Xenon Pharmaceuticals Inc.
Form 10-Q
August 07, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10 Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

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 (State or other jurisdiction of incorporation or organization)	98-0661854 (I.R.S. Employer Identification No.)
200-3650 Gilmore Way Burnaby, British Columbia, Canada (Address of principal executive offices)	V5G 4W8 (Zip Code)

Registrant’s telephone number, including area code: (604) 484-3300

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth 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
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 3, 2018, the registrant had 19,261,889 common shares, without par value, outstanding.

XENON PHARMACEUTICALS INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2018

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In this Quarterly Report on Form 10-Q, "we," "our," "us," "Xenon," and "the Company" refer to Xenon Pharmaceuticals Inc. a its subsidiary. "Xenon" and the Xenon logo are the property of Xenon Pharmaceuticals Inc. and are registered in the United States and used or registered in various other jurisdictions. This report contains references to our trademarks and to trademarks belonging to other entities. Solely for convenience, trademarks and trade names referred to in this report may appear without the ® or ™ symbols, but such references are not intended to indicate, in any way, that their respective owners will not assert, to the fullest extent under applicable law, their rights thereto. We do not intend our use or display of other companies' trade names or trademarks to imply a relationship with, or endorsement or sponsorship of us by, any other companies.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

XENON PHARMACEUTICALS INC.

Consolidated Balance Sheets

(Unaudited)

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

	June 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$47,435	$ 20,486
Marketable securities	15,835	23,181
Accounts receivable	171	438
Prepaid expenses and other current assets	909	716
	64,350	44,821
Prepaid expenses, long term	—	230
Property, plant and equipment, net	1,086	1,070
Total assets	$65,436	$ 46,121
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable and accrued expenses (note 7)	3,094	3,383
Loan payable, current portion (note 8)	—	700
	3,094	4,083
Loan payable, long-term (note 8)	11,721	6,104
	$14,815	$ 10,187
Shareholders' equity:		
Preferred shares, without par value; unlimited shares authorized; issued and outstanding: 2,868,000 (December 31, 2017 - nil) (note 9b)	21,825	—
Common shares, without par value; unlimited shares authorized; issued and outstanding: 17,640,951 (December 31, 2017 - 17,998,420) (note 9)	177,012	173,841
Additional paid-in capital	37,718	36,471
Accumulated deficit	(184,944)	(173,388)
Accumulated other comprehensive loss	(990)	(990)
	$50,621	$ 35,934
Total liabilities and shareholders' equity	$65,436	$ 46,121
Commitments and contingencies (note 10)		

Subsequent events (note 12)

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

XENON PHARMACEUTICALS INC.

Consolidated Statements of Operations and Comprehensive Loss

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue:				
Collaboration revenue	$—	$15	$—	$31
Operating expenses:				
Research and development	5,408	6,109	10,988	12,012
General and administrative	2,178	1,799	4,416	3,899
	7,586	7,908	15,404	15,911
Loss from operations	(7,586)	(7,893)	(15,404)	(15,880)
Other income (expense):				
Interest income	125	109	233	258
Interest expense	(200)	—	(359)	—
Foreign exchange gain (loss)	(140)	404	(424)	725
Gain on termination of collaboration agreement (note 9c)	—	—	4,398	—
Net loss and comprehensive loss	(7,801)	(7,380)	(11,556)	(14,897)
Net loss attributable to preferred shareholders	(1,303)	—	(996)	—
Net loss attributable to common shareholders	$(6,498)	$(7,380)	$(10,560)	$(14,897)
Net loss per common share (note 5):				
Basic	$(0.45)	$(0.41)	$(0.66)	$(0.83)
Diluted	$(0.45)	$(0.41)	$(0.66)	$(0.84)
Weighted-average common shares outstanding (note 5):				
Basic	14,306,491	17,997,194	16,055,456	17,971,702
Diluted	14,306,491	18,015,748	16,055,456	17,995,109

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

XENON PHARMACEUTICALS INC.

Consolidated Statement of Shareholders' Equity

(Unaudited)

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

	Convertible preferred shares		Common shares		Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss[1]	Total shareholders' equity
	Shares	Amount	Shares	Amount				
Balance as of December 31, 2016	—	$—	17,930,590	$173,246	$34,326	$ (142,681)	$ (990)	$ 63,901
Net loss for the year						(30,704)		(30,704)
Stock-based compensation expense					2,460			2,460
Issued pursuant to exercise of stock options			67,830	595	(415)	(3)		177
Issuance of warrants					100			100
Balance as of December 31, 2017	—	$—	17,998,420	$173,841	$36,471	$ (173,388)	$ (990)	$ 35,934
Net loss for the period						(11,556)		(11,556)
Issuance of common shares, net of issuance costs (note 9a)			3,440,000	$28,957				28,957
Issued (cancelled) pursuant to exchange agreement (note 9b)	2,868,000	21,825	(2,868,000)	(21,825)				—
			(1,000,000)	(4,470)				(4,470)

Cancelled pursuant to termination of collaboration agreement (note 9c)							
Stock-based compensation expense				1,327			1,327
Issued pursuant to exercise of stock options	70,531	509		(327)			182
Issuance of warrants				247			247
Balance as of June 30, 2018	2,868,000	$21,825	17,640,951	$177,012	$37,718	$ (184,944)	$ (990)	$ 50,621

(1) Our accumulated other comprehensive loss is entirely related to historical cumulative translation adjustments from the application of U.S. dollar reporting when the functional currency of the Company was the Canadian dollar.

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

XENON PHARMACEUTICALS INC.

Consolidated Statements of Cash Flows

(Unaudited)

(Expressed in thousands of U.S. dollars)

	Six Months Ended June 30,	
	2018	2017
Operating activities:		
Net loss	$ (11,556)	$ (14,897)
Items not involving cash:		
Depreciation	302	334
Amortization of discount on term loan	164	—
Stock-based compensation	1,363	1,076
Unrealized foreign exchange (gain) loss	406	(819)
Gain on termination of collaboration agreement (note 9c)	(4,398)	—
Changes in operating assets and liabilities:		
Accounts receivable	263	5
Prepaid expenses, and other current assets	(193)	590
Prepaid expenses, long term	230	123
Accounts payable and accrued expenses	(338)	326
Net cash used in operating activities	(13,757)	(13,262)
Investing activities:		
Purchases of property, plant and equipment	(318)	(238)
Purchase of marketable securities	(17,911)	(22,281)
	25,146	41,099

Proceeds from marketable securities		
Net cash provided by investing activities	6,917	18,580
Financing activities:		
Proceeds from issuance of second tranche under term loan, net of issuance costs (note 8)	4,989	—
Issuance of common shares, net of issuance costs (note 9a)	28,957	—
Issuance of common shares pursuant to exercise of stock options	182	177
Net cash provided by financing activities	34,128	177
Effect of exchange rate changes on cash and cash equivalents	(339)	500
Increase in cash and cash equivalents	26,949	5,995
Cash and cash equivalents, beginning of period	20,486	17,095
Cash and cash equivalents, end of period	$ 47,435	$ 23,090
Supplemental disclosures:		
Interest paid	$ 164	$ —
Interest received	289	457
Supplemental disclosures of non-cash transactions:		
Fair value of stock options exercised on a cashless basis	212	25
Issuance of preferred shares in exchange for common shares (note 9b)	21,825	—
Termination of Teva agreement through cancellation of	4,470	—

common shares (note 9c)

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

XENON PHARMACEUTICALS INC.

Notes to Consolidated Financial Statements

(Unaudited)

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

1. Nature of the business:
Xenon Pharmaceuticals Inc. (the "Company"), incorporated in 1996 under the British Columbia Business Corporations Act and continued federally in 2000 under the Canada Business Corporation Act, is a clinical stage biopharmaceutical company focused on developing innovative therapeutics to improve the lives of patients with neurological disorders. Building upon its extensive knowledge of human genetics and diseases caused by mutations in ion channels, known as channelopathies, the Company is advancing a novel product pipeline of central nervous system therapies to address areas of high unmet medical need, such as epilepsy and pain.

The Company has incurred significant operating losses since inception. As of June 30, 2018, the Company had an accumulated deficit of $184,944 and a $11,556 net loss for the six months ended June 30, 2018. Management expects to continue to incur significant expenses in excess of revenue and to incur operating losses for the foreseeable future. To date, the Company has financed its operations primarily through funding received from collaboration and license agreements, private placements of common and preferred shares, public offerings of common shares, debt financing, and government funding.

Until such time as the Company can generate substantial product revenue, if ever, management expects to finance the Company's cash needs through a combination of collaboration agreements and equity or debt financings. The continuation of the research and development activities and the future commercialization of its products are dependent on the Company's ability to successfully raise additional funds when needed. It is not possible to predict either the outcome of future research and development programs or the Company's ability to continue to fund these programs in the future.

2. Basis of presentation:
These consolidated financial statements are presented in U.S. dollars.

The Company has one wholly-owned subsidiary as at June 30, 2018, Xenon Pharmaceuticals USA Inc., which was incorporated in Delaware on December 2, 2016.

These unaudited interim consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All intercompany transactions and balances have been eliminated on consolidation.

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") and pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, these consolidated financial statements do not include all of the information and footnotes required for complete consolidated financial statements and should be read in conjunction with the audited consolidated financial statements and notes for the year ended December 31, 2017 and included in the Company's 2017 Annual Report on Form 10-K filed with the SEC and with the securities commissions in British Columbia, Alberta and Ontario on March 7, 2018.

These unaudited interim consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of results for the interim

periods presented. The results of operations for the three and six month periods ended June 30, 2018 and 2017 are not necessarily indicative of results that can be expected for a full year. These unaudited interim consolidated financial statements follow the same significant accounting policies as those described in the notes to the audited consolidated financial statements of the Company included in the Company's 2017 Annual Report on Form 10-K for the year ended December 31, 2017, with the exception of the policy described in note 3 below.

3. Changes in significant accounting policies:

The new revenue standard (Accounting Standards Codification "ASC" 606) became effective for the Company on January 1, 2018, and was adopted using the modified retrospective method under which previously presented financial statements are not restated and the cumulative effect of adopting the new revenue standard on contracts in process is recognized by an adjustment to retained earnings at the effective date. The adoption of the new revenue standard did not change the Company's recognized revenue under its one ongoing significant collaborative research and license agreement with Genentech, a member of the Roche Group, described in note 11b to the audited consolidated financial statements of the Company included in the Company's 2017 Annual Report on Form 10-K for the year ended December 31, 2017 and no cumulative effect adjustment was required.

The new guidance in ASC 606 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers under a five-step model: (i) identify contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when or as a performance obligation is satisfied.

The Company generates revenue primarily through collaboration agreements. Such agreements may require the Company to deliver various rights and/or services, including intellectual property rights or licenses and research and development services. Under such collaboration agreements, the Company is generally eligible to receive non-refundable upfront payments, funding for research and development services, milestone payments, and royalties.

In contracts where the Company has more than one performance obligation to provide its customer with goods or services, each performance obligation is evaluated to determine whether it is distinct based on whether (i) the customer can benefit from the good or service either on its own or together with other resources that are readily available and (ii) the good or service is separately identifiable from other promises in the contract. The consideration under the contract is then allocated between the distinct performance obligations based on their respective relative stand-alone selling prices. The estimated stand-alone selling price of each deliverable reflects the Company's best estimate of what the selling price would be if the deliverable was regularly sold on a stand-alone basis and is determined by reference to market rates for the good or service when sold to others or by using an adjusted market assessment approach if selling price on a stand-alone basis is not available.

The consideration allocated to each distinct performance obligation is recognized as revenue when control is transferred to the customer for the related goods or services. Consideration associated with at-risk substantive performance milestones, including sales-based milestones, is recognized as revenue when it is probable that a significant reversal of the cumulative revenue recognized will not occur. Sales-based royalties received in connection with licenses of intellectual property are subject to a specific exception in the revenue standards, whereby the consideration is not included in the transaction price and recognized in revenue until the customer's subsequent sales or usages occur.

4. Future changes in accounting policies:
In February 2016, the FASB issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842): Recognition and Measurement of Financial Assets and Financial Liabilities. The update requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous U.S. GAAP. The new guidance retains a distinction between finance leases and operating leases, with cash payments from operating leases classified within operating activities in the statement of cash flows. These amendments will be effective for public entities for fiscal years and interim periods within those years, beginning after December 15, 2018. The Company is currently evaluating the new guidance to determine the impact it will have on the Company's consolidated financial statements.

5. Net income (loss) per common and preferred share:
Basic net income (loss) per common share is calculated using the two-class method required for participating securities which includes the convertible preferred shares as a separate class. The preferred shares entitle the holders to participate in dividends and in earnings and losses of the Company on an equivalent basis as common shares. Accordingly, undistributed earnings (losses) are allocated to common shares and participating preferred shares based on the weighted-average shares of each class outstanding during the period.

The treasury stock method is used to compute the dilutive effect of the Company's stock options and warrants. Under this method, the incremental number of common shares used in computing diluted net income (loss) per common share is the difference between the number of common shares assumed issued and purchased using assumed proceeds.

The if-converted method is used to compute the dilutive effect of the Company's convertible preferred shares. Under the if-converted method, dividends on the preferred shares, if applicable, are added back to earnings attributable to common shareholders, and the preferred shares and paid-in kind dividends are assumed to have been converted at the share price applicable at the end of the period. The if-converted method is applied only if the effect is dilutive.

For the three and six month periods ended June 30, 2018, all stock options, warrants and convertible preferred shares were anti-dilutive and were excluded from the diluted weighted average common shares outstanding for the period. For the three and six months ended June 30, 2017, 2,228,637 and 2,086,072 stock options, respectively, were excluded from the calculation of diluted net loss per common share as their inclusion would be anti-dilutive. No warrants or convertible preferred shares were outstanding during the three and six months ended June 30, 2017.

The following table sets out the computation of basic and diluted net loss per common and preferred share:

	Three Months Ended June 30,				Six Months Ended June 30,			
	2018		2017		2018		2017	
Numerator:	Common Shares	Preferred Shares	Common Shares	Preferred Shares	Common Shares	Preferred Shares	Common Shares	Preferred Shares
Allocation of loss attributed to shareholders								
Basic	$(6,498)	$(1,303)	$(7,380)	$ —	$(10,560)	$ (996)	$(14,897)	$ —
Adjustment for change in fair value of liability classified stock options	—	—	(30)	—	—	—	(162)	—
Diluted	$(6,498)	$(1,303)	$(7,410)	$ —	$(10,560)	$ (996)	$(15,059)	$ —
Denominator:								
Weighted average number of shares:								