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 September 30, 2016

OR

☐ **TRANSITION REPORT UNDER SECTION 13 OF 15(d) OF THE EXCHANGE ACT OF 1934**

From the transition period from to .

Commission File Number 001-35798

KALOBIOS PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0557236**
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)

1000 Marina Blvd., Suite 250, Brisbane, CA 94005
(Address of principal executive offices)
(Zip Code)

Registrant's telephone number, including area code: **(650) 243-3100**

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, 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 ☒

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ☒ No ☐

As of November 9, 2016, there were 14,903,022 shares of common stock of the issuer outstanding.

TABLE OF CONTENTS
KALOBIOS PHARMACEUTICALS, INC.
FORM 10-Q

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KaloBios Pharmaceuticals, Inc.
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)
(Unaudited)

	September 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 2,905	$ 8,431
Prepaid expenses and other current assets	1,806	1,963
Total current assets	4,711	10,394
Property and equipment, net	121	288
Restricted cash	101	193
Other assets	-	271
Total assets	$ 4,933	$ 11,146
Liabilities and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$ 3,481	$ -
Accrued expenses	395	-
Total current liabilities	3,876	-
Liabilities subject to compromise	-	5,414
Notes payable to vendors	1,242	-
Total liabilities	5,118	5,414
Stockholders' equity (deficit):		
Common stock, $0.001 par value: 85,000,000 shares authorized at September 30, 2016 and December 31, 2015; 14,903,022 and 4,450,994 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	15	4
Additional paid-in capital	235,352	219,319
Accumulated deficit	(235,552)	(213,591)
Total stockholders' equity (deficit)	(185)	5,732
Total liabilities and stockholders' equity (deficit)	$ 4,933	$ 11,146

See accompanying notes.

KaloBios Pharmaceuticals, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Loss
(in thousands, except share and per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating expenses:				
Research and development	$ 1,741	$ 3,845	$ 7,805	$ 13,082
General and administrative	2,453	2,359	6,169	8,095
Total operating expenses	4,194	6,204	13,974	21,177
Loss from operations	(4,194)	(6,204)	(13,974)	(21,177)
Other (expense) income:				
Interest expense	(30)	(223)	(76)	(755)
Interest income	-	3	-	29
Other income (expense), net	128	(176)	128	(359)
Reorganization items, net	(427)	-	(8,039)	-
Net loss	(4,523)	(6,600)	(21,961)	(22,262)
Other comprehensive income:				
Net unrealized gains on marketable securities	-	-	-	8
Comprehensive loss	$ (4,523)	$ (6,600)	$ (21,961)	$ (22,254)
Basic and diluted net loss per common share	$ (0.30)	$ (1.60)	$ (2.76)	$ (5.40)
Weighted average common shares outstanding used to calculate basic and diluted net loss per common share	14,879,519	4,124,026	7,950,826	4,124,096

See accompanying notes.

KaloBios Pharmaceuticals, Inc.
Condensed Consolidated Statements of Stockholders' Equity (Deficit)
(in thousands, except share and per share data)
(Unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount			
Balances at December 31, 2015	4,450,994	$ 4	$ 219,319	$ (213,591)	$ 5,732
Issuance of common stock to officer and directors	323,155	1	1,451	-	1,452
Issuance of common stock, net of issuance costs	7,147,035	7	10,125	-	10,132
Issuance of common stock in settlement of litigation	631,358	1	(1)	-	-
Issuance of warrants in connection with acquisition of licenses	-	-	272	-	272
Conversion of notes payable and related accrued interest and fees to common stock	2,350,480	2	3,385	-	3,387
Beneficial conversion feature	-	-	484	-	484
Stock-based compensation expense	-	-	317	-	317
Comprehensive loss	-	-	-	(21,961)	(21,961)
Balances at September 30, 2016	14,903,022	$ 15	$ 235,352	$ (235,552)	$ (185)

See accompanying notes.

KaloBios Pharmaceuticals, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)

	Nine Months Ended September 30,	
	2016	2015
Operating activities:		
Net loss	$ (21,961)	$ (22,262)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	81	144
Loss on disposal of property and equipment	-	39
Gain on lease termination	(227)	-
Noncash interest expense	46	164
Financing derivative	-	252
Reorganization items related to debtor-in-possession financing	1,627	-
Amortization of premium on marketable securities	-	130
Stock based compensation expense	317	913
Modification of stock options related to executive retirement	-	389
Modification of stock options related to restructuring activities	-	479
Issuance of warrants in connection with acquisition of licenses	272	-
Issuance of common stock to officer and directors	1,452	-
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	428	940
Accounts payable	3,537	(804)
Accrued expenses	(367)	(1,444)
Deferred rent	-	(9)
Liabilities subject to compromise	(3,153)	-
Net cash used in operating activities	(17,948)	(21,069)
Investing activities:		
Purchase of marketable securities	-	(3,703)
Proceeds from maturities of marketable securities	-	33,371
Purchases of property and equipment	-	(136)
Proceeds from disposal of property and equipment	-	1
Changes in restricted cash	92	7
Net cash provided by investing activities	92	29,540
Financing activities:		
Increase in restricted cash for notes payable	-	(8,291)
Net proceeds from issuance of common stock	10,132	-
Net proceeds from convertible notes payable	2,198	-
Principal payments under notes payable	-	(3,452)
Settlement of fractional shares upon reverse split	-	(1)
Net cash provided by (used in) financing activities	12,330	(11,744)
Net decrease in cash and cash equivalents	(5,526)	(3,273)
Cash and cash equivalents, beginning of period	8,431	10,923
Cash and cash equivalents, end of period	$ 2,905	$ 7,650
Supplemental cash flow disclosure:		
Cash paid for interest	$ -	$ 564
Supplemental disclosure of non-cash investing and financing activities:		
Principal payments under notes payable from restricted cash	$ -	$ 432
Conversion of notes payable and related accrued interest and fees to common stock	$ 3,387	$ -
Issuance of warrants in connection with acquisition of licenses	$ 272	$ -
Issuance of common stock to officer and directors	$ 1,452	$ -
Issuance of notes payable to vendors	$ 1,212	$ -

See accompanying notes.

KaloBios Pharmaceuticals, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Nature of Operations

Description of the Business

KaloBios Pharmaceuticals, Inc. (the "Company") is a biopharmaceutical company focused on developing medicines for patients with neglected and rare diseases, with an ancillary focus on pediatric conditions, and on executing its Responsible Pricing Model in the commercialization of the Company's product candidates that may be approved. The Company's lead product candidate is benznidazole for the treatment of Chagas disease, a parasitic illness that can lead to long-term heart, intestinal and neurological problems. As more fully described in Note 11, the Company acquired certain worldwide rights to benznidazole on June 30, 2016. The Company is developing one of its proprietary monoclonal antibodies, lenzilumab (formerly known as KB003), for the treatment of chronic myelomonocytic leukemia and potentially for the treatment of juvenile myelomonocytic leukemia, both of which are rare hematologic cancers with high unmet medical need. The Company is exploring partnering or developing another of its proprietary monoclonal antibodies, ifabotuzumab (formerly known as KB004), for the treatment of certain rare solid and hematologic cancers. With a focus on neglected, rare and orphan diseases, the Company believes that it has the opportunity to benefit from various regulatory incentives, such as orphan drug exclusivity, breakthrough therapy designation, fast track designation, accelerated approval, priority review and priority review vouchers ("PRV"), where available, that provide for certain periods of exclusivity, expedited review and/or other benefits.

The Company has undergone a significant transformation in the last year. As a result of challenges facing it at the time, on December 29, 2015, the Company filed a voluntary petition for bankruptcy protection under Chapter 11 of Title 11 of the U.S. Bankruptcy Code. On June 30, 2016, the Company's Second Amended Plan of Reorganization, dated May 9, 2016, as amended (the "Plan"), became effective and the Company emerged from its Chapter 11 bankruptcy proceedings. Refer to Note 2 for additional details regarding the Company's bankruptcy proceedings.

The Company was incorporated on March 15, 2000 in California and reincorporated as a Delaware corporation in September 2001.

Liquidity and Going Concern

The Company has incurred significant losses and had an accumulated deficit of $235.6 million as of September 30, 2016. The Company has financed its operations primarily through the sale of equity securities, debt financings, interest income earned on cash and cash equivalents, grants and the payments received under its agreements with Novartis Pharma AG ("Novartis") and Sanofi Pasteur S.A. ("Sanofi"). The Company completed its initial public offering in February 2013. To date, none of the Company's product candidates have been approved for sale and therefore the Company has not generated any revenue from product sales. Management expects operating losses to continue for the foreseeable future. As a result, the Company will continue to require additional capital through equity offerings, debt financing and/or payments under new or existing licensing or collaboration agreements. If sufficient funds are not available on acceptable terms when needed, the Company could be required to significantly reduce its operating expenses and delay, reduce the scope of, or eliminate one or more of its development programs. The Company's ability to access capital when needed is not assured and, if not achieved on a timely basis when needed, could materially harm its business, financial condition and results of operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The Condensed Consolidated Financial Statements for the three and nine months ended September 30, 2016 were prepared on the basis of a going concern, which contemplates that the Company will be able to realize assets and discharge liabilities in the normal course of business. The ability of the Company to meet its total liabilities of $5.1 million at September 30, 2016 and to continue as a going concern is dependent upon the availability of future funding. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Delisting of Common Stock

On January 13, 2016, the Company's common stock was suspended from the Nasdaq Global Market and began trading on the over-the-counter market under the ticker symbol KBIOQ. On January 26, 2016, NASDAQ filed a Form 25 with the Securities and Exchange Commission to complete the delisting of the common stock, and the delisting was effective on February 5, 2016. On June 30, 2016, upon emergence from bankruptcy, the ticker symbol for the trading of the Company's common stock on the over-the-counter market reverted back to KBIO.

Basis of Presentation

The accompanying interim unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information and on a basis consistent with the annual consolidated financial statements and include all adjustments necessary for the presentation of the Company's condensed consolidated financial position, results of operations and cash flows for the periods presented. The Condensed Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. These financial statements have been prepared on a basis that assumes that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The December 31, 2015 Condensed Consolidated Balance Sheet was derived from the audited financial statements but does not include all disclosures required by U.S. GAAP. These interim financial results are not necessarily indicative of the results to be expected for the year ending December 31, 2016, or for any other future annual or interim period. The accompanying unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and the related notes thereto included in the 2015 Annual Report.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts and disclosures reported in the Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates. The Company believes judgment is involved in determining the valuation of the financing derivative, the fair value-based measurement of stock-based compensation, accruals and warrant valuations. The Company evaluates its estimates and assumptions as facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ from these estimates and assumptions, and those differences could be material to the Condensed Consolidated Financial Statements.

2. Chapter 11 Filing

On December 29, 2015, the Company filed a voluntary petition for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. The filing was made in the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") (Case No. 15-12628 (LSS)).

In connection with financing efforts as part of the Company's bankruptcy proceedings, on April 1, 2016, the Company entered into a Debtor-in-Possession Credit and Security Agreement (the "Credit Agreement") with a group of lenders (the "DIP Lenders"), pursuant to which the Company received $3 million in funds for working capital, bankruptcy-related costs, costs related to its plan of reorganization, payment of certain fees to the DIP Lenders and other costs associated with the ordinary course of business. Funds received under the Credit Agreement bore interest at a rate of 12% and were due and payable upon the Effective Date of the Plan, as defined below. Payment due under the Credit Agreement was convertible into shares of the Company's common stock, with share amounts subject to calculation as provided in the Credit Agreement.

On April 1, 2016, the Company also entered into a Securities Purchase Agreement (the "SPA") with the DIP Lenders. The SPA provided for the sale of the Company's common stock, with share amounts subject to calculation as provided in the SPA, in respect of exit financing in the amount of $11,000,000 to be received upon the Effective Date of the Plan, as defined below.

Plan of Reorganization

On May 9, 2016, the Company filed with the Bankruptcy Court the Plan and related amended disclosure statement pursuant to Chapter 11 of the Bankruptcy Code. On June 16, 2016, the Bankruptcy Court entered an order confirming the Plan.

The Plan became effective on June 30, 2016 (the "Effective Date") and the Company emerged from its Chapter 11 bankruptcy proceedings. In connection with such emergence, the Company consummated the transactions and other items described below.

- Pursuant to the SPA and in repayment of its obligations under the Credit Agreement, the Company issued an aggregate of 9,497,515 shares of its common stock to the DIP Lenders.
- The Company became obligated to issue 327,608 shares of common stock to the plaintiffs in litigation related to the Company's 2015 private financing transaction in accordance with the settlement stipulation discussed in Note 12 below. The Company recorded an obligation in stockholders' equity to issue the related shares and recorded the related expense of approximately $1.5 million as of December 31, 2015. As of September 30, 2016, all of the shares of common stock related to this settlement stipulation had been issued.
- The Company reserved 300,000 shares of common stock for issuance to the plaintiffs in class action litigation related to the events surrounding the Company's former Chairman and Chief Executive Officer. The Company recorded an obligation in stockholders' equity to issue the related shares and recorded the related expense of approximately $1.3 million as of December 31, 2015. As of September 30, 2016, all of the shares related to this settlement stipulation had been issued.
- The Company became obligated to issue 3,750 shares of common stock to a former director in satisfaction of claims against the Company. The Company recorded an obligation in stockholders' equity to issue the related shares and recorded the related expense of approximately $16,000 as of December 31, 2015. As of September 30, 2016, the shares related to this settlement stipulation had been issued.
- The Company reserved for issuance shares of common stock in an amount as yet to be determined in connection with the settlement of certain other claims and interests as set forth in the Plan. As of September 30, 2016, management does not believe the issuance of additional common stock for any such claims is probable. As such, no accrual has been made in the Condensed Consolidated Financial Statements.
- The Company issued promissory notes in an aggregate principal amount of approximately $1.2 million to certain vendors in accordance with the Plan. The notes are unsecured, bear interest at 10% per annum and are due and payable in full, including principal and accrued interest on June 30, 2019. As of September 30, 2016, the Company has accrued $30,000 in interest expense related to these promissory notes.

Pre-Petition Claims

On February 29, 2016, the Company filed its schedules of assets and liabilities and statement of financial affairs (the "Schedules") with the Bankruptcy Court. The Bankruptcy Court entered an order setting April 1, 2016 as the deadline for filing proofs of claim (the "Bar Date"). The Bar Date is the date by which non-government claims against the Company relating to the period prior to the commencement of the Company's Chapter 11 case must be filed if such claims are not listed in liquidated, non-contingent and undisputed amounts in the Schedules, or if the claimant disagrees with the amount, characterization or classification of its claim as reflected in the Schedules. Claims that are subject to the Bar Date and that were not filed on or prior to the Bar Date are barred from participating in any distribution that may be made under the Plan.

As of the Effective Date, approximately 195 proofs of claim were outstanding (including claims that were previously identified on the Schedules) totaling approximately $32 million. Prior to the Bar Date, certain investors filed a class action claim in the amount of $20 million in connection with events surrounding the Company's former Chairman and Chief Executive Officer. On June 15, 2016, a settlement stipulation related to the class action suit was approved under order of the Bankruptcy Court. The settlement stipulation required the Company to issue 300,000 shares of common stock and submit a payment of $250,000 to the claimants. See Note 12 for additional information on this matter and settlement. Separately, a claim was filed by certain investors in the Company's 2015 private financing transaction totaling approximately $6.9 million. On May 9, 2016, a settlement stipulation related to this suit was approved under order of the Bankruptcy Court. The settlement stipulation required the Company to issue 327,608 shares of common stock and submit a payment of $250,000 to an escrow account on behalf of the claimants. See Note 12 for additional information on this matter and settlement. As of December 31, 2015, the Company recorded an obligation in Additional paid-in capital to issue the related shares totaling approximately $2.8 million and recorded the cash liability of $500,000 in Liabilities subject to compromise in the accompanying Condensed Consolidated Balance Sheets. Excluding these stipulated claims, all other proofs of claim amount to approximately $5.1 million. As of December 31, 2015, the Company recorded a liability of approximately $4.5 million, which represents its estimate of the amount expected to be allowed by the Bankruptcy Court, in Liabilities subject to compromise in the accompanying Condensed Consolidated Balance Sheets. In addition, the Company also had liabilities related to accrued compensation and deferred rent, totaling approximately $0.4 million, included in Liabilities subject to compromise in the accompanying Condensed Consolidated Balance Sheets, as of December 31, 2015. As of June 30, 2016, the Company emerged from bankruptcy. The Company expects the amounts remaining in Liabilities subject to compromise as of the Effective Date to be paid in accordance with the Plan. Accordingly, as of September 30, 2016, Liabilities subject to compromise have been reduced to zero and reclassified according to their payment terms.

In March 2016, the Company entered into a termination agreement (the "Lease Termination Agreement") related to the lease of its prior facility in South San Francisco, California. The Lease Termination Agreement, approved by order of the Bankruptcy Court issued March 15, 2016, waived all damages related to early termination of the lease, relieved the Company of March rental expenses and set an effective termination date of March 31, 2016. In accordance with the termination of the lease, the Company wrote off remaining deferred rent liabilities of approximately $312,000 and disposed of certain leasehold improvements and furniture and fixtures with a net book value of approximately $85,000. The resulting gain of $227,000 is included in Reorganization items, net in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss for the nine months ended September 30, 2016. Concurrent with the termination of its prior lease, the Company entered into a lease agreement for a new office facility in Brisbane, California. The new lease commenced in April 2016 and will expire in March 2017.

The reconciliation of certain proofs of claim filed against the Company in the Bankruptcy Case, including certain General Unsecured Claims, Convenience Class Claims and Other Subordinated Claims, is ongoing. As a result of its examination of the claims, the Company may ask the Bankruptcy Court to disallow, reduce, reclassify or otherwise adjudicate certain claims the Company believes are subject to objection or otherwise improper. Under the terms of the Plan, the Company has until December 27, 2016 to file additional objections to disputed claims, subject to the Company's right to seek an extension of this deadline from the Bankruptcy Court. The Company may compromise certain claims with or without specific prior approval of the Bankruptcy Court as set forth in the Plan and may identify additional liabilities that will need to be recorded or reclassified to liabilities subject to compromise. The resolution of such claims could result in material adjustments to the Company's financial statements. Although the Bankruptcy Case remains open, other than with respect to certain matters relating to the implementation of the Plan, the administration of certain claims, or over which the Bankruptcy Court may have otherwise retained jurisdiction, the Company is no longer operating under the direct supervision of the Bankruptcy Court. The Company anticipates that the Bankruptcy Case will be closed following the completion of the claims reconciliation process.

As of September 30, 2016, approximately $1.3 million in claims remain subject to review and reconciliation by the Company. The Company intends to file objections to these claims. As of September 30, 2016, the Company has recorded $258,000 and $124,000 related to these claims in Accounts payable and Notes payable to vendors, respectively, which represents management's best estimate of claims to be allowed by the Bankruptcy Court.

Bankruptcy Related Financing Arrangements

On April 1, 2016, the Company entered into the Credit Agreement with Black Horse Capital Master Fund Ltd., as administrative agent and lender ("BHCMF" or "Agent"), Black Horse Capital LP, as a lender ("BHC"), Cheval Holdings, Ltd., as a lender ("Cheval") and Nomis Bay LTD, as a lender ("Nomis" and, together with BHCMF, BHC and Cheval, the "Lenders"). The Credit Agreement provided for a debtor-in-possession credit facility in the original principal amount of $3,000,000 (the "Term Loan"). The Credit Agreement provided that the Term Loan will be made by the Lenders at an original discount equal to $191,000 (the "Upfront Fee") and required the payment by the Company to the Lenders of a commitment fee equal to $150,000 (the "Commitment Fee"). In accordance with the terms of the Credit Agreement, the Company used the proceeds of the Term Loan for working capital, bankruptcy-related costs, costs related to the Company's plan of reorganization, the payment of certain fees and expenses owed to the Agent and the Lenders in connection with the Credit Agreement and other costs incurred in the ordinary course of business.

Pursuant to the terms of the Credit Agreement, the Term Loan bore interest at a rate per annum equal to 12.00%.

In accordance with the bidding procedures order entered by the Bankruptcy Court, the Term Loan and the SPA were together subject to competing, higher and better offers.

In connection with the Company's obligations under the Credit Agreement, the Company executed in favor of the Agent an Intellectual Property Security Agreement, dated as of April 1, 2016 (the "IP Security Agreement"). Under the terms of the IP Security Agreement, the Company pledged all of its intellectual property to the Agent for the ratable benefit of the Lenders, as collateral for its obligations under the Credit Agreement.

The Credit Agreement provided that the outstanding principal balance of the Term Loan, plus accrued and unpaid interest, plus the Upfront Fee, plus the Commitment Fee and all other non-contingent obligations would mature on the earlier of an event of default under the Credit Agreement or the effective date of the Company's plan of reorganization. The Maturity Date was deemed to occur simultaneously with the Effective Date and, accordingly, on June 30, 2016, 2,350,480 shares of common stock were issued to the Lenders in repayment of the Company's debt obligations under the Credit Agreement, including 201,436 shares to BHC, 470,096 shares to BHCMF, 503,708 shares to Cheval, 940,192 shares to Nomis and 235,048 shares to Cortleigh Limited ("Cortleigh"). Pursuant to the terms of the Credit Agreement, the Company also paid $406,285 to BHC in payment of its fees and expenses and $285,000 to Nomis in payment of its fees and expenses.

The Company records discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the fair value of the underlying common stock at the commitment date of the note transaction exceeding the effective conversion price embedded in the note. The Company evaluated the Credit Agreement for beneficial conversion features and calculated a value of approximately $484,000, all of which was expensed as of the Effective Date.

In conjunction with the Credit Agreement, during the nine month period ended September 30, 2016, the Company incurred the following expenses which have been charged to Reorganization items, net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss:

(in thousands)	**Nine months ended September 30, 2016**
Upfront fee	$ 191
Commitment fee	150
Beneficial conversion feature	484
Legal fees	802
Total credit agreement expense	**$ 1,627**

On April 1, 2016, the Company also entered into the SPA with the Lenders. The SPA provides for the sale to the Lenders on the closing date of an aggregate of 5,885,000 shares of common stock, subject to adjustment as provided in the SPA, in respect of exit financing in the amount of $11,000,000 (the "Exit Financing") plus an exit financing commitment fee of $770,000 payable by the Company to the Lenders, plus payment to the Lenders of their fees and expenses incurred in connection with the Exit Financing and the SPA. Nomis subsequently assigned twenty percent (20%) of its interest in the shares of common stock to be purchased by Nomis under the SPA and the Credit Agreement to Cortleigh (collectively with the Lenders, the "Purchasers").

The consummation of the transactions contemplated by the SPA were contingent on, among other things, the funding of the Term Loan, the approval of the Bankruptcy Court of the Company's plan of reorganization, and the simultaneous closing of the Company's transaction with Savant. In addition, the closing of the transactions under the SPA were contingent upon the board of directors of the Company, upon the effectiveness of the confirmed plan of reorganization, consisting of (i) one director to be designated by Nomis; (ii) one director to be jointly designated by BHC, BHCF, and Cheval; (iii) the Chief Executive Officer of the Company to be designated jointly and unanimously by the Lenders; and (iv) two independent directors to be designated jointly and unanimously by the Lenders.

The issuance of the shares contemplated by the SPA was consummated on the Effective Date, and the Company issued to the Purchasers an aggregate of 7,147,035 shares of common stock for an aggregate purchase price of $11,000,000, including 612,501 shares to BHC, 1,429,407 shares to BHCMF, 1,531,610 shares to Cheval, 2,858,814 shares to Nomis and 714,703 shares to Cortleigh. Pursuant to the terms of the SPA, the Company paid $427,383 to BHC in payment of its fees and expenses and $303,886 to Nomis in payment of its fees and expenses.

Under the terms of the SPA, the Company was required to use commercially reasonable efforts to cause a registration statement registering the resale by the Purchasers of the shares issuable under the SPA to be declared effective by the SEC no later than December 27, 2016. The Company was obligated to keep the registration statement effective until all of the shares issued pursuant to the SPA are eligible for resale by the Purchasers without volume restrictions under an exemption from registration under the Securities Act. If the registration statement has not been declared effective by December 27, 2016 and any of the shares issued pursuant to the SPA are not eligible to be sold under Rule 144, then during each subsequent thirty day period (or portion thereof) until the registration statement is declared effective, the Company agrees to issue additional shares of common stock to the Purchasers in an amount equivalent to 10.0% of the shares originally purchased under the SPA that are then held by the Purchasers. On October 28, 2016, the SPA was amended to require the Company to file a registration statement by January 10, 2017 with effectiveness to be no later than March 31, 2017.

Governance Arrangements

On the Effective Date, the Company and Martin Shkreli, the Company's former Chief Executive Officer, former Chairman and former controlling stockholder, entered into a Corporate Governance Agreement (the "Governance Agreement"), which provides for certain terms and conditions regarding the acquisition, disposition, holding and voting of securities of the Company by Mr. Shkreli. The Governance Agreement applies to all common stock owned by Mr. Shkreli or affiliates he controls.

Under the terms of the Governance Agreement, for 180 days following the Effective Date, Mr. Shkreli could not sell his shares of common stock at a price per share that was less than the greater of (x) $2.50 and (y) a 10% discount to the prior two week volume-weighted average price (the "Market Discount Price"). In addition, for 180 days following the 61st day after the Effective Date, the Company had a right to purchase any or all of Mr. Shkreli's shares at a purchase price per share equal to the Market Discount Price. For a limited time, the Company also had a right of first refusal to purchase shares that Mr. Shkreli proposed to sell. Mr. Shkreli was also prohibited from transferring any shares to his affiliates or associates unless such transferee agreed to be subject to the terms of the Governance Agreement. Transfers of shares by Mr. Shkreli not made in compliance with the Governance Agreement would be null and void.

Under the terms of the Governance Agreement, Mr. Shkreli will not have any right to nominate directors to the board of directors of the Company and agreed in connection with any stockholder vote to vote his shares in proportion to the votes of the Company's public stockholders. The Governance Agreement also prohibits Mr. Shkreli or his affiliates for a period of 24 months after the date of the Governance Agreement, from, among other things:

- purchasing any stock or assets of the Company;
- participating in any proposal for any merger, tender offer or other business combination, or similar extraordinary transaction involving the Company or any of its subsidiaries;
- seeking to control or influence the management, the Company's Board or the policies of the Company; or
- submitting any proposal to be considered by the stockholders of the Company.

In addition, any material transaction between Mr. Shkreli or his associates and the Company, or relating to the Governance Agreement, cannot be taken without the prior approval of the Company's Board.

The Governance Agreement provides for a mutual release between the Company and Mr. Shkreli of all claims and liabilities existing as of the date of execution.

On August 25 and August 26, 2016, Mr. Shkreli sold all of his shares of the Company to third party investors in private transactions.

Board Changes

On the Effective Date, in accordance with the Plan, Cameron Durrant, current Chief Executive Officer of the Company, as joint designee of BHCMF, BHC and Cheval (the "Black Horse Entities") and Nomis, continued as a director, Ronald Barliant, current member of the Board, continued as a director as the designee of the Black Horse Entities, Dale Chappell became a director as a designee of Nomis, and Timothy Morris and Ezra Friedberg became directors as joint designees of the Black Horse Entities and Nomis.

Financial Reporting in Reorganization

The Company applied Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 852, *Reorganizations*, which is applicable to companies under bankruptcy protection, and requires amendments to the presentation of key financial statement line items. It requires that the financial statements for periods subsequent to the Chapter 11 filing distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business. Revenues, expenses, realized gains and losses, and provisions for losses that can be directly associated with the reorganization and restructuring of the business must be reported separately as reorganization items in the Condensed Consolidated Statements of Operations and Comprehensive Loss. The balance sheet must distinguish pre-petition liabilities subject to compromise from both those pre-petition liabilities that are not subject to compromise and from post-petition liabilities. Liabilities that may be subject to a plan of reorganization must be reported at the amounts expected to be allowed in the Company's Chapter 11 case, even if they may be settled for lesser amounts as a result of the plan of reorganization or negotiations with creditors.

As of December 31, 2015, the Company had approximately $5.4 million recorded as Liabilities subject to compromise. For the nine months ended September 30, 2016, the Company paid approximately $3.2 million related to Liabilities subject to compromise, issued $1.2 million in promissory notes to vendors and wrote off approximately $0.3 million in deferred rent liabilities related to its lease termination, which as discussed above, were previously included in Liabilities subject to compromise. In conjunction with the Company's exit from bankruptcy, the Company reclassified remaining Liabilities subject to compromise totaling approximately $2.8 million, $0.8 million and $1.2 million to Accounts payable, Accrued expenses and Notes payable to vendors, respectively. As of September 30, 2016, approximately $0.6 million, $0.1 million and $1.2 million remain in Accounts payable, Accrued expenses and Notes payable to vendors, respectively. Remaining amounts will be paid based on terms of the Plan.

For the three and nine month periods ended September 30, 2016, Reorganization items, net consisted of the following charges:

(in thousands)	Three months ended September 30, 2016	Nine months ended September 30, 2016
Legal fees	$ 224	$ 4,780
Professional fees	203	1,159
Debtor-in-possession financing costs	-	1,143
Beneficial conversion on debtor-in-possession financing	-	484
Fair value of shares issued to officer and directors for service in bankruptcy	-	700
Gain on lease termination	-	(227)
Total reorganization items, net	**$ 427**	**$ 8,039**

3. Summary of Significant Accounting Policies

There have been no material changes in the Company's significant accounting policies to those previously disclosed in the 2015 Annual Report.

4. Potentially Dilutive Securities

The Company's potential dilutive securities, which include stock options, restricted stock units and warrants, have been excluded from the computation of diluted net loss per common share as the effect of including those securities would be to reduce the net loss per common share and be antidilutive. Therefore, the denominator used to calculate both basic and diluted net loss per common share is the same in each period presented.

The following outstanding potentially dilutive securities have been excluded from the computations of diluted net loss per common share:

	As of September 30,	
	2016	2015
Options to purchase common stock	2,036,117	527,120
Restricted stock units	3,750	3,750
ESPP contributions to purchase common stock	—	375
Warrants to purchase common stock	331,193	11,067
	2,371,060	542,312

5. Investments

At September 30, 2016, the amortized cost and fair value of investments, with gross unrealized gains and losses, were as follows:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 101	$ —	$ —	$ 101
Total investments	$ 101	$ —	$ —	$ 101
Reported as:				
Cash and cash equivalents				$ —
Restricted cash, long-term				101
Total investments				$ 101

At December 31, 2015, the amortized cost and fair value of investments, with gross unrealized gains and losses, were as follows:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$ 196	$ —	$ —	$ 196
Total investments	$ 196	$ —	$ —	$ 196
Reported as:				
Cash and cash equivalents				$ 3
Restricted cash, long-term				193
Total investments				$ 196

6. Fair Value of Financial Instruments

Cash, accounts payable and accrued liabilities are carried at cost, which approximates fair value given their short-term nature. Marketable securities and cash equivalents are carried at fair value.

The fair value of financial instruments reflects the amounts that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The fair value hierarchy is based on three levels of inputs that may be used to measure fair value, of which the first two are considered observable, and the third is considered unobservable, as follows:

Level 1 — Quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than those included in Level 1 that are directly or indirectly observable, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company measures the fair value of financial assets and liabilities using the highest level of inputs that are reasonably available as of the measurement date. The following tables summarize the fair value of financial assets that are measured at fair value and the classification by level of input within the fair value hierarchy:

	Fair Value Measurements as of September 30, 2016			
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Investments:				
Money market funds	$ 101	$ —	$ —	$ 101
Total assets measured at fair value	$ 101	$ —	$ —	$ 101

	Fair Value Measurements as of December 31, 2015			
(in thousands)	**Level 1**	**Level 2**	**Level 3**	**Total**
Investments:				
Money market funds	$ 196	$ —	$ —	$ 196
Total assets measured at fair value	$ 196	$ —	$ —	$ 196

In 2014, the Company recorded a financing derivative liability resulting from an embedded derivative related to the prepayment feature of its loan and security agreement with MidCap Financial SBIC LP, which was entered into by the Company in September 2012 and subsequently amended (the "Loan and Security Agreement"). At September 30, 2015, the Company re-measured the financing derivative liability as $341,000, resulting in a loss of $114,000 and $252,000 for the three and nine month periods ended September 30, 2015. The loss is included in Other income (expense), net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Loss. The fair value of this derivative was determined using Level 3 inputs, or significant unobservable inputs. The value of the financing derivative was determined by comparing the difference between the fair value of the notes payable with and without the financing derivative by calculating the respective present values from future cash flows using a 14% discount rate, adjusted for the probability of the occurrence of an event of default under the Loan and Security Agreement. The 14% discount rate assumption was based on an effective borrowing rate under the current circumstances considering the quoted borrowing rate for the Company and the imputed fair value of any additional financial instruments that may be required to be extended to the lender in order to obtain such debt financing. The probability of the occurrence of an event of default under the Loan and Security Agreement was based on management's judgment. Refer to Note 7 for additional details regarding the Loan and Security Agreement.

The following table presents changes in financial instruments measured at fair value using Level 3 inputs:

	Fair Value Measurements of Level 3 Liabilities
	(in thousands)
Balance as of December 31, 2014	$ 89
Loss on re-measurement of the financing derivative liability	3
Balance as of March 31, 2015	92
Loss on re-measurement of the financing derivative liability	135
Balance as of June 30, 2015	227
Loss on re-measurement of the financing derivative liability	114
Balance as of September 30, 2015	341
Loan payoff	(341)
Balance as of December 31, 2015, March 31, June 30 and September 30, 2016	$ —

7. Notes Payable

Loan and Security Agreement

In August 2015, the Company entered into Amendment No. 2 to the Loan and Security Agreement, whereby the Company agreed to maintain, in a separate account with a financial institution (held in the Company's name), an amount equal to the aggregate of the remaining future principal, interest and exit fee due under the Loan and Security Agreement, equating to $8.3 million as of the date of Amendment No. 2. Under the terms of the Loan and Security Agreement, as amended, MidCap Financial was permitted to draw payments from this account as they become due, and upon such draws, there would be a corresponding reduction in the amount owed to MidCap Financial by the Company. MidCap Financial had exclusive control to withdraw funds from that account at any time. The account was to be maintained either until the debt has been repaid in full, or until MidCap Financial determined that the Company has satisfied certain capital requirements related to the Company's future operating plans.

In November 2015, the Company elected to exercise its prepayment right to repay the loan in full and paid MidCap Financial $6.6 million in full settlement of the remaining outstanding principal balance, accrued interest, the exit fee and a reduced prepayment fee of 1%. The prepayment resulted in a gain on extinguishment of debt of $61,000 in the fourth quarter of 2015.

Notes Payable to Vendors

On June 30, 2016, the Company issued promissory notes in an aggregate principal amount of approximately $1.2 million to certain claimants in accordance with the Plan. The notes are unsecured, bear interest at 10% per annum and are due and payable in full, including principal and accrued interest on June 30, 2019. As of September 30, 2016, the Company has accrued $30,000 in interest related to these promissory notes.

8. Commitments and Contingencies

Contractual Obligations and Commitments

As of September 30, 2016, there were no material changes to the Company's contractual obligations from those set forth in the 2015 Annual Report.

Guarantees and Indemnifications

The Company has certain agreements with service providers with which it does business that contain indemnification provisions pursuant to which the Company typically agrees to indemnify the party against certain types of third-party claims. The Company accrues for known indemnification issues when a loss is probable and can be reasonably estimated. The Company would also accrue for estimated incurred but unidentified indemnification issues based on historical activity. As the Company has not incurred any indemnification losses to date, there were no accruals for or expenses related to indemnification issues for any period presented.

9. Share Based Compensation

2012 Equity Incentive Plan

Under the Company's 2012 Equity Incentive Plan, the Company may grant shares, stock units, stock appreciation rights, performance cash awards and/or options to employees, directors, consultants, and other service providers. For options, the per share exercise price may not be less than the fair market value of a Company common share on the date of grant. Awards generally vest and become exercisable over three to four years and expire 10 years from the date of grant. Options generally become exercisable as they vest following the date of grant.

On September 13, 2016, the Board of Directors of the Company approved an amendment to the Company's 2012 Equity Incentive Plan to increase the number of shares of the Company's common stock available for issuance under the Plan by 3,000,000 shares and to increase the annual maximum aggregate number of shares subject to stock option awards that may be granted to any one person under the Plan from 125,000 to 1,100,000.

A summary of stock option activity for the three and nine months ended September 30, 2016 under all of the Company's options plans is as follows:

	Options	Weighted Average Exercise Price
Outstanding at December 31, 2015	465,401	$ 19.29
Granted	—	—
Exercised	—	—
Cancelled (forfeited)	(3,416)	5.86
Cancelled (expired)	(63,997)	33.51
Outstanding at March 31, 2016	397,988	$ 17.12
Granted	—	—
Exercised	—	—
Cancelled (forfeited)	—	—
Cancelled (expired)	(9,551)	12.39
Outstanding at June 30, 2016	388,437	$ 17.23
Granted	1,678,022	3.38
Exercised	—	—
Cancelled (forfeited)	—	—
Cancelled (expired)	(30,342)	16.83
Outstanding at September 30, 2016	2,036,117	$ 5.82

The weighted average fair value of options granted during the three months ended September 30, 2016 was $2.41 per share.

The Company valued the options granted using the Black-Scholes options pricing model and the following weighted-average assumption terms for the three months ended September 30, 2016:

	Three Months Ended September 30, 2016
Exercise price	$ 3.38
Market value	$ 3.38
Risk-free rate	1.41%
Expected term	6.0 years
Expected volatility	84.8%
Dividend yield	-

3,750 restricted stock units were outstanding as of September 30, 2016.

2012 Employee Stock Purchase Plan

The Employee Stock Purchase Plan (the "ESPP") provided eligible employees with the opportunity to acquire an ownership interest in the Company through periodic payroll deductions, based on a six-month look-back period, at a price equal to the lesser of 85% of the fair market value of the ordinary shares at either the beginning of the offering period, or the fair market value on the purchase date. The ESPP was structured as a qualified employee stock purchase plan under Section 423 and a qualified pension, profit sharing or stock bonus plan under Section 401(a) of the Internal Revenue Code of 1986 and was not subject to the provisions of the Employee Retirement Income Security Act of 1974. There were 21,058 shares initially authorized for issuance under the plan, and the first offering period commenced on June 1, 2014 and ended on October 31, 2014. The second offering period commenced on November 1, 2014 and ended on April 30, 2015. There were 583 and 375 shares issued under the plan on October 31, 2014 and April 30, 2015, respectively. Under the terms of the ESPP, offerings subsequent to the second offering were to commence on May 1 and November 1 and end on April 30 and October 31 each year. On March 3, 2016, the ESPP was terminated.

Stock-Based Compensation

The Company recorded stock-based compensation expense in the Condensed Consolidated Statements of Operations and Comprehensive Loss as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	**2016**	**2015**	**2016**	**2015**
General and administrative	$ 273	$ 137	$ 275	$ 466
Research and development	40	134	42	447
	$ 313	$ 271	$ 317	$ 913

During the nine months ended September 30, 2015, the Company recorded charges of $389,000 and $479,000 related to the fair value of stock options that were modified due to executive retirement and restructuring activities, and classified $484,000 and $384,000, as general and administrative expenses and research and development expenses, respectively.

On May 24, 2016, the board of directors approved a one-time equity award (the "Equity Award") to each of Cameron Durrant, Ronald Barliant and David Moradi. On June 30, 2016, in accordance with the Plan, the Company issued an aggregate of 323,155 shares of common stock under the Equity Award. The Company recorded a charge of $1.4 million representing the fair value of the shares issued and classified $0.7 million and $0.7 million as Reorganization items, net and General and administrative expenses, respectively.

On September 13, 2016, the Company issued stock options to its Chief Executive Officer to purchase 1,043,022 shares of the Company's common stock at an exercise price of $3.38, the closing price on the date of issuance. The options will vest and become exercisable in 12 equal quarterly increments beginning on October 1, 2016.

At September 30, 2016, the Company had $3.4 million of total unrecognized stock-based compensation expense, net of estimated forfeitures, related to outstanding stock options that will be recognized over a weighted-average period of 2.8 years.

10. Restructuring Charges

Restructuring charges incurred during the nine months ended September 30, 2015 primarily consist of severance and other post-termination benefit costs resulting from the cost reduction program implemented by the Company in January 2015. These activities primarily consisted of 20% reduction of the Company's workforce. Restructuring charges incurred during the three months ended December 31, 2015 primarily relate to a board-approved restructuring plan announced in November 2015 to reduce costs and extend the cash runway in order to allow the Company to evaluate strategic alternatives. As part of the restructuring plan, the Company elected to exercise its right to prepay the Loan and Security Agreement and paid MidCap Financial $6.6 million in full settlement of the remaining outstanding principal balance, accrued interest, the exit fee and a reduced prepayment fee of 1%. In addition, the Company undertook a reduction in force that eliminated the positions of 17 employees or more than 60% of the Company's workforce.

Per ASC 420-10-05-1, Exit or Disposal Cost Obligations, include, but are not limited to, involuntary termination benefits provided to employees under the terms of a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or a deferred compensation contract, and certain contract termination costs. Restructuring costs are expensed during the period in which the Company determines it will incur those costs and all requirements of accrual are met.

A summary of the activity is presented below:

(in thousands)	Contract termination costs - R&D	Salaries and benefits - R&D	Salaries and benefits - G&A	Total
Balance as of December 31, 2014	$ 1,185	$ —	$ —	$ 1,185
Accrued	—	522	82	604
Paid	(479)	(257)	—	(736)
Balance as of March 31, 2015	706	265	82	1,053
Accrued	—	57	122	179
Paid	(135)	(142)	—	(277)
Balance as of June 30, 2015	571	180	204	955
Accrued	—	—	—	—
Adjustments	(78)	—	—	(78)
Paid	(493)	(148)	(136)	(777)
Balance as of September 30, 2015	—	32	68	100
Accrued	—	588	807	1,395
Paid	—	(620)	(864)	(1,484)
Balance as of December 31,2015	—	—	11	11
Accrued	—	—	—	—
Paid	—	—	—	—
Balance as of March 31, June 30 and September 30, 2016	$ —	$ —	$ 11	$ 11

As disclosed in Note 9, during the nine months ended September 30, 2015, the Company recorded stock based compensation expense of $479,000 related to the fair value of stock options of former employees which were modified such that they did not expire upon termination. The Company classified $95,000 and $384,000 as general and administrative expenses and research and development expenses, respectively.

11. Savant Arrangements

On February 29, 2016, the Company entered into a binding letter of intent (the "LOI") with Savant Neglected Diseases, LLC ("Savant"). The LOI provided that the Company would acquire certain worldwide rights relating to benznidazole (the "Compound") from Savant. Under the LOI, the Company made a non-refundable deposit to Savant of $500,000, which was credited towards the Initial Payment (as defined below), and agreed to make monthly payments to Savant equal to $87,500 for development services performed by Savant relating to the Compound.

The LOI provided that in consideration for the assets to be acquired, the Company would provide consideration to Savant, including:

- $3,000,000 (the "Initial Payment") payable as soon as practicable but in no event later than the Company emerging from its Chapter 11 bankruptcy pursuant to a plan of reorganization (the "Bankruptcy Exit");
- a five-year warrant from the date of the Bankruptcy Exit to purchase up to 200,000 shares of common stock at a per share price of $2.25, exercisable for 25% of the shares immediately and exercisable for the remaining shares upon reaching certain milestones related to regulatory approval of the Compound; and
- certain additional payments to be further specified in the definitive agreements.

On the Effective Date, as authorized by the Plan and the Confirmation Order, the Company and Savant entered into an Agreement for the Manufacture, Development and Commercialization of Benznidazole for Human Use (the "MDC Agreement"), pursuant to which the Company acquired certain worldwide rights relating to the Compound. The MDC Agreement consummates the transactions contemplated by the LOI.

Under the terms of the MDC Agreement, the Company acquired certain regulatory and non-intellectual property assets relating to the Compound and any product containing the Compound and an exclusive license of certain intellectual property assets related to the Compound. Savant will retain the right to use the licensed intellectual property for veterinary uses. The MDC Agreement provides that the Company and Savant will jointly conduct research and development activities with respect to the Compound, while the Company will be solely responsible for commercializing the Compound. The Company will fund the development program for the Compound and will reimburse Savant for its development program costs.

As required by the MDC Agreement, on the Effective Date, the Company made payments to Savant totaling $2,687,500, consisting of the remaining portion of the Initial Payment less the deposit in the amount of $2,500,000, an initial monthly Joint Development Program Cost payment of $87,500, and reimbursement of Savant's legal fees capped at $100,000. The MDC Agreement provides for milestone payments, including payments related to U.S. and foreign regulatory submissions of up to $21 million and certain other contingent payments. Additionally, the Company will pay Savant royalties on any net sales of the Compound, which royalty would increase if a PRV is granted subsequent to regulatory approval of the Compound. The MDC Agreement also provides that Savant is entitled to a portion of the amount the Company receives upon the sale, if any, of a PRV relating to the Compound.

In addition, on the Effective Date the Company and Savant also entered into a Security Agreement (the "Security Agreement"), pursuant to which the Company granted Savant a continuing senior security interest in the assets and rights acquired by the Company pursuant to the MDC Agreement and certain future assets developed from those acquired assets.

On the Effective Date, the Company issued to Savant a five year warrant (the "Warrant") to purchase 200,000 shares of the Company's Common Stock, at an exercise price of $2.25 per share, subject to adjustment. The Warrant is exercisable for 25% of the shares immediately and exercisable for the remaining shares upon reaching certain regulatory related milestones. In addition, pursuant to the MDC Agreement, the Company has granted Savant certain "piggyback" registration rights for the shares issuable under the Warrant.

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of ASC 505, *Equity*, using a fair-value approach and the provisions of ASC 815-40, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.*. The equity instruments are valued using the Black-Scholes valuation model. Measurement of share-based compensation is subject to periodic adjustments as the underlying equity instruments vest and performance conditions are satisfied. The related expense is recognized as an expense over the term services are received. The Company determined the fair value of the Warrant to be approximately $670,000 and recorded expense of approximately $244,000 during the three months ended June 30, 2016, which is included in Research and development expenses in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss.

As of September 30, 2016, the Company reevaluated the performance conditions and expected vesting of the Warrant, revalued them and determined the revised fair value to be approximately $518,000 and recorded expense of approximately $28,000 during the three months ended September 30, 2016. The Company will continue to reevaluate the performance conditions and expected vesting of the Warrant on a quarterly basis until all performance conditions have been met.

Before a compound receives regulatory approval, the Company records upfront and milestone payments made to third parties under licensing arrangements as expense. Upfront payments are recorded when incurred and milestone payments are recorded when the specific milestone has been achieved.

The Company has determined that the acquisition of the Compound should be treated as a purchase of in-process research and development. Accordingly, during the nine months ended September 30, 2016, the Company recorded $3,250,000, which includes an additional $250,000 payment made in 2015 to Savant, as Research and development expense in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss. In addition, during the nine months ended September 30, 2016, the Company recorded $262,500 in connection with the Joint Development Program and recorded $100,000 in legal fee reimbursement as Research and development expense in the accompanying Condensed Consolidated Statement of Operations and Comprehensive Loss.

12. Litigation

Bankruptcy Proceeding

The Company filed for protection under Chapter 11 of Title 11 of the United States Bankruptcy Code on December 29, 2015. See Note 2 for additional information related to the bankruptcy.

Securities Class Action Litigation

On December 18, 2015, a putative class action lawsuit (captioned *Li v. KaloBios Pharmaceuticals, Inc. et al.*, 5:15-cv-05841-EJD) was filed against the Company in the United States District Court for the Northern District of California (the "Class Action Court"), alleging violations of the federal securities laws by the Company, Herb Cross and Martin Shkreli, the Company's former Chairman and Chief Executive Officer. On December 23, 2015, a putative class action lawsuit was filed against the Company in the Class Action Court (captioned *Sciabacucchi v. KaloBios Pharmaceuticals, Inc. et al.*, 3:15-cv-05992-CRB), similarly alleging violations of the federal securities laws by the Company and Mr. Shkreli. On December 31, 2015, a putative class action lawsuit was filed against the Company in the Class Action Court (captioned *Isensee v. KaloBios Pharmaceuticals, Inc. et al.*, Case No. 15-cv-06331-EJD) also alleging violation of the federal securities laws by the Company, a former officer and Mr. Shkreli. On April 18, 2016, an amended complaint was filed in the *Isensee* suit, adding Herb Cross and Ronald Martell as defendants. On April 28, 2016, the Class Action Court consolidated these cases (the "Securities Class Action Litigation") and appointed certain plaintiffs as the lead plaintiffs. The lead plaintiffs in the Securities Class Action Litigation were seeking damages of $20.0 million on behalf of all the affected members of the class represented in the Securities Class Action Litigation, (the "Securities Class Action Members").

On June 15, 2016, a settlement stipulation (the "Securities Class Action Settlement"), was approved by the Bankruptcy Court. Subject to the approval of the Class Action Court, the Securities Class Action Settlement required the Company to issue 300,000 shares of common stock and submit a payment of $250,000 to the Securities Class Action Members and advance insurance proceeds of $1.25 million to the Securities Class Action Members (collectively, the consideration is the "Securities Class Action Settlement Consideration"). Subject to the final approval of the Securities Class Action Settlement, any Securities Class Action Member is entitled to share in the Securities Class Action Settlement Consideration. The Securities Class Action Settlement provides for releases and related injunctions to be granted for the benefit of, among others, the Company, Ronald Martell, Herb Cross and all of the Company's past, present and future directors, officers and employees, excluding Mr. Shkreli. Alternatively, Securities Class Action Members may exclude themselves from the Securities Class Action Settlement and are thereby not bound by the terms of the Securities Class Action Settlement nor entitled to receive any amount of the Securities Class Acton Settlement Consideration. Such Securities Class Action Members, to the extent they properly exclude themselves from the Securities Class Action Settlement and have timely and properly filed a proof of claim in the bankruptcy case, may have certain rights under the Plan with respect to such claims. Pursuant to the Plan and Confirmation Order, such claims are subordinated to the level of the Company's common stock that was issued and outstanding when the Company's bankruptcy case was filed. Such claims are also subject to the Company's objection or other response.

The Company's agreement to the Securities Class Action Settlement was not in any way an admission of the Company's wrongdoing or liability. As of September 30, 2016, the 300,000 shares have been issued and the $250,000 payment has been made.

PIPE Litigation

On January 7, 2016, certain investors (the "PIPE Claimants") commenced an adversary proceeding (captioned *Gregory Rea, et al. v. KaloBios Pharmaceuticals, Inc.*, Adv. Pro. No. 16-50001 (LSS)) in the Bankruptcy Court against the Company alleging implied trust theories, breach of contract, fraud and violations of the federal securities laws in connection with the PIPE Claimants' purchase of the Company's common stock in the Private Placement (the "PIPE Litigation"). The PIPE Claimants also raised certain other objections to the Company's bankruptcy proceeding. The PIPE Claimants sought an aggregate total of approximately $6.9 million in damages.

On May 9, 2016, the Bankruptcy Court entered an order approving a settlement stipulation between the Company and the PIPE Claimants (the "Settlement Stipulation"). Under the Settlement Stipulation, in connection with the effectiveness of the Plan, and per the terms of the Settlement Stipulation, the Company became obligated to issue 327,608 shares to the PIPE Claimants and make a payment of $250,000 to the PIPE Claimants for the purpose of satisfying expenses related to the PIPE Litigation. As of September 30, 2016, the 327,608 shares have been issued and the $250,000 payment has been made.

Claim by Marek Biestek

Marek Biestek was a director of the Company who, while not a plaintiff in the above described PIPE Litigation, filed a proof of claim alleging damages from the PIPE transaction and filed an objection to the confirmation of the Plan. To resolve his objection to the Plan and his proof of claim, the Company settled with him individually by issuing him 3,750 additional shares of common stock. Mr. Biestek, as a former director of the Company, was excluded from the Securities Class Action Members and therefore received nothing from the Securities Class Action Litigation.

As of December 31, 2015, the Company recorded an obligation in stockholders' equity to issue the shares related to all of the above claims that totals approximately $2.8 million and recorded the cash liability of $500,000 in Liabilities subject to compromise in the accompanying Condensed Consolidated Balance Sheet. As of September 30, 2016, all of the above claims have been satisfied and shares issued.

13. Subsequent Events

On October 28, 2016, the Company signed an amendment to the SPA (as more fully described in Note 2), the effect of which was to change the requirement for causing a registration statement to be declared effective by December 27, 2016 to now require the Company to file a registration statement by January 10, 2017, with effectiveness to be no later than March 31, 2017.

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

You should read the following discussion and analysis together with our financial statements and the notes to those statements included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. This Quarterly Report on Form 10-Q contains statements that discuss future events or expectations, projections of results of operations or financial condition, trends in our business, business prospects and strategies and other "forward-looking" information. In some cases, you can identify "forward-looking statements" by words like "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential" or "continue" or the negative of those words and other comparable words. These statements may relate to, among other things, our expectations regarding the scope, progress, expansion, and costs of researching, developing and commercializing our product candidates; our intent to in-license or acquire additional product candidates; our opportunity to benefit from various regulatory incentives and the application of our Responsible Pricing Model; expectations for our financial results, revenue, operating expenses and other financial measures in future periods; and the adequacy of our sources of liquidity to satisfy our working capital needs, capital expenditures, and other liquidity requirements. Actual events or results may differ materially due to known and unknown risks, uncertainties and other factors such as:

- *our lack of profitability and the immediate need to raise additional capital to operate our business; and*
- *the uncertainties inherent in the development and launch of any new pharmaceutical product;*
- *our ability to successfully and timely complete clinical trials for our drug candidates in clinical development;*
- *our ability to obtain the necessary U.S. and international regulatory approvals for our drug candidates and to qualify for or benefit from various regulatory incentives;*
- *the scope and validity of intellectual property and other competitive protection for our drug candidates;*
- *our ability to identify, in-license and acquire additional product candidates or to form partnerships for the sale, licensing, collaborative development or marketing of our existing product candidates;*
- *our ability to maintain or engage third-party manufacturers to manufacture, supply, store and distribute supplies of our drug candidates for our clinical trials; and*
- *the success of any product.*

These are only some of the factors that may affect the forward-looking statements contained in this Form 10-Q. For a discussion identifying additional important factors that could cause actual results to vary materially from those anticipated in the forward-looking statements, see "Risk Factors" in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. You should review these risk factors for a more complete understanding of the risks associated with an investment in our securities. However, we operate in a competitive and rapidly changing environment and new risks and uncertainties emerge, are identified or become apparent from time to time. It is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Form 10-Q. You should be aware that the forward-looking statements contained in this Form 10-Q are based on our current views and assumptions. We undertake no obligation to revise or update any forward-looking statements made in this Form 10-Q to reflect events or circumstances after the date hereof or to reflect new information or the occurrence of unanticipated events, except as required by law. The forward-looking statements in this Form 10-Q are intended to be subject to protection afforded by the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Overview

We are a biopharmaceutical company focused on developing medicines for patients with neglected and rare diseases, with an ancillary focus on pediatric conditions, and on executing our Responsible Pricing Model in the commercialization of our products that may be approved. Our lead product candidate is benznidazole for the treatment of Chagas disease, a parasitic illness that can lead to long-term heart, intestinal and neurological problems. We are developing one of our proprietary monoclonal antibodies, lenzilumab (formerly known as KB003), for the treatment of chronic myelomonocytic leukemia, or CMML, and potentially for the treatment of juvenile myelomonocytic leukemia, or JMML, both of which are rare hematologic cancers with high unmet medical need. We are exploring partnering or development of another of our proprietary monoclonal antibodies, ifabotuzumab (formerly known as KB004), for the treatment of certain solid and hematologic cancers. With a focus on neglected, rare and orphan diseases, we believe we have the opportunity to benefit from various regulatory incentives, such as orphan drug exclusivity, breakthrough therapy designation, fast track designation, accelerated approval, priority review and priority review vouchers, or PRVs, where available, that provide for certain periods of exclusivity, expedited review and/or other benefits.

Upon regulatory approval of any of our products, we intend to apply our Responsible Pricing Model, which focuses on affordability for patients and payers, transparency for all stakeholders, and delivery of a reasonable return in recognition of the risks we are taking in our development efforts.

Benznidazole is an oral small molecule antiprotozoal for the treatment of Chagas disease, which is also known as American trypanosomiasis. Benznidazole has undergone numerous clinical trials and studies that show efficacy against Chagas disease. We believe it is the current preferred treatment for Chagas disease in the countries where it is approved. No treatments for Chagas disease are approved by the United States Food and Drug Administration, or FDA, for use in the United States. On June 30, 2016, we acquired certain worldwide rights relating to benznidazole for human use from Savant Neglected Diseases, LLC, or Savant, and we are focused on the development necessary to seek and obtain FDA approval of benznidazole. We believe benznidazole as a treatment for Chagas disease could qualify for priority review and potentially other FDA regulatory incentives, and to receive a PRV if FDA approves the drug for marketing.

Lenzilumab is a recombinant monoclonal antibody, or mAb, that neutralizes soluble granulocyte-macrophage colony-stimulating factor, or GM-CSF, a critical cytokine for the growth of certain hematologic malignancies and solid tumors. Consistent with our strategic focus on neglected and rare diseases, in July 2016, we initiated dosing in a Phase 1 clinical trial in patients with CMML to identify the maximum tolerated dose, or MTD, or recommended Phase 2 dose of lenzilumab and to assess lenzilumab's safety, pharmacokinetics, and clinical activity. We also plan to assess interim data from the lenzilumab CMML Phase I study to determine the feasibility of rapidly commencing a Phase I study in JMML patients, where there is a very high unmet medical need and no FDA-approved therapies.

Ifabotuzumab is an anti-EphA3 mAb that has the potential to offer a novel approach to treating both solid tumors and hematologic malignancies. EphA3 is aberrantly expressed on the surface of tumor cells and stroma cells in certain cancers. We have completed the Phase 1 dose escalation portion of a Phase 1/2 clinical trial in ifabotuzumab in multiple hematologic malignancies and are evaluating whether to conduct further studies of ifabotuzumab in rare solid tumors such as glioblastoma, other brain cancers in children and rare hematologic cancer indications, or to partner it.

We also have an additional drug candidate, KB001-A, a recombinant, PEGylated, anti-Pseudomonas PcrV high-affinity Fab antibody that we are no longer developing, but which is being considered for partnering or out-licensing.

Lenzilumab, ifabotuzumab and KB001-A were each developed with our proprietary, patent-protected Humaneered® technology, which consists of methods for converting antibodies (typically murine) into engineered, high-affinity antibodies designed for human therapeutic use, typically for chronic conditions.

Our strategy also involves identifying, acquiring, developing and supporting the commercialization of additional treatments for neglected and rare diseases. We believe the treatment of neglected and rare diseases represents an opportunity to enter underserved patient populations and serve specialty markets. We also believe our focus on neglected and rare diseases provides us the opportunity to benefit from various regulatory incentives referenced above. The potential opportunities afforded by these regulatory programs provide an important incentive to support our efforts to develop medicines for patients with neglected and rare diseases and to apply our Responsible Pricing Model for any of our approved products.

We have incurred significant losses and had an accumulated deficit of $235.6 million as of September 30, 2016. We expect to continue to incur net losses as we develop our drug candidates, expand clinical trials for our drug candidates currently in clinical development, expand our development activities and seek regulatory approvals. Significant capital is required to continue to develop and to launch a product and many expenses are incurred before revenue is received, if any. We are unable to predict the extent of any future losses or when we will receive revenue or become profitable, if at all.

We will require substantial additional capital to support our business efforts, including obtaining regulatory approvals for benznidazole or other product candidates, clinical trials and other studies, and, if approved, the commercialization of our product candidates. We anticipate that in the future we will seek additional financing from a number of sources, including, but not limited to, the sale of equity or debt securities, strategic collaborations, and licensing of our product candidates. Additional funding may not be available to us on a timely basis or on acceptable terms, if at all. Our ability to access capital when needed is not assured and, if not achieved on a timely basis, would materially harm our business, financial condition and results of operations. If adequate funds are not available, we may be required to delay, reduce the scope of, or eliminate one or more of our development programs. We may also be required to sell or license to others our technologies, product candidates, or development programs that we would have preferred to develop and commercialize ourselves and on less than favorable terms, if at all.

If management is unsuccessful in efforts to raise additional capital, based on our current levels of operating expenses, our current capital will not be sufficient to fund our operations for the next twelve months. These conditions raise substantial doubt about our ability to continue as a going concern. The Condensed Consolidated Financial Statements for the quarter ended September 30, 2016 were prepared on the basis of a going concern, which contemplates that we will be able to realize our assets and discharge liabilities in the normal course of business. Our ability to meet our liabilities and to continue as a going concern is dependent upon the availability of future funding. The financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

As a result of challenges facing us at the time, on December 29, 2015, we filed a voluntary petition for bankruptcy protection under Chapter 11 of Title 11 of the U.S. Bankruptcy Code. On June 30, 2016, our Second Amended Plan of Reorganization, dated May 9, 2016, as amended, or the Plan, became effective and we emerged from our Chapter 11 bankruptcy proceedings. For further information on our bankruptcy and emergence from bankruptcy, see Note 2 to the Condensed Consolidated Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q.

On January 13, 2016, our common stock was suspended from the Nasdaq Global Market and began trading on the over-the-counter market under the ticker symbol KBIOQ. On January 26, 2016, NASDAQ filed a Form 25 with the Securities and Exchange Commission to complete the delisting of our common stock, and the delisting was effective on February 5, 2016. On June 30, 2016, upon emergence from bankruptcy, the ticker symbol for the trading of the Company's common stock on the over-the-counter market reverted back to KBIO.

Critical Accounting Policies and Use of Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States, or GAAP. The preparation of our financial statements in conformity with GAAP requires our management to make estimates and assumptions that affect the amounts and disclosures reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates. Our management believes judgment is involved in determining revenue recognition, valuation of financing derivative, the fair value-based measurement of stock-based compensation, accruals and warrant valuations. Our management evaluates estimates and assumptions as facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ from these estimates and assumptions, and those differences could be material to the consolidated financial statements. If our assumptions change, we may need to revise our estimates, or take other corrective actions, either of which may also have a material adverse effect on our statements of operations, liquidity and financial condition.

We are an emerging growth company under the JOBS Act. Emerging growth companies can delay adopting new or revised accounting standards until such time as those standards apply to private companies. We have elected to avail ourselves of this exemption from new or revised accounting standards and, therefore, we may not be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

There were no significant and material changes in our critical accounting policies and use of estimates during the three and nine months ended September 30, 2016, as compared to those disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Use of Estimates" in our 2015 Annual Report on Form 10-K (File No. 001-35798), filed with the SEC on September 1, 2016.

Results of Operations

General

We have not generated net income from operations, except for the year ended December 31, 2007 during which we recognized a one-time license payment from Novartis. At September 30, 2016 we had an accumulated deficit of $235.6 million primarily as a result of research and development and general and administrative expenses. While we may in the future generate revenue from a variety of sources, including license fees, milestone payments, and research and development payments in connection with strategic partnerships, our product candidates may never be successfully developed or commercialized and we may therefore never realize revenue from any product sales, particularly because most of our product candidates are at an early stage of development. Accordingly, we expect to continue to incur substantial losses from operations for the foreseeable future, and there can be no assurance that we will ever generate significant revenue or profits.

Our operations during the six months ended June 30, 2016 primarily related to our status as a debtor in possession and other matters in connection with our Chapter 11 bankruptcy proceedings, in addition to our efforts to obtain certain rights related to our lead product candidate benznidazole. In addition, our operations during the three months ended September 30, 2016 included further reorganization expenses and our development programs have changed substantially from the same period in 2015. Accordingly, comparisons of our operations and results for the three and nine months ended September 30, 2016 to our operations and results in the prior year periods may only provide a limited benefit, and similarly should not be relied on as an indicator of our future operations or results.

Research and Development Expenses

Conducting research and development is central to our business model. We expense both internal and external research and development costs as incurred. We track external research and development costs incurred by project for each of our clinical programs. We began tracking our external costs by project beginning January 1, 2008, and we have continued to refine our systems and our methodology in tracking external research and development costs. Our external research and development costs consist primarily of:

- expenses incurred under agreements with contract research organizations, investigative sites, and consultants that conduct our clinical trials and a substantial portion of our preclinical activities;
- the cost of acquiring and manufacturing clinical trial and other materials; and
- other costs associated with development activities, including additional studies.

Other research and development costs consist primarily of internal research and development costs such as salaries and related fringe benefit costs for our employees (such as workers compensation and health insurance premiums), stock-based compensation charges, travel costs, lab supplies, overhead expenses such as rent and utilities, and external costs not allocated to one of our clinical programs. Internal research and development costs generally benefit multiple projects and are not separately tracked per project.

The following table shows our total research and development expenses for the three and nine months ended September 30, 2016 and 2015:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
(in thousands)	**2016**	**2015**	**2016**	**2015**
External Costs				
KB001	$ 5	$ 47	$ 10	$ 1,262
Lenzilumab	99	68	215	318
Ifabotuzumab	30	2,131	176	5,611
Benznidazole	829	-	5,024	-
Internal costs	778	1,599	2,380	5,891
Total research and development	$ 1,741	$ 3,845	$ 7,805	$ 13,082

General and Administrative Expenses

General and administrative expenses consist principally of personnel-related costs, professional fees for legal, consulting, audit and tax services, rent and other general operating expenses not otherwise included in research and development.

Comparison of Three Months Ended September 30, 2016 and 2015

(in thousands)	Three Months Ended September 30, 2016	2015	Increase/ (Decrease) in thousands	%
Operating expenses:				
Research and development	$ 1,741	$ 3,845	$ (2,104)	(55)
General and administrative	2,453	2,359	94	4
Loss from operations	(4,194)	(6,204)	(2,010)	(32)
Interest expense	(30)	(223)	(193)	(87)
Interest income	-	3	(3)	(100)
Other income (expense), net	128	(176)	(304)	(173)
Reorganization items, net	(427)	-	427	100
Net loss	$ (4,523)	$ (6,600)	$ (2,077)	(31)

Research and development expenses decreased $2.1 million, from $3.8 million for the three months ended September 30, 2015 to $1.7 million for the three months ended September 30, 2016. The decrease is primarily due to the cessation of development work for ifabotuzumab, a reduction in internal costs related to the restructuring program in the fourth quarter of 2015, offset partially by an increase in costs related to the development of benznidazole.

General and administrative expenses increased $94,000. The increase is primarily due to an increase in legal, accounting and audit fees associated with the work related to becoming current with our SEC filings, offset by a decrease in personnel expenses related to the restructuring activities that took place primarily in the last quarter of 2015 resulting in a decrease of approximately 70% of our workforce and a reduction in facilities expense due to the move from the old office and laboratory space to the new offices.

Reorganization items, net, were $0.4 million for the three months ended September 30, 2016 compared to none for the three months ended September 30, 2015. Reorganization items, net relate to amounts incurred during the quarter related to the Plan, including legal fees of $0.2 million and $0.2 million in other professional fees.

Interest expense of $0.2 million recognized for the three months ended September 30, 2015 was related to the Loan and Security Agreement with MidCap Financial SBIC LP that was entered into by the Company in September 2012. The loan was paid off in the fourth quarter of 2015. Interest expense of $30,000 for the three months ended September 30, 2016 relates to the promissory notes issued to certain vendors in accordance with the Plan.

Other income (expense), net for the three months ended September 30, 2016 primarily consisted of foreign currency gains related to the payment of bankruptcy liabilities in foreign currencies. Other income (expense), net for the three months ended September 30, 2015 primarily consisted of foreign currency losses and realized gains and losses on the sale of investments.

Comparison of Nine Months Ended September 30, 2016 and 2015

(in thousands)	Nine Months Ended September 30, 2016	2015	Increase/ (Decrease) in thousands	%
Operating expenses:				
Research and development	$ 7,805	$ 13,082	$ (5,277)	(40)
General and administrative	6,169	8,095	(1,926)	(24)
Loss from operations	(13,974)	(21,177)	(7,203)	(34)
Interest expense	(76)	(755)	(679)	(90)
Interest income	-	29	(29)	(100)
Other income (expense), net	128	(359)	(487)	(136)
Reorganization items, net	(8,039)	-	8,039	100
Net loss	$ (21,961)	$ (22,262)	$ (301)	(1)

Research and development expenses decreased $5.3 million, from $13.1 million for the nine months ended September 30, 2015 to $7.8 million for the nine months ended September 30, 2016. The decrease is due to the suspension of essentially all development projects until after our emergence from bankruptcy on June 30, 2016. The decrease is partially offset by the amounts paid to Savant for certain rights relating to benznidazole, as well as the fair value of the warrant issued to Savant, all of which has been expensed as research and development expense.

General and administrative expenses decreased $1.9 million, from $8.1 million for the nine months ended September 30, 2015 to $6.2 million for the nine months ended September 30, 2016, primarily due to the restructuring activities that took place mostly in the last quarter of 2015 resulting in a decrease of approximately 70% of our workforce, partially offset by the expense recorded related to the fair value of common stock issued to our CEO and two directors of $0.7 million and an increase in legal, accounting and audit fees associated with the work related to becoming current with our SEC filings.

Reorganization items, net increased $8.0 million, from zero for the nine months ended September 30, 2015 to $8.0 million for the nine months ended September 30, 2016 due to the amounts incurred related to the Plan, including legal fees of $4.8 million, $1.1 million in other professional fees, $0.7 million related to the fair value of common shares issue to our CEO and two directors for their service in bankruptcy, $1.1 million in legal and other costs related to the debtor-in-possession financing, $0.5 million related to the beneficial conversion expense recognized in connection with the debtor-in-possession financing, offset by a net gain on the termination of the South San Francisco lease of $0.2 million.

Interest expense of $0.8 million recognized for the nine months ended September 30, 2015 was related to the Loan and Security Agreement with MidCap Financial SBIC LP that was entered into by the Company in September 2012. The loan was paid off in the fourth quarter of 2015. Interest expense of $76,000 recognized for the nine months ended September 30, 2016 is comprised of $46,000 related to the debtor-in-possession financing entered into on April 1, 2016 and $30,000 related to the promissory notes issued to certain vendors in accordance with the Plan.

Other income (expense), net for the nine months ended September 30, 2016 primarily consisted of foreign currency gains related to the payment of bankruptcy liabilities in foreign currencies. Other income (expense), net for the nine months ended September 30, 2015 primarily consisted of foreign currency gains and losses and realized gains and losses on the sale of investments.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through proceeds from the public offerings of our common stock, private placements of our preferred stock, debt financings, interest income earned on cash, and cash equivalents, and marketable securities, borrowings against lines of credit, and receipts from agreements with Sanofi and Novartis. At September 30, 2016, we had cash and cash equivalents of $2.9 million.

The following table sets forth the primary sources and uses of cash and cash equivalents for each of the periods presented below:

	Nine Months Ended September 30,	
(in thousands)	**2016**	**2015**
Net cash used in operating activities	$ (17,948)	$ (21,069)
Net cash provided by investing activities	92	29,540
Net cash provided by (used in) financing activities	12,330	(11,774)
Net decrease in cash and cash equivalents	$ (5,526)	$ (3,273)

Net cash used in operating activities was $17.9 million and $21.1 million for the nine months ended September 30, 2016 and 2015, respectively. The primary use of cash in 2015 was to fund our operations related to the development of our product candidates, whereas the primary use of cash in 2016 was to fund our operations related to the Plan. Cash used in operating activities of $17.9 million for the nine months ended September 30, 2016 primarily related to our net loss of $21.8 million, adjusted for non-cash items, such as $1.6 million related to reorganization items related to the debtor-in-possession financing, $1.5 million related to the issuance of stock to our CEO and two directors, $0.3 million related to the issuance of warrants to Savant in connection with the acquisition of certain rights related to the benznidazole license, $0.2 million related to a net gain on lease termination, other non-cash items of $0.4 million and net cash outflows of $0.3 million related to changes in operating assets and liabilities, primarily Liabilities subject to compromise, Accounts payable and Accrued expenses.

Net cash used in operating activities of $21.1 million for the nine months ended September 30, 2015 primarily related to our net loss of $22.3 million, adjusted for non-cash items such as $0.9 million of stock-based compensation expense, $0.9 million relating to the fair value of stock options that were modified due to executive retirement and restructuring activities, depreciation and amortization of $0.1 million, noncash expense related to interest and the financing derivative of $0.4 million and other adjustments of $0.2 million, offset by net cash outflows of $1.3 million related to changes in operating assets and liabilities.

Net cash provided by investing activities was $0.1 million for the nine months ended September 30, 2016, primarily related to the reduction in restricted cash related to the termination of our office lease in South San Francisco. Net cash provided by investing activities was $29.5 million for the nine months ended September 30, 2015, primarily related to proceeds from maturities of marketable securities of $33.4 million partially offset by purchases of investments of $3.7 million.

Net cash provided by financing activities was $12.3 million for the nine months ended September 30, 2016 related to the debtor-in-possession and bankruptcy-related equity financings. Net cash used in financing activities was $11.7 million for the nine months ended September 30, 2015 relating to an increase in restricted cash of $8.3 million relating to notes payable obligations and $3.4 million relating to the payments on our borrowings.

In connection with our emergence from bankruptcy, we closed an $11 million financing that provided the funds required to enable our exit from Chapter 11 as well as to fund our current working capital needs. However, we will require substantial additional capital to support our business efforts, including obtaining regulatory approvals for benznidazole or other product candidates, clinical trials and other studies, and, if approved, the commercialization of our product candidates. The amount of capital we will require and the timing of our need for additional capital will depend on many factors, including:

- the type, number, timing, progress, costs, and results of the product candidate development programs that we are pursuing or may choose to pursue in the future;
- the scope, progress, expansion, costs, and results of our pre-clinical and clinical trials;
- the timing of and costs involved in obtaining regulatory approvals;
- our ability to establish and maintain development partnering arrangements and any associated funding;
- the emergence of competing products or technologies and other adverse market developments;
- the costs of maintaining, expanding, and protecting our intellectual property portfolio, including potential litigation costs and liabilities;
- the resources we devote to marketing, and, if approved, commercializing our product candidates;
- the scope, progress, expansion and costs of manufacturing our product candidates; and
- the costs associated with being a public company.

We are pursuing efforts to raise additional capital from a number of sources, including, but not limited to, the sale of equity or debt securities, strategic collaborations, and licensing of our product candidates. Additional funding may not be available to us on a timely basis or at acceptable terms, if at all. Our ability to access capital when needed is not assured and, if not achieved on a timely basis, would materially harm our business, financial condition and results of operations. If adequate funds are not available, we may be required to delay, reduce the scope of, or eliminate one or more of our development programs. We may also be required to sell or license to others our technologies, product candidates, or development programs that we would have preferred to develop and commercialize ourselves and on less than favorable terms, if at all.

If management is unsuccessful in efforts to raise additional capital, based on our current levels of operating expenses, our current capital will not be sufficient to fund our operations for the next twelve months. These conditions raise substantial doubt about our ability to continue as a going concern.

On January 13, 2016, our common stock was suspended from the Nasdaq Global Market and began trading on the over-the-counter market under the ticker symbol KBIOQ. On January 26, 2016, NASDAQ filed a Form 25 with the Securities and Exchange Commission to complete the delisting of our common stock, and the delisting was effective on February 5, 2016. On June 30, 2016, upon emergence from bankruptcy, the ticker symbol for the trading of our common stock on the over-the-counter market reverted back to KBIO. Although our common stock is listed for quotation on the OTC Pink marketplace operated by OTC Markets Group, Inc., trading is limited and an active market for our common stock may never develop in the future, which could harm our ability to raise capital to continue to fund operations.

Off-Balance Sheet Arrangements

We currently have no off-balance sheet arrangements, such as structured finance, special purpose entities or variable interest entities.

Item 4. Controls and Procedures.

Management's Evaluation of our Disclosure Controls and Procedures

"Disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Disclosure controls and procedures include, without limitation, those designed to ensure that this information is accumulated and communicated to our management to allow timely decisions regarding required disclosure. Management, including our Chief Executive Officer and Interim Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based upon the evaluation our Chief Executive Officer and Interim Chief Financial Officer concluded that the disclosure controls and procedures were not effective as of September 30, 2016 to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate to allow timely discussion regarding required disclosure.

Changes in Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act). Our Chief Executive Officer and Interim Chief Financial Officer assessed the effectiveness of our internal control over financial reporting as of September 30, 2016. In making this assessment, our Chief Executive Officer and Interim Chief Financial Officer used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission, or COSO, in *Internal Control—Integrated Framework*. Based on that assessment and using the COSO criteria, our Chief Executive Officer and Interim Chief Financial Officer have concluded that, as of September 30, 2016, our internal control over financial reporting was not effective because of the material weaknesses described below.

A material weakness is defined as "a deficiency, or a combination of deficiencies in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis."

The ineffectiveness of our internal control over financial reporting was due to the following material weaknesses, each of which relates to our limited number of accounting and financial reporting personnel and high levels of turnover in our personnel responsible for performing activities related to our internal control over financial reporting: (i) an insufficient degree of segregation of duties amongst our accounting and financial reporting personnel; and (ii) a lack of technical competency in review and approval of financial reporting processes.

During the quarter ended September 30, 2016, we retained a new controller and other highly qualified accounting support staff and implemented certain other remedial measures, including the implementation of a formal closing procedure. Based on these actions, among others, our management believes it has successfully remediated our previously reported material weakness relating to our inability to complete our financial statement close process in a timely and accurate manner. During the fourth quarter of 2016, our management intends to work to remediate the material weaknesses identified above, which will include the review and implementation of improvements to the segregation of duties as well as the review and implementation of improvements to the review and approval of financial reporting processes.

Despite the existence of the material weaknesses above, we believe that our Condensed Consolidated Financial Statements contained in this Form 10-Q fairly present our financial position, results of operations and cash flows as of and for the periods presented in all material respects.

Other than as described above, there has been no change in our internal control over financial reporting during the quarter ended September 30, 2016, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Controls

Management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. Controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

On June 30, 2016, the Plan became effective and the Company emerged from its Chapter 11 bankruptcy proceedings. Pursuant to the Plan, the Company consummated the transactions described below in the three months ended September 30, 2016.

- On various dates between July 1, 2016 and August 30, 2016, the Company issued 166,675 shares of common stock to the plaintiffs in litigation related to the Company's 2015 private financing transaction in accordance with a settlement stipulation. The Company was obligated to issue a total of 327,608 shares of common stock to such plaintiffs, and 160,933 shares were previously issued on June 30, 2016 in partial satisfaction of such obligation.
- On July 5, 2016, the Company issued 300,000 shares of common stock to the plaintiffs in class action litigation related to the events surrounding the Company's former Chairman and Chief Executive Officer.
- On July 13, 2016, the Company issued 3,750 shares of common stock to a former director in satisfaction of claims against the Company.

The common stock was issued under the Plan pursuant to an exemption from the registration requirements of the Securities Act under Section 1145 of the Bankruptcy Code, Section 4(a)(2) of the Securities Act, and/or Regulation D promulgated thereunder. Please see the Notes to the Condensed Consolidated Financial Statements in this Form 10-Q for more information regarding the Plan, the settlement stipulation and the class action litigation.

Item 6. Exhibits.

A list of exhibits is set forth on the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q, and is incorporated herein by reference.

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.

KALOBIOS PHARMACEUTICALS, INC.

Date: November 10, 2016

By: /s/ Cameron Durrant
Cameron Durrant
Chief Executive Officer
(Principal Executive Officer)

Date: November 10, 2016

By: /s/ David L. Tousley
David L. Tousley
Interim Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit No.	Description
2.1	Findings of Fact, Conclusions of Law, and Order Confirming Second Amended Chapter 11 Plan of Reorganization of the Registrant (incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K (File No. 001-035798) filed on June 22, 2016).
3.1	Amended and Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K (File No. 001-035798) filed on July 6, 2016).
10.1	Amendment to the 2012 Equity Incentive Plan, dated as of September 13, 2016 (incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form S-8 filed on October 14, 2016).
10.2	Employment Agreement, dated as of September 13, 2016, by and between the Company and Cameron Durrant, MD.
31.1	Certification of Chief Executive Officer of the Registrant, as required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Interim Chief Financial Officer of the Registrant, as required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification by the Chief Executive Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 36 of Title 18 of the United States Code (18 U.S.C. §1350).
32.2**	Certification by the Interim Chief Financial Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 36 of Title 18 of the United States Code (18 U.S.C. §1350).
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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** The Certifications attached as Exhibits 32.1 and 32.2 that accompanies this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of KaloBios Pharmaceuticals, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.

Exhibit 10.2

EMPLOYMENT AGREEMENT ("Agreement"), as of July 1, 2016, by and between KaloBios Pharmaceuticals, Inc., a Delaware corporation with offices at 1000 Marina Blvd, Suite 250, Brisbane, CA 94005 (the "Corporation"), and Dr. Cameron Durrant, an individual ("Executive").

W I T N E S S E T H

WHEREAS, Executive currently serves as the Chief Executive Officer of the Corporation pursuant to that certain Letter Agreement between the Corporation and Executive, dated March 1, 2016 (the "Prior Agreement");

WHEREAS, the Corporation desires to continue to employ Executive as its President and Chief Executive Officer upon the terms and conditions hereinafter set forth; and

WHEREAS, Executive desires to serve as the President and Chief Executive Officer of the Corporation upon the terms and conditions hereinafter set forth.

NOW, THEREFORE, the parties mutually agree as follows:

Section 1. Employment. Commencing on July 1, 2016 (hereinafter referred to as the "Effective Date"), the Corporation shall employ Executive and Executive shall commence such employment, as an executive of the Corporation, on the terms and conditions set forth in this Agreement.

Section 2. Duties. As of the Effective Date, Executive shall serve as President and Chief Executive Officer of the Corporation and shall, among other things, be responsible for all aspects of managing the Corporation including its employees and current product portfolio and shall properly perform such duties as may be assigned to him from time to time by the Corporation's Board of Directors (the "Board"). From and after the Effective Date and during the term of this Agreement, Executive shall devote substantially all of his business time to the performance of his duties hereunder, other than 5% for outside board duties unless otherwise authorized by the Board; provided, that Executive may not serve on any public company outside boards without the prior written consent of the Board.

Section 3. Term of Employment. Unless earlier terminated pursuant to the provisions of Section 5 hereof, the term of Executive's employment shall continue as of the Effective Date and shall continue until June 30, 2019, and shall automatically renew for successive (1) year terms unless not renewed by the Corporation upon no less than six (6) months advance written notice to Executive, or non-renewed by Executive upon no less than six (6) months advance written notice to the Corporation (the term of employment hereinafter referred to as the "Term").

Section 4. Compensation of Executive.

4.1. Compensation**.** As compensation for his services hereunder the Corporation shall pay Executive an annual salary ("Salary") equal to Six Hundred Thousand ($600,000) Dollars. The Salary shall be payable according to the salary payment cycle of the Corporation, less such deductions as shall be required to be withheld by applicable law and regulations. Upon each anniversary of the Effective Date during the term of this Agreement, Executive's Salary shall be reviewed by the Compensation Committee of the Board (the "Compensation Committee"), or earlier at the sole discretion of the Compensation Committee and the Board.

4.2. Bonus; Stock Options.

(a) In addition to his Salary, Executive may receive a cash or cash equivalent bonus ("Bonus") in respect of each calendar year during the Term, including, without limitation, calendar year 2016. The Bonus for each calendar year shall be determined by the Compensation Committee and the Board in their sole discretion. The Target Bonus shall be sixty percent (60%) of the Salary in any one year, with a maximum amount at the sole discretion of the Compensation Committee and the Board. Such Bonus may be a mix of cash and stock, as determined by the Board in its sole discretion; provided, that, with respect to calendar year 2016, Executive's Bonus, if any, shall be paid fifty percent (50%) in cash and fifty percent (50%) in shares of the Corporation's Common Stock, with the number of shares of stock to be determined by the Board based on the closing market price of the Corporation's Common Stock on the date the Bonus is approved by the Board. Objectives for the Bonus will be set and agreed to by the Board and Executive at the beginning of each calendar year. The Bonus for any particular calendar year, if any, will be paid by March 15 of the following calendar year. Notwithstanding anything contained in this Section 4.2(a) to the contrary, Executive's Bonus in respect of calendar year 2016 shall be determined based on Executive's achievement of performance objectives during the period commencing on July 1, 2016 and ending on December 31, 2016 (the "2016 Performance Period"), which performance objectives shall be agreed to by the Board and Executive, and the Bonus earned by Executive in respect of calendar year 2016, if any, shall be pro-rated based on the number of days in the 2016 Performance Period as compared to the total number of days in such calendar year.

(b) Subject to Compensation Committee and Board approval, Executive shall be eligible to receive, as promptly as possible following the Effective Date, an option to purchase one million and forty-three thousand, two hundred and twenty-two (1,043,022) shares of the Corporation's Common Stock, subject to and in accordance with the terms and provisions of the Corporation's 2012 Equity Incentive Plan, as amended (the "Plan") and the applicable award agreement. Such stock options will vest quarterly over three years in equal installments.

(c) Subject to Compensation Committee and Board approval, for each fiscal year during the term of his employment following the first fiscal year, Executive may be eligible to receive, at such time as the Compensation Committee and Board may deem appropriate, options to purchase additional shares of the Corporation's Common Stock in accordance with the terms and provisions of the Plan or any successor plan.

4.3. Expenses. The Corporation shall pay or reimburse Executive for all reasonable and necessary business, travel or other expenses incurred by him, upon proper documentation thereof, in accordance with the Corporation's travel and expense policy, which may be incurred by him in connection with the rendition of the services contemplated hereunder.

4.4. Benefits. From and after the Effective Date and during the Term, Executive shall be entitled to participate in such pension, profit sharing, group insurance, term life, option plans, hospitalization, and group health benefit plans and all other benefits and plans as the Corporation provides to its senior executives, subject to the terms and conditions of such plans.

4.5. Vacations. Executive shall be entitled to four (4) weeks of paid vacation during each calendar year of the Term, during which period his Salary shall be paid in full. Executive shall take his vacation at such time or times as Executive and the Corporation shall determine is mutually convenient. It is expected that vacation time for each calendar year will be taken in such calendar year and that unused vacation time shall not rollover to subsequent calendar years.

4.6. Sick Time. Executive shall be entitled to sick time in accordance with the Corporation's sick time policy.

Section 5. Termination.

5.1. Termination. This Agreement and Executive's employment hereunder shall terminate immediately upon: (i) Executive's death or Total Disability (as defined below); or (ii) termination of Executive's employment by the Corporation For Cause (as defined below); or (iii) termination of Executive's employment by the Corporation other than For Cause; or (iv) a Change in Control Termination (as defined below); or (v) termination of Executive's employment by Executive without Good Reason (as defined below); or (vi) termination of Executive's employment by Executive for Good Reason.

5.2. Termination Upon Death or Total Disability. In the event of a termination upon the death or Total Disability of Executive, the Corporation shall pay to Executive, or any person designated by Executive in writing or, if no such person is designated, to his estate, the Salary which has been earned but unpaid. As used herein, the term "Total Disability" shall mean that Executive is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one year.

5.3. Termination For Cause or without Good Reason. In the event Executive's employment is terminated by the Corporation For Cause or by Executive without Good Reason, Executive shall be paid his Salary through the date of termination. As used herein, the term "For Cause" shall mean (i) Executive's failure to perform Executive's material duties hereunder (other than such failure resulting from incapacity due to physical or mental illness); (ii) Executive's substantiated misappropriation of the Corporation's assets or substantiated perpetration of fraud against or proven dishonesty in dealings with the Corporation; (iii) Executive's plea of guilty or nolo contendere to, or conviction in a court of law of, any crime or offense which constitutes a felony, in each case whether or not involving the Corporation; (iv) Executive's willful misconduct; (v) Executive's habitual drunkenness or habitual use of illegal substances; (vi) Executive's failure to cooperate with a governmental or regulatory investigation concerning the Corporation or Executive; (vii) Executive's behavior which is materially detrimental to the Corporation's reputation; (viii) Executive's willful refusal to follow, or reckless disregard of, the policies and directives of the Corporation or the Board; or (ix) Executive's material breach of this Agreement, which material breach, if curable, is not cured within fifteen (15) calendar days after notice thereof by the Corporation. Whether a termination is "For Cause," as such term is defined in this Section 5.3, shall be determined by the Board in its sole discretion. For purposes of this Section 5.3, no act or failure to act by Executive shall be considered "willful" if such act is done by Executive in the good faith belief that such act is or was in the best interests of the Corporation or one or more of its businesses.

5.4. Termination for Good Reason. Executive may terminate this Agreement, upon notice to the Corporation, for Good Reason, which Good Reason is not remedied by the Corporation within thirty (30) calendar days after notice thereof by Executive. The term "Good Reason" shall include any of the following, (i) any assignment to Executive of duties inconsistent with Executive's position of President and Chief Executive Officer or which constitutes a significant reduction in authority, responsibilities, or status; (ii) any demotion, including, but not limited to, reporting to someone other than the Board; (iii) any material reduction in Executive's base salary, or other benefit plans available to executive officers of the Corporation, or the level, amount or value of any accrued benefit; or (iv) any attempted reduction of Executive's bonus potential which is inconsistent with the provisions of this Agreement.

5.5. Termination by the Corporation other than For Cause or by Executive for Good Reason. If, other than as set forth in Section 10.1, Executive's employment is terminated during the Term by the Corporation other than For Cause or by Executive as a result of Good Reason, then the Corporation shall pay to Executive after such termination, subject to his execution and non-revocation of the release described in Section 5.6, severance payments ("Severance") equal to (i) twelve (12) months of Executive's Salary for the year in which the termination for Good Reason occurs plus (ii) the amount of the actual bonus earned by Executive under Section 4.2(a) hereof for the year prior to the year of termination, pro-rated based on the number of days Executive was employed by the Corporation during the year of termination as compared to the total number of days in such year. The Severance shall be paid in a lump sum within thirty (30) days after the Release Effective Date (as defined below), less such deductions as shall be required to be withheld by applicable law and regulations. In addition, if Executive timely and properly elects continuation coverage under the Consolidated Omnibus Reconciliation Act of 1985 ("COBRA"), then, subject to his execution and non-revocation of the release described in Section 5.6, the Corporation shall reimburse Executive for the monthly COBRA premium paid by Executive for Executive and Executive's eligible dependents. Executive shall be eligible to receive such reimbursement until the earliest of: (x) the twelve (12) month anniversary of the date of Executive's termination of employment; (y) the date Executive is no longer eligible to receive COBRA continuation coverage; or (z) the date on which Executive either receives or becomes eligible to receive substantially similar coverage from another employer.

5.6. Release. Executive agrees that, as a condition to receiving the payments and benefits set forth in Section 5.5 or Section 10.1, as applicable, Executive will execute a release of claims substantially in the form of the release attached hereto as Exhibit A. Within five business days of the date of Executive's termination of employment, the Corporation shall deliver to Executive the release for Executive to execute. Executive will forfeit all rights to the payments and benefits set forth in Section 5.5 or Section 10.1, as applicable, unless, within sixty (60) days of delivery of the release by the Corporation to Executive, Executive executes and delivers the release to the Corporation and such release has become irrevocable by virtue of the expiration of the revocation period without the release having been revoked (the first such date, the "Release Effective Date"). In the event that the Release Effective Date could occur in one of two taxable years of Executive, the Release Effective Date shall be deemed to occur on the earliest date in the later such taxable year as otherwise would apply hereunder. The Corporation shall have no obligation to provide the payments and benefits set forth in Section 5.5 or Section 10.1, as applicable, prior to the Release Effective Date.

Section 6. Confidential Information; Restrictive Covenants.

6.1. Disclosure. Executive hereby acknowledges that he will acquire confidential information concerning the Corporation, its business, products, product development, formulas, research and development, know-how, names and contact information of the Corporation's customers, suppliers, contract manufacturers, and vendors, and the Corporation's current and future business plans and that, among other things, his knowledge of the Corporation's business will be enhanced through his employment by the Corporation. Executive acknowledges that such information is of great value to the Corporation, is the sole property of the Corporation, other than those customers, suppliers, contract manufacturers, and vendors introduced to the Corporation by Executive, and has been and will be acquired by him in confidence.

6.2. Confidentiality. In consideration of the obligations undertaken by the Corporation herein, Executive will not, at any time during or after the Term, directly or indirectly, use for Executive's own benefit or any other party's benefit, or reveal, divulge or make known to any person, any information which is treated as confidential by the Corporation and not otherwise in the public domain. Confidential information shall not include information which was previously known by Executive, information which was given to Executive by any third party under no obligation of confidentiality, or information which Executive is required to disclose as a result of a governmental investigation or by a court order. Executive agrees that all materials or copies thereof containing confidential information of the Corporation in Executive's custody or possession will not, at any time, be removed from the Corporation's premises without the prior written consent of the Board. The parties hereto acknowledge that pursuant to 18 USC § 1833(b), an individual may not be held liable under any criminal or civil federal or state trade secret law for disclosure of a trade secret: (i) made in confidence to a government official, either directly or indirectly, or to an attorney, solely for the purpose of reporting or investigating a suspected violation of law or (ii) in a complaint or other document filed in a lawsuit or other proceeding, if such filing is made under seal. The parties hereto further acknowledge that an individual suing an employer for retaliation based on the reporting of a suspected violation of law may disclose a trade secret to his or her attorney and use the trade secret information in the court proceeding, so long as any document containing the trade secret is filed under seal and the individual does not disclose the trade secret except pursuant to court order.

6.3. Restrictive Covenants. Executive recognizes that the services to be performed by him hereunder are special, unique and extraordinary. The parties confirm that it is reasonably necessary for the protection of the Corporation that Executive agrees, and, accordingly, Executive does hereby agree, that he will not, either on Executive's own behalf or as an officer, director, stockholder, partner, principal, consultant, associate, employee, owner, agent, creditor, independent contractor, or co-venturer of any third party or in any other relationship or capacity, directly or indirectly, at any time during his employment and for the Restricted Period (as defined below) solicit, induce, persuade or encourage, or attempt to solicit, induce, persuade or encourage, any individual employed by the Corporation, with whom Executive has worked, to terminate such employee's position with the Corporation, whether or not such employee is a full-time or temporary employee of the Corporation and whether or not such employment is pursuant to a written agreement, for a determined period, or at will. The provisions of this Section 6.3 shall only apply to those individuals employed by the Corporation at the time of solicitation or attempted solicitation.

6.4. Restricted Period. "Restricted Period" shall mean the term following Executive's employment to last for as long as Executive receives Severance or his regular Salary and benefits from the Corporation.

6.5. Modification of Restrictions. If any of the restrictions contained in this Section 6 shall be deemed to be unenforceable by reason of the extent, duration or geographical scope thereof, or otherwise, then after such restrictions have been reduced so as to be enforceable, in its reduced form this Section shall then be enforceable in the manner contemplated hereby.

Section 7. Work for Hire.

7.1. Executive agrees to make full and prompt disclosure to the Corporation of all inventions, improvements, discoveries, methods, developments, formulas, computer software (and programs and code) and works of authorship, whether or not patentable or copyrightable, which were or are created, made, conceived or reduced to practice by Executive or under Executive's direction or jointly with others during Executive's employment by the Corporation, whether or not during normal working hours or on the premises of the Corporation (all of which are collectively referred to in this Agreement as "Developments").

7.2. Executive agrees to assign and, by executing this Agreement, Executive does hereby assign, to the Corporation (or to any person or entity designated by the Corporation) all of Executive's rights, titles and interests, if any, in and to all Developments and all related patents, patent applications, copyrights and copyright applications. However, this Section 7.2 shall not apply to Developments (i) which do not relate to the present or planned business or research and development of the Corporation and (ii) which are made and conceived by Executive: (A) at a time other than during normal working hours, (B) not on the Corporation's premises and (C) not using the Corporation's tools, devices, equipment or proprietary information. Executive understands that to the extent that the terms of this Agreement shall be construed in accordance with the laws of any state which precludes a requirement in an employment agreement to assign certain classes of inventions made by an employee, this Section 7 shall be interpreted not to apply to any invention which a court rules and/or the Corporation agrees falls within such class or classes. Executive also agrees to waive all claims to moral and/or equitable rights in any Developments.

7.3. Executive agrees to cooperate fully with the Corporation, both during and after Executive's employment with the Corporation, with respect to the procurement, maintenance and enforcement of copyrights, patents and other intellectual property rights (both in the United States and foreign countries) relating to Developments. Executive agrees that he will sign all papers, including, without limitation, copyright applications, patent applications, declarations, oaths, formal assignments, assignments of priority rights, and powers of attorney, which the Corporation may deem necessary or desirable in order to protect its rights and interests in any Development. Executive further agrees that if the Corporation is unable, after reasonable effort, to secure Executive's signature on any such papers, any executive officer of the Corporation shall be entitled to execute any such papers as Executive's agent and attorney-in-fact, and Executive hereby irrevocably designates and appoints each executive officer of the Corporation as Executive's agent and attorney-in-fact to execute any such papers on Executive's behalf, and to take any and all actions as the Corporation may deem necessary or desirable, in order to protect its rights and interests in any Development, under the conditions described in this sentence.

Section 8. Conflicts of Interest; Insider Trading.

8.1. Conflicts of Interest. Further, in order to avoid actual or apparent conflicts of interest, except with the Corporation's consent, Executive shall not have any direct or indirect ownership or financial interest in any company, person or entity which is: (i) a service provider to, or vendor of the Corporation; (ii) a customer of the Corporation; or (iii) a competitor of the Corporation. Executive shall not be deemed to have any direct or indirect ownership or financial interest for any such interest that does not exceed five (5%) percent of the issued and outstanding voting securities of any class of any corporation whose voting capital stock is traded on a national securities exchange or in the over-the-counter market.

8.2. General Requirements. Executive shall observe such lawful policies of the Corporation as may from time to time be in effect.

8.3. Insider Trading. Considering that the Corporation is a publicly-traded corporation, Executive hereby agrees that Executive shall comply with the Corporation's Insider Trading Policy and any and all federal and state securities laws, including but not limited to those that relate to non-disclosure of information, insider trading and individual reporting requirements and shall specifically abstain from discussing the non-public aspects of the Corporation's business affairs with any individual or group of individuals (e.g., Internet chat rooms) who does not have a business need to know such information for the benefit of the Corporation. Executive hereby agrees to immediately notify the Corporation's Compliance Officer or Chief Financial Officer in accordance with the Corporation's Insider Trading Policy prior to Executive's acquisition or disposition of Corporation's securities.

Section 9. Indemnification.

9.1. Indemnification. The Corporation hereby agrees to indemnify and hold harmless Executive to the fullest extent permitted by the Corporation's Certificate of Incorporation, By-Laws, the Delaware General Corporation Law or any other applicable law, as any or all may be amended from time to time. Such reimbursements shall include but not be limited to Executive's reasonable and necessary out of pocket expenses including attorneys and expert fees, losses, judgments, claims, and settlement payments and any other such costs and expenses.

9.2. Undertaking. To the extent that the Corporation advances payment for any fees or expenses to Executive pursuant to this Section 9, such advance shall be accompanied by a written undertaking by Executive to repay such amounts if it shall be ultimately determined by a court of competent jurisdiction in a final disposition, that Executive (i) is not entitled to be indemnified by the Corporation or (ii) that the amount advanced exceeded the indemnification to which he is entitled, in which case the amount of such excess shall be repaid to the Corporation.

9.3. Notice. As a condition precedent to his right to be indemnified hereunder, Executive shall give the Corporation notice in writing as soon as practicable of any claim made against him for which indemnity will or could be sought under this Agreement.

9.4. Cooperation. Executive shall fully cooperate with the Corporation in connection with any matter, which results in the assertion of a claim by Executive for indemnification hereunder. The Corporation shall be entitled at its own expense to participate in the defense of any proceeding, claim or action, or, if it shall elect, to assume such defense, in which event such defense shall be conducted by counsel chosen by the Corporation, subject to the consent of Executive, which consent shall not be unreasonably withheld or delayed.

9.5. Exceptions. The Corporation shall not be liable under this Agreement to make any payment in connection with any claim:

(a) For which payment is actually made to Executive under valid and collectable insurance policies, the premiums of which are paid by the Corporation or any of its affiliates, except in respect of any deductible and excess beyond the amount of payment under such insurance;

(b) For which Executive is indemnified by the Corporation otherwise than pursuant to this Agreement, provided such amount has previously been paid to Executive;

(c) Brought about or contributed to by the dishonesty of Executive;

(d) For which Executive fails to cooperate in a criminal or civil investigation involving the claim; and

(e) By Executive who acts as a plaintiff suing the Corporation, its affiliates or directors, officers or shareholders of the Corporation or its affiliates, except with regard to Executive's successful enforcement of Section 9.1 hereof**.**

9.6. Survival. The obligations of the Corporation hereunder will survive (i) any actual or purported termination of this Agreement by the Corporation or its successors or assigns, whether by operation of law or otherwise, (ii) any change in the Corporation's Certificates of Incorporation or By-laws, and (iii) termination of Executive's services to the Corporation or its affiliates (whether such services were terminated by the Corporation, such affiliate or Executive), if such claim arises as a result of an occurrence prior to the termination of this Agreement, whether or not a claim is made or an action or proceeding is threatened or commenced before or after the actual or purported termination of this Agreement, change in the Corporation's Certificate of Incorporation or By-laws, or termination of Executive's services.

Section 10. Change in Control.

10.1. Payment on Change in Control Termination. The Corporation will provide or cause to be provided to Executive the rights and benefits described below if, during the Term, within the three (3) month period prior to and the twelve (12) month period following a Change in Control, (x) Executive terminates his employment for Good Reason, or (y) the Corporation or its successor terminates Executive's employment ("Change in Control Termination"); provided however, that a Change in Control Termination shall not include a termination For Cause or a termination as a result of Executive's death or Total Disability. In the event of a Change in Control Termination during the Term, the Corporation shall pay or cause its successor to pay to Executive, in cash, in a lump sum within thirty (30) days after the Release Effective Date, less such deductions as shall be required to be withheld by applicable law and regulations, and subject to his execution and non-revocation of the release described in Section 5.6, an amount equal to two (2) times Executive's base compensation which equals the sum of the following: (i) Executive's annual Salary on the day preceding the Change in Control Termination, plus (ii) an amount equal to the aggregate bonus received by Executive for the year immediately preceding the Change in Control Termination or if no Bonus had been received, then at minimum fifty percent (50%) of the Target Bonus. In addition, if Executive timely and properly elects continuation coverage under COBRA, then, subject to his execution and non-revocation of the release described in Section 5.6, the Corporation shall reimburse Executive for the monthly COBRA premium paid by Executive for Executive and Executive's eligible dependents. Executive shall be eligible to receive such reimbursement until the earliest of: (x) the eighteen (18) month anniversary of the date of Executive's termination of employment; (y) the date Executive is no longer eligible to receive COBRA continuation coverage; or (z) the date on which Executive either receives or becomes eligible to receive substantially similar coverage from another employer. In addition, in the event of a Change in Control Termination, subject to Executive's execution and non-revocation of the release described in Section 5.6, any and all outstanding stock options held by Executive shall become fully vested and exercisable. Executive shall have six (6) months to exercise any such stock options following his termination of employment, provided that in no event may Executive exercise a stock option following the original expiration date of such stock option as set forth in the applicable award agreement.

10.2. Change in Control Defined. A "Change in Control" shall be deemed to occur upon the earliest to occur after the date of this Agreement of any of the following events;

(a) Any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) becomes the "beneficial owner" (as defined in Rule 13d-3 of the Exchange Act), directly or indirectly, of securities of the Corporation representing more than fifty percent (50%) of the total voting power represented by the Corporation's then-outstanding voting securities;

(b) The consummation of the sale or disposition by the Corporation of all or substantially all of the Corporation's assets;

(c) The consummation of a merger or consolidation of the Corporation with or into any other entity, other than a merger or consolidation which would result in the voting securities of the Corporation outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or its parent) more than fifty percent (50%) of the total voting power represented by the voting securities of the Corporation or such surviving entity or its parent outstanding immediately after such merger or consolidation; or

(d) Individuals who are members of the Board (the "Incumbent Board") cease for any reason to constitute at least a majority of the members of the Board over a period of 12 months; provided, however, that if the appointment or election (or nomination for election) of any new Board member was approved or recommended by a majority vote of the members of the Incumbent Board then still in office, such new member shall, for purposes of this Plan, be considered as a member of the Incumbent Board.

A transaction shall not constitute a Change in Control if its sole purpose is to change the state of the Corporation's incorporation or to create a holding company that will be owned in substantially the same proportions by the persons who held the Corporation's securities immediately before such transaction.

Section 11. Miscellaneous.

11.1. Section 409A. The parties intend for the payments and benefits under this Agreement to be exempt from Section 409A of the Internal Revenue Code ("Section 409A") or, if not so exempt, to be paid or provided in a manner which complies with the requirements of such section, and intend that this Agreement shall be construed and administered in accordance with such intention. Any payments that qualify for the "short-term deferral" exception or another exception under Section 409A shall be paid under the applicable exception. For purposes of the limitations on nonqualified deferred compensation under Section 409A, each payment of compensation under this Agreement shall be treated as a separate payment of compensation. All in-kind benefits, reimbursements, and tax-gross-ups (if any) to be provided under this Agreement shall be made or provided in accordance with the requirements of Section 409A of the Code, including, where applicable, the requirements that (x) the amount of expenses eligible for reimbursement, or in kind benefits provided, during a calendar year may not affect the expenses eligible for reimbursement, or in kind benefits to be provided, in any other calendar year, (y) the reimbursement of an eligible expense will be made no later than the last day of the calendar year following the year in which the expense is incurred, and (z) the right to reimbursement or in kind benefits is not subject to liquidation or exchange for another benefit. Notwithstanding anything contained herein to the contrary, to the extent required in order to avoid accelerated taxation and/or tax penalties under Section 409A, (i) no amounts payable under this Agreement to Executive on termination of employment shall be paid until Executive would be considered to have incurred a separation from service from the Corporation within the meaning of Section 409A and (ii) amounts that would otherwise be payable and benefits that would otherwise be provided pursuant to this Agreement during the Applicable Period (as defined below) shall instead be paid on the first business day after the expiration of the Applicable Period, with interest from the date such amounts would otherwise have been paid at the short-term applicable federal rate, compounded semi-annually, as determined under Section 1274 of the Internal Revenue Code of 1986, as amended, for the month in which payment would have been made but for the delay in payment required to avoid the imposition of an additional rate of tax on Executive under Section 409A. The "Applicable Period" shall be the period commencing on Executive's separation from service and ending on the date that is six (6) months following Executive's separation from service.

11.2. Survival. The provisions of Sections 5, 6.1, 6.2, 6.4, 6.5, 7, 8, 9, 10 and 11 shall indefinitely survive Executive's employment with the Corporation. The provisions of Section 6.3 shall survive for the Restricted Period, as defined therein.

11.3. Injunctive Relief. Executive agrees that any breach or threatened breach by him of Sections 6, 7 or 8 of this Agreement shall entitle the Corporation, in addition to all other legal remedies available to it, to apply to any court of competent jurisdiction to enjoin such breach or threatened breach without proving actual damage or posting a bond or other security. The parties understand and intend that each restriction agreed to by Executive herein shall be construed as separable and divisible from every other restriction, that the unenforceability of any restriction shall not limit the enforceability, in whole or in part, of any other restriction, and that one or more or all of such restrictions may be enforced in whole or in part as the circumstances warrant. In the event that any restriction in this Agreement is more restrictive than permitted by law in the jurisdiction in which the Corporation seeks enforcement thereof, such restriction shall be limited to the extent permitted by law.

11.4. Entire Agreement. This Agreement constitutes and embodies the entire and complete understanding and agreement of the parties with respect to Executive's employment by the Corporation, supersedes all prior understandings and agreements, if any, whether oral or written, between Executive and the Corporation, including, without limitation, the Prior Agreement, and shall not be amended, modified or changed except by an instrument in writing executed by the party to be charged. The invalidity or partial invalidity of one or more provisions of this Agreement shall not invalidate any other provision of this Agreement. No waiver by either party of any provision or condition to be performed shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or any prior or subsequent time.

11.5. Assignment; Binding Effect. Executive may not assign or delegate any of his or duties under this Agreement. This Agreement shall inure to the benefit of, be binding upon and enforceable against, the parties hereto and their respective successors and permitted assigns.

11.6. Captions. The captions contained in this Agreement are for convenience of reference only and shall not affect in any way the meaning or interpretation of this Agreement.

11.7. Notices. All notices, requests, demands and other communications required or permitted to be given hereunder shall be in writing and shall be deemed to have been duly given when personally delivered or sent by fax or certified, mail, postage prepaid, to the party at the address set forth above or to such other address as either party may hereafter give notice of in accordance with the provisions hereof.

11.8. Governing Law. This Agreement shall be governed by and interpreted under the laws of the State of California applicable to contracts made and to be performed therein without giving effect to the principles of conflict of laws thereof. Except in respect of any action commenced by a third party in another jurisdiction, the parties hereto agree that any legal suit, action, or proceeding against them arising out of or relating to this Agreement may be brought in the United States Federal Courts in the State of California or the state courts, in the State of California. By its execution hereof, the parties hereby irrevocably waive any objection and any right of immunity on the ground of venue, the convenience of the forum or the jurisdiction of such courts or from the execution of judgments resulting therefrom. The parties hereby irrevocably accept and submit to the jurisdiction of the aforesaid courts in any such suit, action or proceeding.

11.9. Waiver of Jury Trial. THE PARTIES HEREBY WAIVE ANY RIGHT TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING ARISING OUT OF OR RELATING TO THIS AGREEMENT OR ANY TRANSACTION CONTEMPLATED HEREBY, WHETHER NOW EXISTING OR HEREAFTER ARISING, AND WHETHER SOUNDING IN CONTRACT, TORT OR OTHERWISE. THE PARTIES AGREE THAT ANY OF THEM MAY FILE A COPY OF THIS PARAGRAPH WITH ANY COURT AS WRITTEN EVIDENCE OF THE KNOWING, VOLUNTARY AND BARGAINED-FOR AGREEMENT AMONG THE PARTIES IRREVOCABLY TO WAIVE TRIAL BY JURY AND THAT ANY ACTION OR PROCEEDING WHATSOEVER BETWEEN THEM RELATING TO THIS AGREEMENT OR ANY TRANSACTION CONTEMPLATED HEREBY SHALL INSTEAD BE TRIED IN A COURT OF COMPETENT JURISDICTION BY A JUDGE SITTING WITHOUT A JURY.

11.10. Counterparts. This Agreement may be executed and delivered in counterparts, including by facsimile transmission or portable document format (".pdf"), each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date set forth above.

KalaBios Pharmaceuticals, Inc.

By: /s/ Timothy Morris
Timothy Morris, Chair of Compensation Committee
Date:

Executive

By: /s/ Cameron Durrant
Dr. Cameron Durrant
Date: September 13, 2016

EXHIBIT A

General Release of Claims

You, for yourself, your spouse and your agents, successors, heirs, executors, administrators and assigns, hereby irrevocably and unconditionally forever release and discharge KaloBios Pharmaceuticals, Inc. (the "Corporation"), its parents, divisions, subsidiaries and affiliates and its and their current and former owners, directors, officers, stockholders, insurers, benefit plans, representatives, agents and employees, and each of their predecessors, successors, and assigns (collectively, the "Releasees"), from any and all actual or potential claims or liabilities of any kind or nature, including, but not limited to, any claims arising out of or related to your employment and separation from employment with the Corporation and any services that you provided to the Corporation; any claims for salary, commissions, bonuses, other severance pay, vacation pay, allowances or other compensation, or for any benefits under the Employee Retirement Income Security Act of 1974 ("ERISA") (except for vested ERISA benefits); any claims for discrimination, harassment or retaliation of any kind or based upon any legally protected classification or activity; any claims under Title VII of the Civil Rights Acts of 1964, the Civil Rights Act of 1866 and 1964, as amended, 42 U.S.C. § 1981, the Age Discrimination in Employment Act, the Older Workers Benefit Protection Act, the Americans with Disabilities Act, 42 U.S.C. §1981, 42 U.S.C. § 1983, the Family Medical Leave Act and any similar state law, the Fair Credit Reporting Act and any similar state law, the Fair Credit Reporting Act, 15 U.S.C. § 1681, et seq., the Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101, et seq., the Equal Pay Act and any similar state law, including the California Worker Adjustment and Retraining Notification Act, Cal. Labor Code § 1400, et seq., the California Fair Employment and Housing Act, Cal. Gov't Code § 12940, et seq., California Government Code Section 12900 et seq. (which prohibits discrimination based on protected characteristics including race, color, religion, sex, gender, sexual orientation, marital status, national origin, language restrictions, ancestry, physical or mental disability, medical condition, age, and denial of leave), California Civil Code Section 51 et seq. (which prohibits discrimination based on age, sex, race, color, religion, ancestry, national origin, disability, medical condition, marital status, or sexual orientation), the California Family Rights Act of 1993, the California Equal Pay Law, Cal. Lab. Code § 1197.5, et seq. or any California wage payment law, any other section of the California Labor Code, or any section of the applicable Order of the California Industrial Welfare Commission, as well as any amendments to any such laws; any claims for any violation of any federal or state constitutions or executive orders; any claims for wrongful or constructive discharge, violation of public policy, breach of contract or promise (oral, written, express or implied), personal injury not covered by workers' compensation benefits, misrepresentation, negligence, fraud, estoppel, defamation, infliction of emotional distress, contribution and any claims under any other federal, state or local law, including those not specifically listed in this Release, that you, your heirs, executors, administrators, successors, and assigns now have, ever had or may hereafter have, whether known or unknown, suspected or unsuspected, up to and including the date of your execution of this Release.

For the purpose of implementing a full and complete release and discharge of the Releasees as set forth above, you acknowledge that this Release is intended to include in its effect, without limitation, all claims known or unknown that you have or may have against the Releasees which arise out of or relate to your employment, including but not limited to compensation, performance or termination of employment with the Corporation, except for, and notwithstanding anything in this Release to the contrary, claims which cannot be released solely by private agreement. This Release also excludes any claims relating to any right you may have to payments pursuant to Section 5.5 or Section 10.1, as applicable of the Employment Agreement, entered into as of _____, 2016, by and between the Corporation and you, any claim for workers' compensation benefits and any rights you may have to indemnification or directors' and officers' liability insurance under the Corporation's bylaws or certificate of incorporation, any indemnification agreement to which you are a party or beneficiary or applicable law, as a result of having served as an officer, director or employee of the Corporation or any of its affiliates. You further acknowledge and agree that you have received all leave, compensation and reinstatement benefits to which you were entitled through the date of your execution of this Release, and that you were not subjected to any improper treatment, conduct or actions as a result of a request for leave, compensation or reinstatement.

You further acknowledge that you have read Section 1542 of the Civil Code of the State of California, which provides as follows:

A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS OR HER FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM OR HER MUST HAVE MATERIALLY AFFECTED HIS OR HER SETTLEMENT WITH THE DEBTOR.

You understand that Section 1542 gives you the right not to release existing claims of which you are not now aware, unless you voluntarily choose to waive this right. **Even though you are aware of this right, you nevertheless hereby voluntarily waive the right described in Section 1542 and any other statutes of similar effect, and elect to assume all risks for claims that now exist in your favor*, known or unknown*, arising from the subject matter of the Release.** You acknowledge that different or additional facts may be discovered in addition to what you now know or believe to be true with respect to the matters released in this Release, and you agree that this Release will be and remain in effect in all respects as a complete and final release of the matters released, notwithstanding any such different or additional facts.

You affirm, by signing this Release, that you have not suffered any unreported injury or illness arising from your employment, and that you have not filed, with any federal, state, or local court or agency, any actions or charges against the Releasees relating to or arising out of your employment with or separation from the Corporation. You further agree that while this Release does not preclude you from filing a charge with the National Labor Relations Board ("NLRB"), the Equal Employment Opportunity Commission ("EEOC") or a similar state or local agency, or from participating in any investigation or proceeding with them, you do waive your right to personally recover monies or reinstatement as a result of any complaint or charge filed against the Corporation with the NLRB, EEOC or any federal, state or local court or agency, except as to any action to enforce or challenge this Release, to recover any vested benefits under ERISA, or to recover workers' compensation benefits.

You acknowledge:

(a) That you were provided **[**twenty-one (21) / forty-five (45)**]** full days during which to consider whether to sign this Release. If you have signed this Agreement prior to the expiration of the **[**21-day / 45-day**]** period, you have voluntarily elected to forego the remainder of that period.

(b) That you have carefully read and fully understand all of the terms of this Release **[**, including its Attachment A**]**.

(c) That you understand that by signing this Release, you are waiving your rights under the Age Discrimination in Employment Act, as amended by the Older Workers Benefit Protection Act, 29 U.S.C. § 621, et seq., and that you are not waiving any rights arising after the date that this Release is signed.

(d) That you have been given an opportunity to consult with anyone you choose, including an attorney, about this Release.

(e) That you understand fully the terms and effect of this Release and know of no claim that has not been released by this Release. And, you further acknowledge that you are not aware of, or that you have fully disclosed to the Corporation, any matters for which you are responsible or which has come to your attention as an employee of the Corporation that might give rise to, evidence, or support any claim of illegal conduct, regulatory violation, unlawful discrimination, or other cause of action against the Corporation.

(f) That these terms are final and binding on you.

(g) That you have signed this Release voluntarily, and not in reliance on any representations or statements made to you by any employee or officer of the Corporation or any of its subsidiaries.

(h) That you have seven (7) days following your execution of this Release to revoke it in writing, and that this Release is not effective or enforceable until after this seven (7) day period has expired without revocation. If you wish to revoke this Release after signing it, you must provide written notice of your decision to revoke this Release to the Corporation, to the attention of the Chair of the Compensation Committee pursuant to customary communications between you and such Chair, by no later than 11:59 p.m. on the seventh calendar day after the date on which you have signed this Release.

PLEASE READ CAREFULLY. THIS RELEASE INCLUDES A RELEASE OF ALL KNOWN AND UNKNOWN CLAIMS.

ACKNOWLEDGED AND AGREED

Dr. Cameron Durrant Date

Exhibit 31.1

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATIONS

I, Cameron Durrant, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of KaloBios Pharmaceuticals, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2016

/s/ Cameron Durrant
Cameron Durrant,
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002
CERTIFICATIONS

I, David L. Tousley, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of KaloBios Pharmaceuticals, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 10, 2016

/s/ David L. Tousley
David L. Tousley
Interim Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit 32.1

CERTIFICATION OF
PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Cameron Durrant, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of KaloBios Pharmaceuticals, Inc. for the quarter ended September 30, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of KaloBios Pharmaceuticals, Inc.

By: /s/ Cameron Durrant
Name: Cameron Durrant
Title: Chief Executive Officer
(Principal Executive Officer)
Date: November 10, 2016

Exhibit 32.2

CERTIFICATION OF
PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, David L. Tousley, certify, to the best of my knowledge, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of KaloBios Pharmaceuticals, Inc. for the quarter ended September 30, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of KaloBios Pharmaceuticals, Inc.

By:	/s/ David L. Tousley
Name:	David L. Tousley
Title:	Interim Chief Financial Officer (Principal Financial and Accounting Officer)
Date:	November 10, 2016