions and broker non-votes will have the effect of a vote against this proposal.

The Board of Directors recommends a vote FOR the proposal to authorize the Company, pursuant to approval of the Board of Directors of the Company, to sell shares of its common stock during the next twelve months at a price below the Company's then-current net asset value per share, subject to certain conditions as set forth in this proxy statement.

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OTHER BUSINESS

The Board of Directors knows of no other business to be presented for action at the 2016 Annual Meeting of Stockholders. If any matters do come before the meeting on which action can properly be taken, it is intended that the proxies shall vote in accordance with the judgment of the person or persons exercising the authority conferred by the proxy at the meeting. The submission of a proposal does not guarantee its inclusion in our proxy statement or presentation at the meeting unless certain securities law requirements are met.

You are cordially invited to attend the 2016 Annual Meeting of Stockholders in person. Whether or not you plan to attend the meeting, you are requested to indicate your vote as to the matters to be acted on at the meeting by following the instructions provided in the enclosed proxy card or voting instruction form.

By order of the Board of Directors

Aaron D. Peck
Chief Financial Officer, Chief Investment Officer and Corporate Secretary

Chicago, Illinois
April 20, 2016

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