UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2004

or

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

Commission File Number: 000-21088

VICAL INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware	**93-0948554**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
10390 Pacific Center Court, San Diego, California	**92121**
(Address of principal executive offices)	(Zip code)

(858) 646-1100
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes☒ No ☐

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

Total shares of common stock outstanding at May 3, 2004: 23,475,016

VICAL INCORPORATED

FORM 10-Q

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Part I. Financial Information
Item 1. Financial Statements

VICAL INCORPORATED
BALANCE SHEETS
(Unaudited)

	March 31, 2004	December 31, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 21,526,823	$ 16,573,912
Cash equivalents—restricted	—	2,355,700
Marketable securities—available-for-sale	68,733,423	65,588,091
Marketable securities—restricted	3,813,859	—
Receivables and other	5,269,331	5,386,211
Total current assets	99,343,436	89,903,914
Property and Equipment:		
Equipment	15,886,483	17,922,355
Leasehold improvements	11,469,184	8,426,848
	27,355,667	26,349,203
Less—accumulated depreciation and amortization	(12,758,849)	(12,013,962)
	14,596,818	14,335,241
Intangible Assets, net	5,851,966	5,870,123
Other Assets	539,499	597,912
	$ 120,331,719	$ 110,707,190
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable and accrued expenses	$ 5,164,186	$ 5,626,914
Current portion of capital lease obligations	4,332,570	3,918,118
Current portion of notes payable	247,619	340,476
Current portion of deferred revenue	2,315,734	2,337,019
Total current liabilities	12,060,109	12,222,527
Long-Term Obligations:		
Long-term obligations under capital leases	7,269,330	7,196,376
Deferred revenue	—	131,130
Deferred lease credits	2,401,830	1,334,880
Total long-term obligations	9,671,160	8,662,386
Commitments and Contingencies		
Stockholders' Equity:		
Preferred stock, $0.01 par value—5,000,000 shares authorized— none outstanding	—	—
Common stock, $0.01 par value—40,000,000 shares authorized— 23,474,244 and 20,092,594 shares issued and outstanding at March 31, 2004, and December 31, 2003, respectively	234,742	200,926
Additional paid-in capital	220,955,271	203,607,418
Accumulated other comprehensive income	1,269,300	798,223
Accumulated deficit	(123,858,863)	(114,784,290)
Total stockholders' equity	98,600,450	89,822,277
	$ 120,331,719	$ 110,707,190

See accompanying notes to financial statements.

VICAL INCORPORATED
STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended March 31,	
	2004	2003
Revenues:		
License and royalty revenue	$ 622,120	$ 495,982
Contract revenue	287,063	412,352
	909,183	908,334
Operating expenses:		
Research and development	8,175,248	6,583,390
General and administrative	1,946,261	1,540,363
Write-down of investment	—	482,217
	10,121,509	8,605,970
Loss from operations	(9,212,326)	(7,697,636)
Other income (expense):		
Investment income	300,344	743,740
Interest expense	(162,591)	(71,001)
Net loss	$ (9,074,573)	$ (7,024,897)
Net loss per common share (basic and diluted-Note 4)	$ (0.45)	$ (0.35)
Weighted average shares used in computing net loss per common share (Note 4)	20,316,597	20,091,344

See accompanying notes to financial statements.

VICAL INCORPORATED
STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended March 31,	
	2004	2003
OPERATING ACTIVITIES:		
Net loss	$ (9,074,573)	$ (7,024,897)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	912,414	973,633
Write-down of investment	—	482,217
Loss on sublease	—	32,000
Compensation expense related to grant of stock options	33,814	(11,133)
Compensation expense related to restricted stock awards	43,588	—
Deferred lease credits	66,950	90,956
Change in operating assets and liabilities:		
Receivables and other	116,880	(326,053)
Other assets	58,413	(129,142)
Accounts payable and accrued expenses	537,272	(528,221)
Deferred revenue	(152,415)	(11,227)
Net cash used in operating activities	(7,457,657)	(6,451,867)
INVESTING ACTIVITIES:		
Sales of marketable securities	15,623,769	29,399,897
Sales of restricted cash equivalents	2,355,700	—
Purchases of marketable securities	(18,298,024)	(37,300,917)
Purchases of restricted marketable securities	(3,813,859)	—
Capital expenditures	443,637	(2,750,932)
Licensed technology expenditures	—	(80,000)
Patent expenditures	(141,311)	(227,617)
Net cash used in investing activities	(3,830,088)	(10,959,569)
FINANCING ACTIVITIES:		
Issuance of common stock, net	17,304,267	—
Payments on notes payable	(92,857)	(164,285)
Principal payments under capital lease obligations	(970,754)	(309,978)
Net cash provided from (used in) financing activities	16,240,656	(474,263)
Net increase (decrease) in cash and cash equivalents	4,952,911	(17,885,699)
Cash and cash equivalents at beginning of period	16,573,912	32,608,954
Cash and cash equivalents at end of period	$ 21,526,823	$ 14,723,255
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for interest	$ 199,087	$ 71,580
Non-Cash Investing and Financing Activities:		

Investment accounted for on the cost method, subsequently reclassified to marketable securities available-for-sale, at quoted market value	$ —	$ 317,783
Property and equipment acquired under capital lease financing	$ 1,458,159	$ 123,604

See accompanying notes to financial statements.

VICAL INCORPORATED

NOTES TO FINANCIAL STATEMENTS

March 31, 2004
(Unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

Vical Incorporated, or the Company, was incorporated in April 1987 and has devoted substantially all of its resources since that time to its research and development programs. The Company researches and develops potential biopharmaceutical products based on its patented DNA delivery technologies for the prevention and treatment of serious or life-threatening diseases.

Basis of Presentation

The information contained herein has been prepared in accordance with instructions for Form 10-Q. The information at March 31, 2004, and for the three-month periods ended March 31, 2004 and 2003, is unaudited. In the opinion of management, the information reflects all adjustments necessary to present fairly the Company's financial position and results of operations for the interim periods presented. All such adjustments are of a normal recurring nature. Interim results are not necessarily indicative of results for a full year. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2003, included in its Form 10-K filed with the Securities and Exchange Commission, or SEC.

2. CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company invests its excess cash in debt instruments of financial institutions and of corporations with strong credit ratings, in U.S. government obligations, and in money market funds and certificates of deposit in financial institutions. The Company has established guidelines relative to investment ratings, diversification and maturities that maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. Cash equivalents are short-term, highly liquid investments with original maturities at time of purchase of less than three months. Cash equivalents consist primarily of commercial paper, corporate asset backed securities, federal agency discount notes and money market funds.

The Company classifies its cash equivalents and marketable securities as available-for-sale or restricted. Unrealized holding gains or losses, net of related tax effect, are recorded as a separate component of stockholders' equity. Realized gains or losses are calculated based on the specific identification method. A decline in the market value below cost that is deemed to be other than temporary would result in a charge to earnings in the period the decline occurs.

3. ACCOUNTING FOR STOCK OPTIONS AND AWARDS

The Company accounts for stock options issued to its employees and non-employee directors using the intrinsic value method. Under this method, no compensation expense is recorded for the fair value of options issued to employees and non-employee directors because the exercise price of the option is equal to the fair market value of a share of common stock on the measurement date. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards, or SFAS, No. 123, "Accounting for Stock Based Compensation," as amended by SFAS No. 148. Had compensation cost for the Company's stock option plans been determined consistent with the provisions of SFAS No. 123, the Company's net loss and net loss per common share would have increased to the pro forma amounts indicated below:

	Three months ended March 31,	
	2004	2003
Net loss, as reported	$ (9,074,573)	$ (7,024,897)
Add stock-based compensation expense included in reported net loss	77,401	(11,133)
Less stock-based compensation expense determined under fair value based method for all awards	(837,605)	(1,003,662)
Pro forma net loss	$ (9,834,777)	$ (8,039,692)
Net loss per common share (basic and diluted), as reported	$ (0.45)	$ (0.35)
Pro forma net loss per common share (basic and diluted)	$ (0.48)	$ (0.40)

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants: risk-free interest rates of 2.81% for the three-month period ended March 31, 2004, and 2.58% for the three-month period ended March 31, 2003. Expected volatility was 81% for the three-month periods ended March 31, 2004 and 2003. An expected option life of four years and a dividend rate of zero were assumed for the periods presented.

In February 2004, the Company granted 82,500 shares of restricted stock to certain officers. These shares vest in equal quarterly installments over a two-year period. The participants are not entitled to vote, sell or transfer any unvested shares. Additionally, granted but unvested shares are forfeited at termination of employment. Compensation expense related to these grants for the three months ended March 31, 2004, was approximately $44,000.

4. NET LOSS PER SHARE

Basic and diluted net loss per common share has been computed using the weighted average number of shares of common stock outstanding during each of the three-month periods ended March 31, 2004 and 2003. The weighted average number of shares used to compute diluted loss per share excludes any assumed exercise of stock options, as the effect would be antidilutive. The number of shares so excluded was 3,841,539 and 3,464,478 for the three-month periods ended March 31, 2004 and 2003, respectively.

5. COMPREHENSIVE LOSS

Comprehensive loss consists of net loss and other comprehensive income. Accumulated other comprehensive income represents net unrealized gains on marketable securities. For the three-month periods ended March 31, 2004 and 2003, marketable securities consisted of investments in debt instruments of financial institutions and corporations with strong credit ratings, and in U.S. government obligations. Beginning March 31, 2003, marketable securities also included the Company's investment in common stock of Corautus Genetics Inc., or Corautus. See also Note 6 below. For the three-month periods ended March 31, 2004 and 2003, other comprehensive income and loss was $0.5 million and $0.2 million, respectively, and total comprehensive losses were $8.6 million and $7.3 million, respectively.

6. INVESTMENT IN CORAUTUS GENETICS INC.

In February 2000, the Company received shares of preferred stock in Vascular Genetics Inc., or VGI, a privately held company, in exchange for a license to Vical technology. In February 2003, VGI and GenStar Therapeutics Corporation merged, resulting in the creation of a new entity, Corautus. In connection with the merger, the shares of VGI were exchanged for common stock of Corautus, which is listed on the American Stock Exchange, or AMEX. The Company is restricted in the number of Corautus shares it can sell over a period of time. The value of the Company's Corautus shares, as measured by the quoted price on the AMEX on March 31, 2003, was $0.3 million. Based on this market information, on March 31, 2003, the Company wrote down its investment to $0.3 million. The market value of the Company's investment in Corautus at March 31, 2004, was approximately $1.4 million.

7. LEASED FACILITY; LEASE LINE

In addition to its lease of the Pacific Center Court facility, or PCC, which terminates in 2017, the Company also holds leases, which terminate in late 2004, at three facilities for manufacturing, research and office space. The Company is negotiating to renew its lease on approximately 15,000 square feet in one of these facilities for at least one year and on approximately 10,000 square feet in another of these facilities for five years. The lease on the third facility will not be renewed at termination.

In March 2004, the Company signed a leasing agreement with the leasing division of a bank to provide the Company with up to $8.5 million of financing for tenant improvements and equipment, with drawdowns available through December 15, 2004. The financial covenants of the agreement require the Company to maintain cash collateral equal to the amount of outstanding borrowings. The bank has a secured interest in the equipment financed under this agreement. Additionally, if unrestricted cash and marketable securities, as defined, are less than $45 million, the Company would be required to maintain a letter of credit issued by another financial institution equal to the amount of outstanding borrowings at that time. In the event this occurred, the Company expects that its restricted cash deposits securing the lease would be returned, but the Company would have to make restricted cash deposits with another financial institution in order to obtain a letter of credit. At March 31, 2004, $1.5 million of borrowings were outstanding against this lease line, and an equivalent amount of marketable securities were pledged as collateral and are included as marketable securities—restricted in the balance sheet. At March 31, 2004, marketable securities—restricted also included $2.4 million of securities pledged as collateral for a standby letter of credit.

8. RECENT CONTRACT ACTIVITIES

The Company has an agreement to manufacture DNA vaccines for HIV, Ebola, West Nile Virus and severe acute respiratory syndrome, or SARS, for the Dale and Betty Bumpers Vaccine Research Center, or VRC, of the National Institutes of Health, or NIH. The Company manufactures these vaccines in its Eastgate manufacturing facility under a subcontract awarded in July 2002, which was amended most recently in January 2004 for additional production of one of these vaccines. In November 2003, the VRC began testing an investigational DNA vaccine against Ebola in healthy human volunteers, using clinical supplies provided by the Company under this agreement.

In May 2003, the Company announced a separate subcontract to manufacture bulk DNA vaccines for the VRC, which will be produced in a 500-liter fermenter and related purification equipment being furnished as government equipment, or GFE, in the Company's PCC manufacturing facility.

In February 2004, the Company received orders under the two subcontracts totaling approximately $6 million. Production began in the first half of 2004 in the Company's Eastgate manufacturing facility, and will expand in the second half of 2004 to the Company's PCC facility.

If the Company fails to satisfy its contractual obligations to deliver the vaccines ordered by the VRC in the manner required by the agreement, the applicable Federal Acquisition Regulations allow the VRC to cancel the agreement in whole or in part, and the Company may be required to perform corrective actions, including but not limited to delivering to the VRC any uncompleted or partially completed work, or government property in its possession, or paying a third-party supplier selected by the VRC to complete any uncompleted work. The performance of these corrective actions could have a material adverse impact on the Company's financial results in the period or periods affected. There are only a limited number of other contractors that could perform under this contract in the unlikely event that Vical was unable to perform. The price they might charge could be more than what Vical would charge based on their capacity, utilization, size of order and other factors. Accordingly, the Company is unable to estimate a range of potential cost it could be required to pay if the VRC were to engage a substitute contractor to meet any performance obligations that the Company was unable to meet.

These contracts are issued and managed on behalf of the VRC by SAIC-Frederick, Inc. under the umbrella of a federally funded prime contract with the NIH.

In addition, the Company has received notification of funding of approximately $1 million for research and development related to its CMV vaccine program under two grants from the U.S. National Institute of Allergy and Infectious Diseases, or NIAID. A six-month Phase I Small Business Innovation Research, or SBIR, grant of approximately $0.3 million will partially fund preclinical safety and toxicity evaluation of the CMV vaccine in support of the Company's planned Phase 1 human trial. An 18-month research grant of approximately $0.7 million will partially fund novel assays to measure and characterize immune responses in volunteers participating in the trial.

9. CONTINGENCIES

On July 29, 2003, the Wisconsin Alumni Research Foundation, or WARF, filed a complaint against the Company in the United States District Court for the Western District of Wisconsin, seeking a declaratory judgment regarding the meaning of certain payment provisions in a license agreement the Company entered into with the WARF in 1991, as well as fees related to the Company's sublicense of certain inventions jointly owned by the Company and the WARF, the amount of which is unspecified in the WARF's complaint. The Company counterclaimed, likewise seeking a declaratory judgment as to the correct interpretation of the payment provisions of the agreement and a return of amounts overpaid to the WARF under this agreement in excess of $1.5 million. In the first quarter of 2004, the Company accrued $1.5 million for settlement of this matter.

Vical's core DNA delivery technology was covered by a patent issued in Europe in 1998, which was subsequently opposed by seven companies under European patent procedures. This patent was revoked on formal grounds in October 2001 under an initial ruling by the Opposition Division of the European Patent Office, or EPO. In April 2002, the Company filed an appeal, which is still pending, seeking to overturn this initial ruling.

The Company's core DNA delivery technology is also covered by a Canadian patent application that was allowed and then withdrawn after protests against its

issuance were filed on behalf of an undisclosed party or parties in August and December 2001. The Company has responded to the protests and is continuing prosecution of the application in the Canadian Patent Office.

In addition, the Company's core DNA delivery technology is covered by a Japanese patent that was published in January 2002 and thereafter revoked by the examining panel at the Japanese Patent Office, or JPO, on formal and substantive grounds. The Company filed a rebuttal response to the revocation. Based on the Company's arguments and supporting evidence in that response, the JPO decided to reinstate the patent in July 2003. The Company also has received notice that four Trial for Invalidation, or TFI, requests against this patent were filed in the JPO by two companies. The Company filed responses to the TFI requests in a timely manner and is awaiting further action by the JPO.

A European patent issued in 2003 covering a range of applications of the Company's core DNA delivery technology, including cationic lipid-formulated, gene-based immunotherapeutics such as its clinical-stage Allovectin-7® treatment for melanoma, cationic lipid-formulated DNA vaccines such as its investigational anthrax vaccine, and similar pharmaceutical products under development by others. This patent has been opposed by two companies. The Company intends to respond to the oppositions in a timely manner.

A European patent issued to the Company in 2003 with broad claims related to gene-based, extra-tumoral delivery of any cytokines for the treatment of cancer. Delivery can be either free from or formulated with transfection-facilitating materials such as cationic lipids or polymers. Cytokines are proteins such as interleukins and interferons which regulate specific cell functions, and

typically are used to stimulate an immune response against cancer cells. Three companies have opposed this patent. The Company intends to respond to the oppositions in a timely manner.

The Company has licensed from the University of Michigan rights to various U.S. and international patents related to injection of DNA-based therapeutics into tumors that, for example, provide additional protection for Allovectin-7® and Leuvectin®. Included in this license is a European patent granted in March 2002. The Company has received notice from the EPO that one company filed an opposition in December 2002 alleging both formal and substantive grounds for revocation, and that the opposition was declared admissible in February 2003. The Company has submitted a rebuttal response to the opposition.

In the ordinary course of business, the Company may become a party to lawsuits involving various matters. The Company is unaware of any such lawsuits presently pending against it, except as noted above, and none of which, individually or in the aggregate, is deemed to be material to the financial condition of the Company.

In addition, the Company has undertaken certain commitments under agreements with its collaborators, and its officers and directors. Under license agreements with its collaborators, the Company has agreed to continue to maintain and defend the patent rights licensed to the collaborators. In addition, the Company has entered into indemnification agreements with each officer and director of the Company which would indemnify those individuals for any expenses and liabilities in the event of a threatened, pending or actual investigation, lawsuit, or criminal or investigative proceeding. At March 31, 2004, the Company was also obligated to pay salary continuation to four officers under certain circumstances.

10. RELATED-PARTY TRANSACTIONS

R. Gordon Douglas, M.D., Chairman of the Board of Directors of the Company, is also the Director of Strategic Planning at the VRC. For varying periods beginning from November 2000, the VRC has contracted with Vical for providing regulatory support, manufacturing services, and the production of research and clinical trial supplies. In May 2003, the Company announced a separate subcontract to manufacture bulk DNA vaccines for the VRC, which will be produced in a 500-liter fermenter and related purification equipment being furnished as GFE in the Company's new PCC manufacturing facility. Under this agreement, the Company is guaranteed minimum annual production orders beginning in 2004, subject to annual extension of the agreement. In February 2004, the Company received orders under the two subcontracts totaling approximately $6 million. Production began in the first half of 2004 in the Company's Eastgate manufacturing facility, and will expand in the second half of 2004 to the Company's PCC facility.

Revenue recognized under these subcontracts was $0.0 million, for the three-month periods ended March 31, 2004 and 2003. Included in "receivables and other" at March 31, 2004, is a receivable from the VRC in the amount of $0.6 million, of which $0.4 million pertains to equipment reimbursements.

Dr. Douglas was on the board of directors of the International AIDS Vaccine Initiative, or IAVI, a not-for-profit entity, until June 30, 2003. Vijay B. Samant, President and CEO of the Company, serves on the Project Management Subcommittee of the IAVI. In 2002, the Company signed an agreement with the IAVI to provide clinical trial supplies. Revenue recognized under this agreement for the three-month periods ended March 31, 2004 and 2003, was $0.0 million and $0.2 million, respectively.

The above related-party agreements were approved by a majority or more of the disinterested members of the Company's Board of Directors.

11. SHELF REGISTRATION STATEMENT

In December 2003, a shelf registration statement that the Company filed with the SEC was declared effective, which will allow the Company to issue from time to time an aggregate of up to $50 million, less amounts raised to date, of common stock or preferred stock. The shelf registration is intended to provide flexibility in financing the Company's business needs. Specific terms of any offering under the shelf registration and the securities involved would be established at the time of sale.

In March 2004, the Company raised approximately $17.3 million in net proceeds from the sale of approximately 3.4 million shares of its common stock at $5.50 per share in a registered direct offering to a select group of institutional investors. All of the shares of common stock were offered by the Company pursuant to the effective shelf registration statement previously filed with the SEC.

12. STOCK INCENTIVE PLAN

The Company has a stock incentive plan, under which 5,700,000 shares of common stock, subject to adjustment as provided in the plan, are reserved for issuance to employees, non-employee directors and consultants of the Company.

13. SUBSEQUENT EVENTS

In April 2004, the Company announced that Martha J. Demski had decided for personal reasons to resign from her position as Vice President, Chief Financial Officer, Treasurer, and Secretary, effective June 1.

FORWARD-LOOKING STATEMENTS

The statements incorporated by reference or contained in this report discuss our future expectations, contain projections of our results of operations or financial condition, and include other "forward-looking" information within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act. Our actual results may differ materially from those expressed in forward-looking statements made or incorporated by reference in this report. Forward-looking statements that express our beliefs, plans, objectives or assumptions, or that describe future events or performance, may involve estimates, assumptions, risks and uncertainties. Therefore, our actual results and performance may differ materially from those expressed in the forward-looking statements. Forward-looking statements often, although not always, include words or phrases such as the following, or the negative of such words, or other comparable terminology:

- "Will likely result,"
- "Are expected to,"
- "Will continue,"
- "Is anticipated,"
- "Estimate,"
- "Believe,"
- "Predict,"
- "Potential,"
- "Intends,"
- "Plans,"
- "Projection," and
- "Outlook."

You should not unduly rely on forward-looking statements contained or incorporated by reference in this report. Actual results or outcomes may differ materially from those predicted in our forward-looking statements due to the risks and uncertainties inherent in our business, including risks and uncertainties related to:

- Progress of our preclinical and clinical product development programs,
- Clinical trial results,
- Obtaining and maintaining regulatory approval,
- The attainment and defense of patent protection for any of these products,
- Market acceptance of and continuing demand for our products,
- The impact of competitive products, pricing and reimbursement policies,
- The continuation of our corporate collaborations and licenses,
- Our ability to enter into new corporate collaborations and licenses,
- Our ability to obtain additional financing to support our operations,
- Changing market conditions, and
- Other risks detailed below.

You should read and interpret any forward-looking statements together with the following documents:

- The risk factors contained in this report under the caption "Additional Business Risks,"
- Our Annual Report on Form 10-K for the year ended December 31, 2003, and
- Our other filings with the SEC.

Any forward-looking statement speaks only as of the date on which that statement is made. We disclaim any duty to update any forward-looking statement to reflect events or circumstances that occur after the date on which such statement is made.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We were incorporated in Delaware in 1987. We research and develop biopharmaceutical products based on our patented DNA delivery technologies for the prevention and treatment of serious or life-threatening diseases. In addition, we have gained access to enhancing technologies through licensing and collaborative agreements. We believe the following areas of research offer the greatest potential for our product development efforts:

- Vaccines for use in high-risk populations for infectious disease targets for which there are significant U.S. needs,
- Vaccines for general pediatric or adult populations for infectious disease applications for which a challenge model or accepted surrogate marker are available, and
- Cancer vaccines or immunotherapies that complement our existing programs and core expertise.

For opportunities outside these areas, we plan to continue leveraging our patented technology through licensing and collaborations. In addition, we plan to use our expertise, infrastructure, and financial strength to explore in-licensing or acquisition opportunities. The table below summarizes our independent, collaborative and out-licensed product development programs.

Product Area	Project Target and Indication(s)	Development Status(1)	Development Rights(3)
INFECTIOUS DISEASES			
Infectious disease vaccines	*Plasmodium falciparum* (malaria)	Phase 1/2	Vical

	Cytomegalovirus	Phase 1	Vical
	Bacillus anthracis (anthrax)	Preclinical	Vical
	Ebola	Phase 1	Vical/NIH
	West Nile Virus	Preclinical	Vical/NIH
	HIV – preventive	Phase 1	Merck & Co., Inc.
	HIV – therapeutic	Phase 1	Merck & Co., Inc.
	Hepatitis B virus – preventive	Research	Merck & Co., Inc.
	Hepatitis B virus – therapeutic	Research	Merck & Co., Inc.
	Hepatitis C virus – preventive	Research	Merck & Co., Inc.
CANCER			
Immunotherapeutic vaccine	High-dose Allovectin-7® for metastatic melanoma	Phase 2	Vical
Tumor-associated antigen	Unspecified cancer(2)	Research	Aventis Pasteur
therapeutic vaccines	Unspecified cancer(2)	Research	Merck & Co., Inc.
CARDIOVASCULAR			
Angiogenic growth factors	VEGF-2	Phase 2	Corautus Genetics Inc.
	FGF-1	Phase 2	Gencell S.A., a subsidiary of Aventis Pharma S.A.
VETERINARY			
Preventive vaccines	Various undisclosed(2)	Research-Clinical	Merial
	Undisclosed (2)	Clinical	Aqua Health Ltd.

(1) "Research" indicates exploration and/or evaluation of a potential product candidate in a nonclinical setting. "Preclinical" indicates that a specific product candidate in a nonclinical setting has shown functional activity that is relevant to a targeted medical need, and is undergoing toxicology testing in preparation for filing an Investigational New Drug, or IND, application. "Phase 1" clinical trials mark the first time a new drug or treatment is administered to humans and are normally conducted to determine the safety profile of a new drug. "Phase 2" clinical trials are conducted in order to determine preliminary effectiveness, or efficacy, optimal dosage, and to confirm the safety profile. At times, a single trial may incorporate elements from different phases of development. An example might be a trial designed to determine both safety and initial efficacy. Such a trial may be referred to as a "Phase 1/2" clinical trial. For non-human indications, "Clinical" indicates testing in the target species.

(2) Pursuant to our collaborative agreements, we are bound by confidentiality obligations to our collaborators that prevent us from publicly disclosing these targets and indications unless such information has been made generally available to the public. Additionally, some project targets and indications cannot currently be disclosed because they have not yet been selected by our collaborators.

(3) See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Other Matters" for costs associated with Vical independent product development programs.

Recent Events

Allovectin-7®

Allovectin-7® is a DNA plasmid/lipid complex containing the DNA sequences encoding HLA-B7 and β2 microglobulin, which together form a Class I Major Histocompatibility Complex, or MHC-I antigen. Injection of Allovectin-7® directly into tumors, or intratumoral injection, may augment the immune response to both local and metastatic tumors by one or more mechanisms. In HLA-B7 negative recipients, a T-cell response may be initiated by the introduction of a foreign HLA, similar to that observed in tissue transplant rejections. In HLA-B7 positive recipients, enhanced HLA-B7 and b2 microglobulin surface expression by injected tumor cells could increase antigen presentation to tumor specific T-cells. In any recipient, a pro-inflammatory anti-tumor response may occur following intratumoral injection of the plasmid DNA/lipid complex, as demonstrated in preclinical animal tumor models.

In February 2001, we began a high-dose Phase 2 trial evaluating the Allovectin-7® gene-based immunotherapeutic for patients with Stage III or IV melanoma, who have few other treatment options. Patient enrollment was completed in July 2003. We continue to be encouraged by the results in our high-dose Allovectin-7® program. We assembled a panel of leading melanoma experts with both clinical and regulatory expertise to provide guidance on the Allovectin-7® program. This panel reviewed the safety and efficacy data from our high-dose and low-dose trials. Based on this review, we decided to seek guidance from the U.S. Food and Drug Administration, or FDA, in two formal End-of-Phase 2, or EOP2, meetings on the potential for the results from our high-dose Phase 2 trial to support accelerated approval for marketing Allovectin-7® for use in certain patients with recurrent and/or otherwise treatment-intolerant metastatic melanoma.

We have completed our scheduled EOP2 meetings with the FDA for Allovectin-7®, and have received detailed guidance from those meetings. Based on those meetings, we believe that:

- although Allovectin-7® appears to be safe in patients who received different doses of the product, the safety database would need to be expanded to determine the safety profile required for licensure of the high dose product;
- a meaningful response rate with a reasonable duration of response could be acceptable as the surrogate endpoint for efficacy;
- for efficacy, approval would require at least 25 responders in the Allovectin-7® arm of a new registration trial; and
- no major issues were identified with our commercial lot release or product characterization plans.

As a result, we are designing a registration trial with high-dose Allovectin-7® for certain patients with metastatic melanoma. The trial design would include an interim analysis that could provide the basis for seeking approval before trial completion. We intend to review the design of the new registration trial with the FDA through a Special Protocol Assessment (SPA), which we intend to complete in the second half of 2004.

Summary safety and efficacy data from the high-dose Phase 2 study, which provided the basis for the EOP2 meeting, will be reported in June 2004 at meetings of the American Society of Clinical Oncology and the American Society of Gene Therapy.

Cytomegalovirus

In February 2003, we announced our first independent development program focused on infectious diseases, a DNA-based immunotherapeutic vaccine against cytomegalovirus, or CMV. We announced the initiation of a Phase 1 clinical trial with our CMV immunotherapeutic vaccine in March 2004. Enrollment of eight healthy volunteers in the first dose-escalation stage of the trial has now been completed. The initial trial will test the vaccine for safety and immune responses in healthy volunteers, in preparation for planned trials in hematopoietic cell transplant, or HCT, patients.

The multi-center, randomized, open-label clinical trial will evaluate the safety and immunogenicity of Vical's CMV immunotherapeutic vaccine in up to 34 healthy subjects. Each subject will receive three doses of the vaccine at either a 1 mg or 5 mg dose. All subjects will be followed for six months after the last immunization. Subjects will be monitored primarily for safety. Secondary endpoints in this trial will include the immunogenicity of the vaccine in CMV seronegative and CMV seropositive healthy subjects.

CMV infection is a life-long complication for transplant patients, who are tied to the clinic because of frequent testing for viral reactivation, and who must rely on expensive and toxic antiviral therapy. Currently, there is no approved vaccine or even a late-stage vaccine development program for CMV. CMV infection is the leading infectious disease cause of birth defects in the United States.

The Institute of Medicine, or IOM, of the National Academy of Sciences estimated the cost of treating the consequences of CMV infection in the United States at more than $4 billion per year in a 1999 report, and placed a CMV vaccine in its first priority

category on the basis of cost-effectiveness. Our initial focus on the transplantation indication should allow proof of concept that could then lead to the opportunity to develop a CMV vaccine for other groups such as immunocompromised individuals and women of reproductive age.

Our CMV immunotherapeutic vaccine program is based on:

- CMV genes that encode highly immunogenic proteins associated with protective antibody and cellular immune responses,
- Our DNA vaccine technologies that have the ability to induce potent cellular immune responses and trigger production of antibodies without the safety concerns that conventional attenuated vaccines have posed for immunocompromised patients, and
- A focused clinical development plan that is designed to allow us to quickly establish proof of concept in transplant patients.

The initial clinical development plan includes vaccination of both HCT donors and recipients. We have established working relationships with some of the country's leading transplant centers, which have contributed to trial design and may participate in upcoming CMV vaccine trials. We also have secured intellectual property rights to the selected CMV gene sequences.

Our lead vaccine configuration consists of two plasmid constructs, one encoding the surface antigen, glycoprotein B, and the other a potent T-cell target, phosphoprotein 65, or pp65. These constructs have been tested individually and in combination in our own laboratories. We have verified in preclinical studies that these immunogens elicit potent immune responses, generating both antibodies and T-cell responses.

Recently we identified a third viable immunogen that can be manufactured and that elicits a potent T-cell response. We are evaluating the benefit of incorporating this third plasmid into a trivalent vaccine to determine how this might further increase the likelihood of success of our CMV immunotherapeutic product, and are exploring the best way to integrate this discovery into our CMV immunotherapeutic program.

In addition, we have received notification of funding of approximately $1 million for research and development related to our CMV vaccine program under two grants from the U.S. National Institute of Allergy and Infectious Diseases, or NIAID. A six-month Phase I Small Business Innovation Research, or SBIR, grant of approximately $0.3 million will partially fund preclinical safety and toxicity evaluation of the CMV vaccine in support of our planned Phase 1 human trial. An 18-month research grant of approximately $0.7 million will partially fund novel assays to measure and characterize immune responses in volunteers participating in the trial. The trial and immunological assays will be conducted in collaboration with the Fred Hutchinson Cancer Research Center in Seattle, Washington.

Anthrax

In March 2003, we announced our second independent infectious disease DNA vaccine development program, a next-generation vaccine designed to provide broader protection than any of the other anthrax vaccines either on the market or in development. Where the others target the single anthrax protein called Protective Antigen, or PA, our vaccine also targets the anthrax protein called Lethal Factor, or LF. This second-generation, bivalent, cationic-lipid formulated vaccine is designed to provide broader protection against weaponized forms of anthrax than the currently approved anthrax vaccine.

We believe that we can develop a safe and effective DNA vaccine for anthrax that will validate the potential advantages of our proprietary vaccine technologies while addressing a pressing public need, because:

- The key anthrax immunogens have been identified, and we have verified in small animal studies that nucleotide sequences encoding certain of these immunogens can be delivered effectively by formulated DNA, resulting in protective immune responses. Our technology allows us to readily produce detoxified forms of PA and LF that together may provide broader protection against weaponized forms of anthrax than the currently licensed anthrax vaccine or proposed single recombinant protein vaccines;
- Our cationic lipid formulated DNA delivery technology, in which positively charged lipid molecules can interact with the negatively charged DNA molecules, has established an excellent safety profile in previous clinical studies, and an important goal of this program is to extend that safety profile to vaccine applications;
- DNA vaccines may induce protective antibodies in humans and can do so with fewer injections than the currently licensed anthrax vaccine, offering a potentially shorter time to protection; and
- The potential stability of plasmid formulations may offer advantages in handling and storage, which would be important considerations for stockpiling.

Our anthrax vaccine team advanced this program from initial concept to evaluation of effectiveness in a stringent challenge model in less than ten months, and held a pre-IND meeting with the FDA in December 2002.

Encouraging results with multiple formulations of the vaccine in mouse and rabbit immunogenicity and challenge models were presented at an American Society for Microbiology, or ASM, meeting in March 2003. At several scientific conferences during the third quarter of 2003, we presented preclinical data from our anthrax vaccine program, including rabbit data which demonstrated protection against an aerosolized spore inhalation challenge at 7.5 months post-vaccination. Additional rabbit data presented at an ASM meeting in March 2004 suggested production of sterile immunity with our anthrax vaccine.

This research has been supported, in part, by a one-year Small Business Technology Transfer Research, or STTR, grant from the NIAID, as announced in July 2002. In July 2003, we were awarded a three-year, $5.7 million Phase II SBIR grant from the NIAID. The grant is partially funding the development of our DNA vaccine against anthrax.

In October 2003, we secured an exclusive license from The Ohio State University to allow use of proprietary technology in our anthrax vaccine.

We have now completed all required preclinical work, which was supported, in part, under the SBIR grant from the NIAID. We have not, however, received a commitment for additional government funding to support human studies. Nevertheless, we remain excited about the potential for this vaccine and are continuing to work on non-clinical development supported under our existing grant.

We believe that the Animal Rule, which allows demonstration of effectiveness in two animal species in addition to safety in humans, would apply to the FDA's review of this vaccine.

NIH Vaccine Research Center

We have an agreement to manufacture HIV, Ebola, West Nile Virus and severe acute respiratory syndrome, or SARS, DNA vaccines for the VRC in our Eastgate manufacturing facility under a subcontract awarded in July 2002 and amended most recently in January 2004 for additional production of one of these vaccines. In November 2003, the VRC began testing an investigational DNA vaccine against Ebola, using clinical supplies provided by us under this agreement, in healthy human volunteers.

In May 2003, we announced a separate subcontract to manufacture bulk DNA vaccines for the VRC, which will be produced in a 500-liter fermenter and related purification equipment being furnished as government equipment, or GFE, in our new Pacific Center Court, or PCC, manufacturing facility. Under this agreement, we are guaranteed minimum annual production orders beginning in 2004, subject to annual extension of the agreement.

In February 2004, we received orders under the two subcontracts totaling approximately $6 million. Production began in the first half of 2004 in our Eastgate manufacturing facility, and will expand in the second half of 2004 to our PCC facility. Additional orders may be placed under both subcontracts. Revenue from these orders will be recognized as product is shipped. This should substantially increase our contract revenues to more than $10 million in future years, subject to annual renewal. We are on track to begin production as scheduled and we fully intend to meet the VRC's requirements, including vaccines for HIV, Ebola, West Nile Virus and SARS. Under Federal Acquisition Regulations, or FARs, the government has the right to terminate these agreements for convenience.

If we fail to satisfy our contractual obligations to deliver the vaccines ordered by the VRC in the manner required by the agreement, the applicable FARs allow the VRC to cancel the agreement in whole or in part, and we may be required to perform corrective actions, including but not limited to delivering to the VRC any uncompleted or partially completed work, or government property in our possession, or paying a third-party supplier selected by the VRC to complete any uncompleted work. The performance of these corrective actions could have a material adverse impact on our financial results in the period or periods affected.

These contracts are issued and managed on behalf of the VRC by SAIC-Frederick, Inc. under the umbrella of a federally funded prime contract with the NIH.

In October 2003, we obtained an option to secure exclusive commercialization rights for a West Nile Virus vaccine being developed in collaboration with the VRC under a Cooperative Research and Development Agreement, or CRADA. In January 2004, we secured a license from the CDC for technology used in a similar DNA vaccine, which was shown in independent tests at the CDC to protect horses from West Nile Virus after a single injection.

Other Recent Events

Shelf Registration. In December 2003, a shelf registration statement that we filed with the SEC was declared effective, which will allow us to issue from time to time an aggregate of up to $50 million, less amounts raised to date, of common stock or preferred stock. The shelf registration is intended to provide flexibility in financing our business needs. Specific terms of any offering under the shelf registration and the securities involved would be established at the time of sale.

In March 2004, we raised approximately $17.3 million in net proceeds from the sale of approximately 3.4 million shares of our common stock at $5.50 per share in a registered direct offering to a select group of institutional investors. All of the shares of common stock were offered by us pursuant to the effective registration statement previously filed with the SEC.

Patents. During the first quarter of 2004, we were issued U.S. Patent No. 6,670,332, covering a class of cationic lipids useful in gene delivery applications, U.S. Patent No. 6,673,776, covering novel methods of using DNA to deliver biologically active proteins, U.S. Patent No. 6,696,424 covering a class of cationic lipids useful in gene delivery applications, U.S. Patent No. 6,710,035, covering administration of plasmid DNA encoding pathogen-specific antigens to generate immune responses, with or without adjuvants, and U.S. Patent No. 6,706,694, covering delivery to the heart of DNA encoding biologically active proteins. In addition, in the first quarter of 2004, we were issued European Patent EP0795015 specifically claiming the composition, manufacture and application of gene-based cancer treatments delivering the cytokine interleukin-2, or IL-2.

Also during the first quarter of 2004, European Patent 0737750, issued in 2003, was opposed by two companies, and European Patent 1032428, also issued in 2003, was opposed by three companies. We intend to respond to the oppositions in a timely manner.

We are the assignee of 32 issued U.S. and foreign patents having remaining lives of 5 to 15 years, which are listed below:

Patent No.	Description
U.S. PATENTS	
6,710,035	Generation of an immune response to a pathogen
6,706,694	Expression of exogenous polynucleotide sequences in a vertebrate
6,696,424	Cytofectin dimers and methods of use thereof
6,673,776	Expression of exogenous polynucleotide sequences in a vertebrate, mammal, fish, bird or human
6,670,332	Complex cationic lipids having quaternary nitrogens therein
6,586,409	Adjuvant compositions and methods for enhancing immune responses to polynucleotide-based vaccines
6,413,942	Methods of delivering a physiologically active polypeptide to a mammal
6,399,588	Cancer treatment method utilizing plasmids suitable for IL-2 expression
6,228,844	Stimulating vascular growth by administration of DNA sequences encoding VEGF
6,214,804	Induction of a protective immune response in a mammal by injecting a DNA sequence
6,147,055	Cancer treatment method utilizing plasmids suitable for IL-2 expression

6,022,874	Piperazine based cytofectins
5,994,317	Quaternary cytofectins
5,910,488	Plasmids suitable for gene therapy
5,891,718	Tetracycline inducible/repressible systems
5,861,397	Piperazine based cytofectins
5,707,812	Purification of plasmid DNA during column chromatography
5,703,055	Generation of antibodies through lipid mediated DNA delivery
5,693,622	Expression of exogenous polynucleotide sequences cardiac muscle of a mammal
5,641,665	Plasmids suitable for IL-2 expression
5,589,466	Induction of a protective immune response in a mammal by injecting a DNA sequence
5,580,859	Delivery of exogenous DNA sequences in a mammal
5,576,196	Process for reducing RNA concentration in a mixture of biological material using diatomaceous earth
5,561,064	Production of pharmaceutical-grade plasmid DNA
5,459,127	Cationic lipids for intracellular delivery of biologically active molecules
5,264,618	Cationic lipids for intracellular delivery of biologically active molecules

FOREIGN PATENTS	
EP0523189	Cationic lipids for intracellular delivery of biologically active molecules
EP0742820	Production of pharmaceutical-grade plasmid DNA
EP0795015	Plasmids suitable for IL-2 expression
EP0802975	Process for reducing RNA concentration in a mixture of biological material using diatomaceous earth
EP0902780	Quaternary cytofectins

JP2538474	Cationic lipids for intracellular delivery of biologically active molecules

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Specifically, management must make estimates in the following areas:

Intangible assets. We capitalize the license fees we pay to acquire access to proprietary technology if the technology is expected to have alternative future use in multiple research and development projects. The cost of licensed technology rights is amortized to expense over the estimated average useful life of the technology, which is generally ten years. We also capitalize certain costs related to patent applications which have alternative future use in multiple research and development projects. Accumulated costs are amortized over the estimated economic life of the patent, which is generally 20 years and usually commences at the time the patent application is filed. Costs related to patent applications are written off to expense at the time such costs are deemed to have no continuing value. Intangible assets are amortized using the straight-line method. We review long-lived assets and intangible assets for impairment at least annually and whenever events or changes in circumstances indicate that the total amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. If assets are to be disposed of, they are reported at the lower of the carrying amount or fair value less costs to sell. Loss of legal ownership or rights to patents or licensed technology, or significant changes in our strategic business objectives and utilization of the assets, among other things, could give rise to asset impairment.

Deferred tax assets. Deferred tax assets are recorded net of a 100% valuation allowance. This valuation allowance reduces the gross deferred tax assets to the amount that we believe is more likely than not realizable. We considered projections of future taxable income, past operating results and tax planning strategies in making this determination.

Clinical trial expenses. We account for our clinical trial costs by estimating the total cost to treat a patient in each clinical trial and accruing this total cost for the patient over the estimated treatment period, which corresponds with the period over which the services are performed, beginning when the patient enrolls in the clinical trial. This estimated cost includes payments to the trial site and other external expenses related to the conduct of the trial. Cost per patient varies based on the type of clinical trial, the site of the clinical trial, the method of administration of the treatment, and the number of treatments for each patient. Treatment periods vary depending on the clinical trial. We make revisions to the clinical trial cost estimates as clinical trials progress. Clinical trial expense was $0.1 million and $0.2 million for the three-month periods ended March 31, 2004 and 2003, respectively. No material revisions to the estimates were made in the periods presented.

Accruals for potential disallowed costs on contracts. We have contracts with agencies of the U.S. government under which we bill for direct and indirect costs incurred. These billed costs are subject to audit by government agencies, such as the NIH. We have established accruals of approximately $0.6 million at March 31, 2004, to provide for potential disallowed costs. In the event that the final costs allowed are different from what we have estimated, we may need to make a change in our estimated accrual, which could also affect our results of operations and cash flow. No material adjustments were made to the accruals in the periods presented.

Revenue recognition

We earn revenue from licensing our proprietary technology and by performing services under research and development contracts and grants, and service contracts. In general, revenue is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determined, and collection is reasonably assured. Any initial license or option payment received under an agreement under which we also provide research and development services is recognized as revenue over the term of the research and development period. Payments for options on a license to our technology are recognized as revenue over the option period. Fees paid to extend an option are recognized as revenue over the option extension period. Upfront license payments are recognized as revenue upon contract signing if the fee is nonrefundable and noncreditable, and if there are no significant performance obligations remaining. Revenue from milestones is recognized as agreed-upon events representing the achievement of substantive steps in the development process are achieved, or the passage of time, and where the amount of the milestone payment approximates the value of achieving the milestone, and collection of payment is reasonably assured. Royalty revenue is recognized as the cash is received from the licensee.

Revenue under research and development contracts and grants, and manufacturing and regulatory service contracts, except for fixed-price contracts, is recognized as the research and development expenses for services performed are incurred, provided that all of

the revenue recognition criteria noted above have been met. We do not recognize revenue on contract change orders until the service is performed and we have a signed modification for additional funding for the contract. Prior to that time, any costs incurred for change orders on contracts are deferred if it is highly probable that we will receive a signed modification, or if we have received a signed modification, increasing the funding under the contract which will allow us to recover the costs incurred. Otherwise, the costs are expensed as incurred. Once the signed modification for additional funding is received, the deferred costs and any related revenue are both recognized. Advance payments received in excess of amounts earned are classified as deferred revenue.

We also have entered into fixed-price manufacturing contracts under which the primary deliverables are investigational vaccines to be used for preclinical and clinical research. Under these contracts, revenue is recognized when the product is shipped, and any deferred manufacturing costs are recognized as expense at that time.

Recent Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51," or FIN 46. FIN 46 addresses the consolidation by business enterprises of variable interest entities as defined in the interpretation. FIN 46 applies immediately to variable interest in variable interest entities created after January 31, 2003, and to variable interest in variable interest entities obtained after January 21, 2003. FIN 46 requires certain disclosures in financial statements issued after January 31, 2003, if it is reasonably possible that the company will consolidate or disclose information about variable interest entities when FIN 46 becomes effective. The application of this interpretation did not have a material effect on our consolidated financial statements.

In December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities," which supercedes FIN 46. The application of the revised interpretation is required in the financial statements of companies that have interests in special purpose entities for periods after December 15, 2003. The application of this interpretation did not have a material effect on our consolidated financial statements.

Results of Operations

We recorded revenues of $0.9 million for the three months ended March 31, 2004. License/royalty revenue of $0.6 million for the three months ended March 31, 2004, represented recognition of deferred license fees from Corautus and royalty revenue. Contract revenue of $0.3 million for the three months ended March 31, 2004, was primarily from the NIH, and included $0.3 million of grant revenue for a CMV SBIR grant.

We recorded revenues of $0.9 million for the three months ended March 31, 2003. License/royalty revenue of $0.5 million for the three months ended March 31, 2003, represented recognition of deferred license fees from Corautus and royalty revenue. Contract revenue for the three months ended March 31, 2003, was $0.4 million and included revenues from IAVI for production of clinical trial supplies, and from the Office of Naval Research, or ONR, for development work on an investigational DNA vaccine to prevent malaria.

Our total operating expenses for the three months ended March 31, 2004, were $10.1 million compared with $8.6 million for the same period in the prior year. Operating expenses for the three months ended March 31, 2003, included a write-down of investment of $0.5 million, as more fully explained below.

Research and development expenses increased to $8.2 million for the three months ended March 31, 2004, from $6.6 million for the same period in 2003. This increase in research and development expenses was due to increased royalty expense due to an accrual for settlement of the WARF litigation, personnel-related costs, and facilities costs, and was partially offset by the deferral of certain

contract manufacturing costs until the related revenue is recognized and lower clinical trial expenses related to the reduced cancer product trial activities.

General and administrative expenses were $1.9 million for the three months ended March 31, 2004, and $1.5 million for the same period in 2003. The increase in general and administrative expenses for the three months ended March 31, 2004, compared with the same period in the prior year, was due to increased legal fees associated with the WARF litigation and higher personnel-related costs.

Operating expenses for the three months ended March 31, 2003, also included a write-down of investment of $0.5 million. In February 2003, GenStar Therapeutics Corporation, a public company listed on AMEX, and VGI, a private company in which we received shares of preferred stock when we licensed our technology to VGI, completed their previously announced merger and created a new entity, known as Corautus. Subsequent to the merger, the shares of VGI were exchanged for common stock of Corautus, which is listed on AMEX. The value of our shares as measured by the quoted price on AMEX on March 31, 2003, was $0.3 million compared with our recorded value of $0.8 million. Based on this market information, we wrote down our investment to $0.3 million as of that date.

We expect research and development expense to increase for the full year 2004 compared with 2003 as a result of relocation to a new facility and expansion of our preclinical programs to broaden our future pipeline.

Investment income for the three-month period ended March 31, 2004, was $0.3 million. Investment income for the three months ended March 31, 2003, was $0.7 million and included realized gains on sales of investments of $0.1 million. The decrease in investment income in 2004 compared with 2003 is due to lower rates of return and lower investment balances. Some of our investments currently are yielding higher returns than we could expect when reinvesting the proceeds upon sale or maturity. Thus, our interest yields are expected to be lower in the full year 2004 than in 2003.

Our net loss was $9.1 million, or $0.45 per common share, for the three months ended March 31, 2004, compared with a net loss of $7.0 million, or $0.35 per common share, for the same period in the prior year. We expect to incur losses throughout the remainder of 2004 and we expect our net loss for the year ending December 31, 2004, to be between $26 million and $29 million.

Other Matters

Since inception, we estimate that we have spent approximately $191 million on research and development. Approximately $71 million of this amount was for our two cancer programs, Allovectin-7®, which is currently in a high-dose Phase 2 trial in melanoma, but for which we have elected not to proceed with a Biologics License Application, or BLA, filing for a low dose based on low-dose clinical trial results, and Leuvectin®, for which development was discontinued in September 2002 due to other priorities. We expect the high-dose Phase 2 trial to determine whether higher dosing will provide the level of efficacy needed to support further development. From inception, we have spent about $53 million in our Allovectin-7® program. If future trials are needed, this would add to the time and cost of development. From inception, we have spent approximately $18 million in our Leuvectin® program. From inception, we have spent approximately $4 million on our malaria program.

Additionally, we are in the early stages of research and development of vaccine candidates for infectious diseases such as CMV and anthrax. These infectious disease candidates will require significant costs to advance through the development stages. From inception, we have spent approximately $11 million on our CMV program. See "Recent Events—Allovectin-7®" for a more detailed explanation of the status of Allovectin-7®. See also "Recent Events—Cytomegalovirus" and "—Anthrax" for more detailed discussions of our CMV and anthrax vaccine programs.

Costs incurred by major program, as well as other expenses for research and development and technology enhancements, for the three-month periods ended March 31, 2004 and 2003 , were as follows (in thousands):

	2004	2003
Allovectin-7®	$ 2,126	$ 1,645
Leuvectin®	0	46
Anthrax	1,472	1,350
CMV	2,126	1,433
Malaria	0	26
Other research and development, and technology enhancements	2,452	2,084
Total R&D spending	$ 8,176	$ 6,584

We have several other product candidates in the research stage. It can take many years from the initial decision to screen product candidates, perform preclinical and safety studies, and perform clinical trials leading up to possible FDA approval of a product. The outcome of the research is unknown until each stage of the testing is completed, up through and including the registration clinical trials. Accordingly, we are unable to predict which potential product candidates we may proceed with, the time and cost to complete development, and ultimately whether we will have a product approved by the FDA.

Liquidity and Capital Resources

Since our inception, we have financed our operations primarily through private placements of preferred and common stock, five public offerings of common stock, and revenues from collaborative agreements. Cash, cash equivalents and marketable securities totaled approximately $94.1 million at March 31, 2004, compared with $84.5 million at December 31, 2003. In December 2003, a shelf registration statement that we filed with the SEC was declared effective, which will allow us to issue from time to time an aggregate of up to $50 million, less amounts raised to date, of common stock or preferred stock. The shelf registration is intended to provide flexibility in financing our business needs. Specific terms of any offering under the shelf registration and the securities involved would be established at the time of sale.

In March 2004, we raised approximately $17.3 million in net proceeds from the sale of approximately 3.4 million shares of Vical common stock at $5.50 per share in a registered direct offering to a select group of institutional investors. All of the shares of common stock were offered by us pursuant to the effective shelf registration statement previously filed with the SEC.

Cash used in operating activities increased to $7.5 million for the three months ended March 31, 2004, compared with $6.5 million for the same period in 2003. The increase in cash used in operating activities for the three months ended March 31, 2004, compared with same period in the prior year, is due to a higher net loss for the three months ended March 31, 2004 compared to the same period in the prior year combined with an increase in deferred contract costs. The increased net loss was offset by an increase in the outstanding balance of accounts payable and cash provided from collection of receivables. Net loss for the three month period ended March 31, 2003, also included a noncash write-down of our investment in Corautus, as more fully explained under “Results of Operations” above.

Cash used in investing activities was $3.8 million for the three months ended March 31, 2004, compared with $11.0 million for the same period in 2003. Capital expenditures for the three months ended March 31, 2004, decreased $3.2 million from the same period in the prior year, and are expected to be lower for the full year 2004 compared with 2003 as the purchases for, and improvements to, our new facility near completion. Additionally, spending for licensed technology and patents decreased from the same period in the prior year.

Cash provided from financing activities for the three months ended March 31, 2004, was $16.2 million compared with cash used in financing activities of $0.5 million for the same period in 2003. Net proceeds from the registered direct stock offering in the first quarter of 2004 provided $17.3 million of cash. Reimbursements under our capital lease line provided $1.5 million of cash for the three months ended March 31, 2004. Payments on capital lease obligations for the three months ended March 31, 2004, increased by $0.7 million, compared with the same period in 2003, due to greater capital lease obligations.

In March 2004, we entered into a new lease line with the leasing division of a bank to provide up to $8.5 million of financing for tenant improvements and equipment, with drawdowns available through December 15, 2004. At March 31, 2004, we had used $1.5 million of this lease line, and an equivalent amount of marketable securities were pledged as collateral and are included as marketable securities—restricted in the balance sheet. At March 31, 2004, marketable securities—restricted also included $2.4 million of securities pledged as collateral for a standby letter of credit. We intend to pursue additional lease financing at the expiration of the drawdown period under this agreement. In the event we are unable to obtain additional financing, we will be required to use our existing cash resources to finance additional purchases.

In addition to our lease of PCC, which terminates in 2017, we also hold leases, which terminate in late 2004, at three facilities for manufacturing, research and office space. We are negotiating to renew our lease on approximately 15,000 square feet in one of these three older facilities for at least one year and on approximately 10,000 square feet in another of these facilities for five years.

We expect to incur substantial additional research and development expenses and general and administrative expenses, including personnel-related costs, costs related to preclinical testing and clinical trials, costs related to outside services and facilities, and costs to maintain and enhance our intellectual property. Our future capital requirements will depend on many factors, including continued scientific progress in our research and development programs, the scope and results of preclinical testing and clinical trials, the time and costs involved in obtaining regulatory approvals, the costs involved in filing, prosecuting and enforcing patent claims, competing technological and market developments, the cost of manufacturing scale-up, and construction costs of the new facility. We intend to seek additional funding through government contracts and grants, and research and development relationships with suitable

potential corporate collaborators. We may also seek additional funding through public or private financings, or an increase in our credit facilities. We cannot assure that additional financing will be available on favorable terms or at all.

We anticipate that our available cash and existing sources of funding will be adequate to satisfy our operating needs through at least 2005.

We do not utilize “special purpose entities” for any transactions. Our most significant “off balance sheet” obligations, which are for operating leases, are disclosed in Note 7 of the Notes to Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2003. We also have other contractual obligations as described in such Annual Report under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations.”

Additional Business Risks

You should consider carefully the risks described below, together with all of the other information included in this report, and in our other filings with the SEC, before deciding whether to invest in or continue to hold our common stock. The risks described below are all material risks currently known, expected or reasonably foreseeable by us. If any of these risks actually occurs, our business, financial condition, results of operations or cash flow could be seriously harmed. This could cause the trading price of our common stock to decline, resulting in a loss of all or part of your investment.

None of our products has been approved for sale, and we have only two product candidates in clinical trials. If we do not develop commercially successful products, we may be forced to curtail or cease operations.

All of our potential products are either in research or development. We must conduct a substantial amount of additional research and development before any U.S. or foreign regulatory authority will approve any of our products. Very little data exists regarding the safety and efficacy of DNA-based vaccines or therapies. Results of our research and development activities may indicate that our potential products are unsafe or ineffective. In this case, regulatory authorities will not approve them.

For example, our only product candidates currently in clinical trials are high-dose Allovectin-7® for metastatic melanoma, which is currently in Phase 2 clinical testing, and our immunotherapeutic CMV vaccine, which is currently in Phase 1 clinical testing. We may not be able to establish with the FDA, by the second half of 2004, if at all, the design of a high-dose Allovectin-7® registration trial adequate to support clinical and regulatory requirements for approval of Allovectin-7®. We may not have the resources to conduct such a trial independently, if at all. Results of such a registration trial may not demonstrate sufficient efficacy to support approval before trial completion, if at all. We may not conduct additional CMV vaccine trials, and leading transplant centers may not participate in our CMV vaccine trials.

Additionally, we are in preclinical stages of research and development with product candidates including an anthrax vaccine, a solid tumor application of our in-licensed electroporation technology, and others. These product candidates will require significant costs to advance through the development stages. If such product candidates are advanced through clinical trials, the results of such trials may not support FDA approval. Even if approved, our products may not be commercially successful. If we fail to develop and commercialize our products, we may be forced to curtail or cease operations.

Our revenues partially depend on the development and commercialization of products by others to whom we have licensed our technology. If our collaborators or licensees are not successful or if we are unable to find collaborators or licensees in the future, we may not be able to derive revenues from these arrangements.

We have licensed our technology to corporate collaborators and licensees for the research, development and commercialization of specified product candidates. Our revenues partially depend upon the performance by these collaborators and licensees of their responsibilities under these arrangements. Some collaborators or licensees may not succeed in their product development efforts or devote sufficient time or resources to the programs covered by these arrangements, causing us to derive little or no revenue from these arrangements.

Our collaborators and licensees may breach or terminate their agreements with us, and we may be unsuccessful in entering into and maintaining other collaborative arrangements for the development and commercialization of products using our technology.

A significant portion of our revenue is derived from agreements with government agencies, which are subject to termination and uncertain future funding.

We have entered into agreements with government agencies, such as the NIH, and we intend to continue entering into these agreements in the futureFor example, we have entered into an agreement to manufacture bulk DNA vaccines for the VRC. In connection with this agreement, the VRC has agreed to provide a 500-liter fermenter and related purification equipment being furnished as GFE in our PCC manufacturing facility. Our business is partially dependent on the continued performance by these government agencies of their responsibilities under these agreements, including adequate continued funding of the agencies and their

programs. We have no control over the resources and funding that government agencies may devote to these agreements, which may be subject to annual renewal and which generally may be terminated by the government agencies at any time. If we fail to satisfy our contractual obligations to deliver the vaccines ordered by the VRC in the manner required by the agreement, the applicable Federal Acquisition Regulations allow the VRC to cancel the agreement in whole or in part, and we may be required to perform corrective actions, including but not limited to delivering to the VRC any uncompleted or partially completed work, or GFE or other government property in our possession, or paying a third-party supplier selected by the VRC to complete any uncompleted work. The performance of these corrective actions could have a material adverse impact on our financial results in the period or periods affected. Government agencies may fail to perform their responsibilities under these agreements, which may cause them to be terminated by the government agencies. In addition, we may fail to perform our responsibilities under these agreements. We may also be unsuccessful in entering into additional agreements with government agencies.

There are only a limited number of other contractors that could perform under the bulk DNA vaccines manufacturing contract in the unlikely event that we were unable to perform. The price they might charge could be more than what we would charge based on their capacity, utilization, size of order and other factors. Accordingly, we are unable to estimate a range of potential cost that we could be required to pay if the VRC were to engage a substitute contractor to meet any performance obligations that we were unable to meet.

We have a history of net losses. We expect to continue to incur net losses and we may not achieve or maintain profitability.

To date, we have not sold or received approval to sell any products. We do not expect to sell any products for the next several years. Our net losses were approximately $24.4 million, $27.9 million and $9.2 million for 2003, 2002 and 2001, respectively. As of March 31, 2004, we have incurred cumulative net losses totaling approximately $123.9 million. Moreover, we expect that our net losses will continue and may increase for the foreseeable future. For 2004, we have forecast a net loss of between $26 million and $29 million. We may not be able to achieve our projected results, either because we generate lower revenues or lower investment income than expected, or we incur greater expenses than expected, or all of the above. We may never generate sufficient product revenue to become profitable. We also expect to have quarter-to-quarter fluctuations in revenues, expenses, and losses, some of which could be significant.

We may need additional capital in the future. If additional capital is not available, we may have to curtail or cease operations.

We may need to raise more money to continue the research and development necessary to bring our products to market and to establish marketing and additional manufacturing capabilities. We may seek additional funds through public and private stock offerings, government contracts and grants, arrangements with corporate collaborators, borrowings under lease lines of credit or other sources. For example, we currently have on file an effective shelf registration statement with the SEC seeking to register an aggregate of up to $50 million of common stock or preferred stock. In March 2004, we raised approximately $17.3 million in net proceeds from the sale of approximately 3.4 million shares of Vical common stock at $5.50 per share in a registered direct offering to a select group of institutional investors. However, we may not be able to raise additional funds on favorable terms, or at all. In March 2004, we signed a leasing agreement with the leasing division of a bank to provide us with up to $8.5 million of financing for tenant improvements and equipment with drawdowns available through December 15, 2004. The financial covenants of the agreement require us to maintain cash collateral equal to the amount of outstanding borrowings. The bank has a secured interest in the equipment financed under this agreement. Additionally, if unrestricted cash and marketable securities, as defined, are less than $45 million, we would be required to maintain a letter of credit issued by another financial institution equal to the amount of outstanding borrowings at that time. In the event this occurred, we expect that our restricted cash deposits securing the lease would be returned to us, but we would have to make restricted cash deposits with another financial institution in order to obtain a letter of credit. If we are unable to obtain additional funds, we may have to reduce our capital expenditures, scale back our development of new products, reduce our workforce or license to others products or technologies that we otherwise would seek to commercialize ourselves. The amount of money we may need will depend on many factors, including:

- The progress of our research and development programs,
- The scope and results of our preclinical studies and clinical trials, and
- The time and costs involved in: obtaining necessary regulatory approvals; filing, prosecuting and enforcing patent claims; scaling up our manufacturing

capabilities; and the commercial arrangements we may establish.

We anticipate that our available cash and existing sources of funding will be adequate to satisfy our operating needs through at least 2005.

The regulatory approval process is expensive, time consuming and uncertain, which may prevent us from obtaining required approvals for the commercialization of our products.

Our product candidates under development and those of our collaborators and licensees are subject to extensive and rigorous regulations by numerous governmental authorities in the United States and other countries. The regulations are evolving and uncertain. The regulatory process can take many years and require us to expend substantial resources. For example:

- The FDA has not established guidelines concerning the scope of clinical trials required for gene-based therapeutic and vaccine products,
- The FDA has provided only limited guidance on how many subjects it will require to be enrolled in clinical trials to establish the safety and efficacy of gene-based products, and
- Current regulations and guidances are subject to substantial review by various governmental agencies.

Therefore, U.S. or foreign regulations could prevent or delay regulatory approval of our products or limit our ability to develop and commercialize our products. Delays could:

- Impose costly procedures on our activities,
- Diminish any competitive advantages that we attain, or
- Negatively affect our results of operations and cash flows.

We believe that the FDA and comparable foreign regulatory bodies will regulate separately each product containing a particular gene depending on its intended use. For example, an advisory committee meeting may be required before the FDA would allow Phase 1 human clinical testing of our anthrax vaccine to begin. Presently, to commercialize any product we must sponsor and file a regulatory application for each proposed use. We then must conduct clinical studies to demonstrate the safety and efficacy of the product necessary to obtain FDA approval. The results obtained so far in our clinical trials may not be replicated in our ongoing or future trials. This may prevent any of our potential products from receiving FDA approval.

We use recombinant DNA molecules in our product candidates, and therefore we also must comply with guidelines instituted by the NIH and its Office of Biotechnology Activities. The NIH could restrict or delay the development of our product candidates.

We understand that both the FDA and the NIH are considering rules and regulations that would require public disclosure of commercial development data that is presently confidential. This potential disclosure of confidential commercial information, if implemented, may result in loss of advantage of competitive secrets. In March 2004, the NIH Office of Biotechnology Activities and the FDA Center for Biologics Evaluation and Research launched the jointly developed Genetic Modification Clinical Research Information System, or GeMCRIS, an Internet-based database of human gene transfer trials. In its current form, GeMCRIS enables individuals to easily view information on particular characteristics of clinical gene transfer trials, and includes special security features to protect patient privacy and confidential commercial information.

A rule published in 2002 by the FDA, known commonly as the "Animal Rule," attempts to establish requirements for demonstrating effectiveness of drugs and biological products in settings where human clinical trials for efficacy are not feasible or ethical. The rule requires as conditions for market approval the demonstration of safety and biological activity in humans, and the demonstration of effectiveness under rigorous test conditions in up to two appropriate species of animal. We believe that with appropriate guidance from the FDA, we may seek and gain market approval under the Animal Rule for DNA-based products designed to treat or prevent a disease for which clinical efficacy trials in humans are neither feasible nor ethical, such as our DNA vaccine for anthrax. At the moment, however, we cannot guarantee that the Animal Rule will be applied to any of our products, or if applied, that its application would result in expedited development time or regulatory review.

Adverse events in the field of gene therapy, or with respect to our product candidates, may negatively impact regulatory approval or public perception of our products.

The death in 1999 of a patient undergoing a viral-delivered gene therapy at the University of Pennsylvania in an investigator-sponsored trial was widely publicized. In October 2002 and January 2003, two children in France who received retroviral-delivered ex vivo gene transfer for the treatment of X-linked Severe Combined Immunodeficiency Disease, called X-SCID or "bubble boy" syndrome, were diagnosed with leukemia that was caused by the integration of the viral delivery vehicle in or near a cancer-causing region of the children's genome. The FDA responded to these events in France by temporarily halting all U.S. clinical trials using retroviral vectors to transduce hematopoietic stem cells. Following public advisory committee review by experts in the field, the FDA allowed these trials in the U.S. to continue under careful scrutiny, because the potential benefit of the investigational gene therapy in patients with this life-threatening condition was believed to justify the risk.

In March 2003, the FDA proposed a new rule on "Safety Reporting Requirements for Human Drug and Biological Products" that would change the reporting requirements for drugs and biological products, such that any serious adverse event that cannot be definitely excluded as related to the product will be reported in an expedited manner. At present, sponsors of clinical research typically report on an annual basis all serious adverse event reports that have been deemed to be "unlikely" or "improbable." The effect of this

proposed rule will likely be to increase the number of expedited reports of serious adverse events reported to the FDA, which may create a perception of increased adverse events and higher risk profiles, despite no change in the actual severity or the actual number of adverse events that occur in the course of a product's development.

Some of our potential products may be administered to patients who are suffering from, or are vulnerable to, diseases which can themselves be life-threatening. For example, one patient who had undergone treatment with Allovectin-7® for advanced metastatic melanoma died more than two months later of progressive disease and numerous other factors after receiving multiple other cancer therapies. The death was originally reported as unrelated to the treatment. Following an autopsy, the death was reclassified as "probably related" to the treatment because the possibility could not be ruled out. We do not believe Allovectin-7® was a significant factor in the patient's death.

As another example, we may administer our investigational CMV vaccine to patients who are at risk of CMV reactivation. Likewise, our investigational anthrax

vaccine may eventually be administered to patients who have been exposed to anthrax. Although we do not believe our vaccine candidates could cause the diseases they are designed to protect against, a temporal relationship between vaccination and disease onset could be perceived as causal.

These adverse events, and real or perceived risks, could result in greater government regulation and stricter labeling requirements for DNA-based vaccines or therapies, and may adversely impact market acceptance of some of our product candidates. Increased scrutiny in the field of gene therapy also may cause regulatory delays or otherwise affect our product development efforts or clinical trials.

Our patents and proprietary rights may not provide us with any benefit and the patents of others may prevent us from commercializing our products.

We are the assignee of 32 issued U.S. and foreign patents. We are also co-assignee, together with Pasteur Mérieux Sérums et Vaccins, subsequently Aventis Pasteur, and the University of Texas Health Science Center of two issued U.S. patents related to vaccines against Lyme disease. In addition, we have been granted a Japanese patent related to our core gene delivery technology that was maintained after an opposition proceeding but is subject to requests for four TFIs, a patent in Europe related to our core gene delivery technology that was revoked as a result of an opposition is currently under appeal, a patent granted in Europe covering a range of applications of our core DNA delivery technology using cationic lipid formulations has been opposed, and a patent granted in Europe covering gene-based, extra-tumoral delivery of any cytokine for the treatment of cancer has also been opposed.

We are also prosecuting 66 pending patent applications in the U.S. and in foreign countries that cover various aspects of our proprietary technology, not including patent applications for which we are a co-assignee and that are being prosecuted by our partners. Five of the pending foreign patent applications are international patent applications under the PCT, each of which preserves our right to pursue national-phase patent applications in a large number of foreign countries. In addition, we are co-assignee, together with Merck, of foreign patent applications related to DNA-based vaccines against influenza that are being prosecuted by Merck.

We may not receive any patents from our current patent applications. Moreover, if patents are issued to us, governmental authorities may not allow claims sufficient to protect our technology and products. Finally, others may challenge or seek to circumvent or invalidate our patents. In that event, the rights granted under our patents may be inadequate to protect our proprietary technology or to provide any commercial advantage.

Once issued, we maintain our patents by paying maintenance fees to the patent office in each country when due. Where appropriate, we participate in legal proceedings to vigorously defend against the revocation or withdrawal of our patents. The scope and nature of these proceedings generally differ depending on the country in which they are initiated.

For example, our core DNA delivery technology is covered by a European patent that has been issued and revoked as a result of an opposition in Europe, and a Japanese patent that was originally revoked but subsequently reinstated in Japan. Furthermore, two European patents issued in 2003, one covering a range of applications of our core DNA delivery technology, including cationic lipid-formulated, gene-based pharmaceuticals, and the second patent broadly claiming gene-based, extra-tumoral delivery of any cytokine for the treatment of cancer, have both been opposed. In addition, our core DNA delivery technology is covered by a patent application that was allowed and then withdrawn as a result of a protest procedure in Canada. We are currently appealing the European revocation, have responded to TFI requests in Japan, are preparing responses to the two new European oppositions, and are continuing prosecution of the patent application that was protested in Canada, but if our actions do not succeed, we may lose all or part of our proprietary protection on our product candidates in these countries or regions.

Some components of our gene-based product candidates are, or may become, patented by others. As a result, we may be required to obtain licenses to conduct research, to manufacture, or to market such products. Licenses may not be available on commercially reasonable terms, or at all, which may impede our ability to commercialize our products.

The legal proceedings to obtain and defend patents, and litigation of third-party claims of intellectual property infringement, could require us to spend money and could impair our operations.

Our success will depend in part on our ability to obtain patent protection for our products and processes, both in the United States and in other countries. The patent positions of biotechnology and pharmaceutical companies, however, can be highly uncertain and involve complex legal and factual questions. Therefore, it is difficult to predict the breadth of claims allowed in the biotechnology and pharmaceutical fields.

We also rely on confidentiality agreements with our corporate collaborators, employees, consultants and certain contractors to protect our proprietary technology. However, these agreements may be breached and we may not have adequate remedies for such breaches. In addition, our trade secrets may otherwise become known or independently discovered by our competitors.

Protecting intellectual property rights can be very expensive. Litigation will be necessary to enforce patents issued to us or to determine the scope and validity of third-party proprietary rights. Moreover, if a competitor were to file a patent application claiming technology also invented by us, we would have to participate in an interference proceeding before the United States Patent and Trademark Office to determine the priority of the invention. We may be drawn into interferences with third parties or may have to provoke interferences ourselves to unblock third-party patent rights to allow us or our licensees to commercialize products based on our technology. Litigation could result in substantial costs and the diversion of management's efforts regardless of the results of the litigation. An unfavorable result in litigation could subject us to significant liabilities to third parties, require disputed rights to be licensed or require us to cease using some technology.

Our products and processes may infringe, or be found to infringe, patents not owned or controlled by us. Patents held by others may require us to alter our products or processes, obtain licenses, or stop activities. If relevant claims of third-party patents are upheld as valid and enforceable, we could be prevented from practicing the subject matter claimed in the patents, or may be required to obtain licenses or redesign our products or processes to avoid infringement. In addition, we could be required to pay money damages. A number of genetic sequences or proteins encoded by genetic sequences that we are investigating are, or may become, patented by others. As a result, we may have to obtain licenses to test, use or market these products. Our business will suffer if we are not able to obtain licenses at all or on terms commercially reasonable to us and we are not able to redesign our products or processes to avoid infringement.

We are currently involved in several legal proceedings involving our intellectual property rights. Our core DNA delivery technology was covered by a patent issued in Europe in 1998, which was subsequently opposed by seven companies under European patent procedures. This patent was revoked on formal grounds in October 2001 under an initial ruling by the Opposition Division of the EPO. In April 2002, we filed an appeal, which is still pending, seeking to overturn this initial ruling. Our core DNA delivery technology is also covered by a Canadian patent that was allowed and then withdrawn after protests against its issuance were filed on behalf of an undisclosed party or parties in August and December 2001. We have responded to the protests and are continuing prosecution of the application in the Canadian Patent Office.

In addition, our core DNA delivery technology is covered by a Japanese patent that was published in January 2002 and thereafter revoked by the examining panel at the JPO on formal and substantive grounds. We filed a rebuttal response to the revocation which resulted in the maintenance of the patent. Based on our arguments and supporting evidence in that response, the JPO decided to reinstate the patent in July 2003. We also received notice that four TFI requests against this patent were filed in the JPO by two companies. We filed responses to the TFI requests in a timely manner and are awaiting further action by the JPO.

A European patent issued in 2003, covers a range of applications of our core DNA delivery technology, including cationic lipid-formulated, gene-based immunotherapeutics such as our clinical-stage Allovectin-7® treatment for melanoma, cationic lipid-formulated DNA vaccines such as our investigational anthrax vaccine, and similar pharmaceutical products under development by others. This patent has been opposed by two companies. We intend to respond to the oppositions in a timely manner.

A European patent issued to us in 2003 with broad claims related to gene-based, extra-tumoral delivery of any cytokines for the treatment of cancer. Delivery can be either free from or formulated with transfection-facilitating materials such as cationic lipids or polymers. Cytokines are proteins such as interleukins and interferons which regulate specific cell functions, and typically are used to stimulate an immune response against cancer cells. Three companies have opposed this patent. We intend to respond to the oppositions in a timely manner.

We have licensed from the University of Michigan rights to various U.S. and international patents related to injection of DNA-based therapeutics into tumors that, for example, provide additional protection for Allovectin-7® and Leuvectin®. Included in this license is a European patent granted in March 2002. We have received notice from the EPO that one company filed an opposition in December 2002 alleging both formal and substantive grounds for revocation, and that the opposition was declared admissible in February 2003. We filed a rebuttal response to the opposition in a timely manner and are awaiting further action by the EPO.

A lawsuit was filed against us in July 2003 by the WARF in the United States District Court for the Western District of Wisconsin. This lawsuit concerns the interpretation of payment provisions of a license agreement that we entered into with the WARF in 1991, and payments made under this agreement. The WARF seeks a declaratory judgment as to the correct interpretation of the payment provisions of the agreement and additional compensation from us, the amount of which is unspecified in the WARF's complaint. We counterclaimed, likewise seeking a declaratory judgment as to the correct interpretation of the payment provisions of the agreement and a return of amounts overpaid to the WARF under this agreement in excess of $1.5 million. In the first quarter of 2004, we accrued $1.5 million for settlement of this matter.

Competition and technological change may make our product candidates and technologies less attractive or obsolete.

We compete with companies, including major pharmaceutical and biotechnology firms, that are pursuing other forms of treatment or prevention for diseases that we target. We also may experience competition from companies that have acquired or may acquire technology from universities and other research institutions. As these companies develop their technologies, they may develop proprietary positions which may prevent us from successfully commercializing products.

Some of our competitors are established companies with greater financial and other resources. Other companies may succeed in developing products and obtaining FDA approval faster than we do, or in developing products that are more effective than ours. While we will seek to expand our technological capabilities to remain competitive, research and development by others will seek to render our technology or products obsolete or noncompetitive or result in treatments or cures superior to any therapeutics developed by us. Additionally, even if our product development efforts are successful, and even if the requisite regulatory approvals are obtained, our products may not gain market acceptance among physicians, patients, healthcare payers and the medical communities. If any of our products do not achieve market acceptance, we may lose our investment in that product, which could have a material adverse impact on our operations.

The method of administration of some of our product candidates can cause adverse events in patients, including death.

Some of our potential products are designed to be injected directly into malignant tumors. There are medical risks inherent in direct tumor injections. For example, in clinical trials of Allovectin-7®, attending physicians have punctured patients' lungs in less than one percent of procedures, requiring hospitalization. In addition, a physician administering Allovectin-7® in an investigator-sponsored clinical trial inadvertently damaged tissue near the heart of a patient, which may have precipitated the patient's death. These events are reported as adverse events in our clinical trials. These risks may adversely impact market acceptance of some of our product candidates.

If we lose our key personnel or are unable to attract and retain additional personnel, we may not be able to pursue collaborations or develop our own products.

We are highly dependent on our principal scientific, manufacturing, clinical, regulatory and management personnel, including Vijay B. Samant, our President and Chief Executive Officer, and David C. Kaslow, our Chief Scientific Officer. The loss of the services of these individuals might significantly delay or prevent the achievement of our objectives. We do not maintain "key person" life insurance on any of our personnel. We depend on our continued ability to attract, retain and motivate highly qualified management and scientific personnel. We face competition for qualified individuals from other companies, academic institutions, government entities and other organizations in attracting and retaining personnel. To pursue our product development plans, we may need to hire additional management personnel and additional scientific personnel to perform research and development, as well as personnel with expertise in clinical trials, government regulation and manufacturing. We have not had any problem attracting and retaining key personnel and qualified staff in the recent past. However, due to the reasons noted above, we may not be successful in hiring or retaining qualified personnel.

We have limited experience in manufacturing our product candidates in commercial quantities. We may not be able to comply with applicable manufacturing regulations or produce sufficient product for contract or commercial purposes.

The commercial manufacturing of vaccines and other biological products is a time-consuming and complex process, which must be performed in compliance with the FDA's current Good Manufacturing Practices, or cGMP, regulations. We may not be able to comply with the cGMP regulations, and our manufacturing process may be subject to delays, disruptions or quality control problems. In addition, we must complete the installation and validation of a large-scale fermenter and related purification equipment in order to produce the quantities of product expected to be required under certain contract manufacturing agreements or for commercial purposes. We do not have any experience in manufacturing at this scale. Noncompliance with the cGMP regulations, the inability to complete the installation or validation of our large-scale equipment, or other problems with our manufacturing process may limit or delay the development or commercialization of our product candidates, and cause us to breach our contract manufacturing arrangements.

We may initially depend on third parties to manufacture our product candidates commercially.

We may initially depend on collaborators, licensees or other third parties to manufacture our product candidates in commercial quantities. We may be unable to enter into any arrangement for the commercial manufacture of our product candidates,

and any arrangement we secure may not meet our requirements for manufacturing quality or quantity. Our dependence on third parties for the commercial manufacture of our product candidates may also reduce our profit margins and our ability to develop and deliver products in a timely manner.

We have no marketing or sales experience, and if we are unable to develop our own sales and marketing capability, we may not be successful in commercializing our products.

Our current strategy is to market our proprietary products directly in the United States, but we currently do not possess pharmaceutical marketing or sales capabilities. In order to market and sell our proprietary products, we will need to develop a sales force and a marketing group with relevant pharmaceutical experience, or make appropriate arrangements with strategic partners to market and sell these products. Developing a marketing and sales force is expensive and time-consuming and could delay any product launch. If we are unable to successfully employ qualified marketing and sales personnel or develop other sales and marketing capabilities, our business will be harmed.

Healthcare reform and restrictions on reimbursement may limit our returns on potential products.

Our ability to earn sufficient returns on our products will depend in part on how much, if any, reimbursement for our products and related treatments will be available from:

- Government health administration authorities,
- Government agencies procuring biodefense products for military or public use, including some for which we may become a sole-source vendor,
- Private health coverage insurers,
- Managed care organizations, and
- Other organizations.

If we fail to obtain appropriate reimbursement, we could be prevented from successfully commercializing our potential products. There are efforts by governmental and third-party payers to contain or reduce the costs of healthcare through various means. We expect that there will continue to be a number of legislative proposals to implement government controls. The announcement of proposals or reforms could impair our ability to raise capital. The adoption of proposals or reforms could impair our business.

Certain portions of the Health Insurance Portability and Accountability Act of 1996, or HIPAA, have become effective and may complicate the process by which clinical trials may be initiated, however the specific nature and degree of impact are not yet known.

Additionally, third-party payers are increasingly challenging the price of medical products and services. If purchasers or users of our products are not able to obtain adequate reimbursement for the cost of using our products, they may forego or reduce their use. Significant uncertainty exists as to the reimbursement status of newly approved healthcare products, and whether adequate third-party coverage will be available.

We use hazardous materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly.

Our research and development processes involve the controlled storage, use and disposal of hazardous materials, biological hazardous materials and minor amounts of low-level radioactive compounds. Our hazardous materials include certain compressed gases, flammable liquids, acids and bases, and other toxic compounds. We are subject to federal, state and local regulations governing the use, manufacture, storage, handling and disposal of materials and waste products. Although we believe that our safety procedures for handling and disposing of these hazardous materials comply with the standards prescribed by law and regulation, the risk of accidental contamination or injury from hazardous materials cannot be completely eliminated. In the event of an accident, we could be held liable for any damages that result. We have insurance that covers our use of hazardous materials with the following coverage limits: up to $25,000 per occurrence for losses related to the release of bio-contaminants, $1 million per occurrence for losses from refrigerant contamination and $25,000 per occurrence for losses from radioactive contamination. Any liability could exceed the limits or fall outside the coverage of our insurance. We could be required to incur significant costs to comply with current or future environmental laws and regulations.

We may have significant product liability exposure.

We face an inherent business risk of exposure to product liability and other claims in the event that our technologies or products are alleged to have caused harm. We also have potential liability for products manufactured by us on a contract basis for third parties. These risks are inherent in the development and manufacture of chemical and pharmaceutical products. Although we currently maintain product liability insurance in the amount of $10 million in the aggregate, this insurance coverage may not be sufficient, and we may not be able to obtain sufficient coverage in the future at a reasonable cost. Our inability to obtain product liability insurance at

an acceptable cost or to otherwise protect against potential product liability claims could prevent or inhibit the commercialization of any products developed by us or our collaborators, or our ability to manufacture products for third parties. To date, no product liability claims have been filed against us. However, if we are sued for any injury caused by our technology or products, or by third-party products that we manufacture, our liability could exceed our insurance coverage and total assets.

Our stock price could continue to be highly volatile and you may not be able to resell your shares at or above the price you pay for them.

The market price of our common stock, like that of many other life sciences companies, has been and is likely to continue to be highly volatile. During the three-year period ended March 31, 2004, our stock price has ranged from $2.12 to $18.00. The following factors, among others, could have a significant impact on the market price of our common stock:

- The results of our preclinical studies and clinical trials or those of our collaborators, licensees or competitors or for gene therapies in general,
- Evidence or lack of evidence of the safety or efficacy of our potential products or those of our collaborators, licensees or competitors,
- The announcement by us or our collaborators, licensees or competitors of technological innovations or new products,
- Developments concerning our patent or other proprietary rights or those of our collaborators, licensees or competitors, including litigation and challenges to our proprietary rights,
- Other developments with our collaborators or licensees,
- Geopolitical developments, natural or man-made disease threats, or other events beyond our control,
- U.S. and foreign governmental regulatory actions,
- Changes or announcements in reimbursement policies,
- Concern as to the safety of our potential products,
- Period-to-period fluctuations in our operating results,

- Market conditions for life science stocks in general,
- Changes in the collective short interest in our stock,
- Changes in estimates of our performance by securities analysts, and
- Our cash balances, need for additional capital, and access to capital.

We are at risk of securities class action litigation due to our expected stock price volatility.

In the past, stockholders have brought securities class action litigation against a company following a decline in the market price of its securities. This risk is especially acute for us because life science companies have experienced greater than average stock price volatility in recent years and, as a result, have been subject to, on average, a greater number of securities class action claims than companies in other industries. To date, we have not been subject to class action litigation. However, we may in the future be the target of this litigation. Securities litigation could result in substantial costs and divert our management's attention and resources, and could seriously harm our business.

The ability of our investors to seek remedies against Arthur Andersen LLP, who audited some of the financial statements included in our Annual Reports on Form 10-K for the years ended December 31, 2003, 2002 and 2001, may be significantly limited.

Our annual financial statements for the year ended December 31, 2001, which were included in our Annual Reports on Form 10-K for the years ended December 31, 2003, 2002 and 2001, were audited by Arthur Andersen LLP. We dismissed Arthur Andersen as our independent public accountants effective April 16, 2002. After reasonable efforts, we were unable to obtain Arthur Andersen's written consent to incorporate by reference its report dated February 1, 2002, with respect to these audited financial statements. The absence of this consent may limit the ability of investors to seek remedies against Arthur Andersen for any untrue statement of a material fact contained in these financial statements, or any omission of a material fact required to be stated in these financial statements. In addition, as a practical matter, any claims that may be available under federal securities laws against auditing firms may not be available against Arthur Andersen due to the diminished amount of assets of Arthur Andersen that are or in the future may be available for claims.

Anti-takeover provisions in our stockholder rights plan, our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Pursuant to the terms of our stockholder rights plan, we have distributed a dividend of one preferred stock purchase right for each outstanding share of common stock. These rights will cause substantial dilution to the ownership of a person or group that attempts to acquire us on terms not approved by our board of directors. Our certificate of incorporation and bylaws include other anti-takeover provisions, such as a classified board of directors, a prohibition on stockholder actions by written consent, the authority of our board of directors to issue preferred stock without stockholder approval, and supermajority voting requirements for specified actions. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which prohibits stockholders owning in excess of 15% of our outstanding voting stock from merging or combining with us. These provisions may delay or prevent an acquisition of us, even if the acquisition may be considered beneficial by some stockholders. In addition, they may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

The issuance of preferred stock could adversely affect our common stockholders.

In December 2003, a shelf registration statement that we filed with the SEC was declared effective, which will allow us to issue from time to time an aggregate of up to $50 million of common stock or preferred stock, of which to date we have issued approximately $18.6 million of common stock. The issuance of preferred stock could adversely affect the voting power of holders of our common stock, and reduce the likelihood that our common stockholders will receive dividend payments and payments upon liquidation. The issuance of preferred stock could also decrease the market price of our common stock, or have terms and conditions that could discourage a takeover or other transaction that might involve a premium price for our shares or that our stockholders might believe to be in their best interests.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to interest rate risk. Our investment portfolio is maintained in accordance with our investment policy which defines allowable investments, specifies credit quality standards and limits the credit exposure of any single issuer. Our investment portfolio consists of cash equivalents and marketable securities. The average maturity of our non-equity investments is approximately nine months. Our investments are classified as available-for-sale securities, or restricted securities in the case of securities used to secure lease financing or a standby letter of credit.

Marketable securities also include our investment in common stock of Corautus. Any subsequent change in the fair value of the Corautus shares we own, based on the market price of the listed shares, is reflected as an unrealized gain or loss in the stockholders' equity section of our balance sheet at the end of each quarter, provided any reduction in value is not due to impairment which is other than temporary.

To assess our interest rate risk, we performed a sensitivity analysis projecting an ending fair value of our cash equivalents and marketable securities using the following assumptions: a 12-month time horizon, a 9-month average maturity and a 150-basis-point increase in interest rates. This pro forma fair value would have been $0.7 million lower than the reported fair value of our non-equity investments at March 31, 2004. At March 31, 2004, our unrealized gain on marketable securities was $1.3 million, including an unrealized gain of $1.1 million on our investment in Corautus. We expect lower investment income in the full year 2004 compared with 2003 due to lower investment balances.

The fair market value of floating interest rate debt is subject to interest rate risk. Generally, the fair market value of floating interest rate debt will vary as interest rates increase or decrease. Based on our market risk-sensitive instruments outstanding at March 31, 2004, and December 31, 2003, we believe that there were no material market risk exposures to our financial position, results of operations or cash flows as of such dates.

ITEM 4. CONTROLS AND PROCEDURES

Prior to the filing of this report, we carried out an evaluation, under the supervision and with the participation of our principal executive officer and principal financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures are designed to ensure that information required to be disclosed in our periodic reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Based upon that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report. There has been no change in our internal control over financial reporting during the three months ended March 31, 2004, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On July 29, 2003, the WARF filed a complaint against us in the United States District Court for the Western District of Wisconsin, seeking a declaratory judgment regarding the meaning of certain payment provisions in a license agreement we entered into with the WARF in 1991, as well as fees related to our sublicense of certain inventions jointly owned by us and the WARF, the amount of which is unspecified in the WARF's complaint. We counterclaimed, likewise seeking a declaratory judgment as to the correct interpretation of the payment provisions of the agreement and a return of amounts overpaid to the WARF under this agreement in excess of $1.5 million. In the first quarter of 2004, we accrued $1.5 million for settlement of this matter.

Our core DNA delivery technology was covered by a patent issued in Europe in 1998, which was subsequently opposed by seven companies under European patent procedures. This patent was revoked on formal grounds in October 2001 under an initial ruling by the Opposition Division of the EPO. The Opposition Division ruled that, as a result of amendments to the claims made during the process of obtaining the European patent and during the opposition process, the claims did not comply with European patent laws. In April 2002, we filed an appeal, which is still pending, seeking to overturn this initial ruling. We intend to vigorously defend our patent position in the European opposition proceedings. If we are not successful in the appeal and opposition proceedings, we may lose part or all of our proprietary protection on our product candidates in Europe. However, we may also use additional issued patents and patent applications that are pending in Europe to protect our core DNA delivery technology.

Our core DNA delivery technology is also covered by a Canadian patent application that was allowed and then withdrawn after protests against its issuance were filed on behalf of an undisclosed party or parties in August and December 2001. We have responded to the protests and are continuing prosecution of the application in the Canadian Patent Office.

In addition, our core DNA delivery technology is covered by a Japanese patent that was published in January 2002 and thereafter revoked by the examining panel at the JPO, on formal and substantive grounds. We filed a rebuttal response to the revocation. Based on our arguments and supporting evidence in that response, the JPO decided to reinstate the patent in July 2003. We also received notice that four TFI requests against this patent were filed in the JPO by two companies. We filed responses to the TFI requests in a timely manner and are awaiting further action by the JPO.

A European patent issued in 2003 covering a range of applications of our core DNA delivery technology, including cationic lipid-formulated, gene-based immunotherapeutics such as our clinical-stage Allovectin-7® treatment for melanoma, cationic lipid-formulated DNA vaccines such as our investigational anthrax vaccine, and similar pharmaceutical products under development by others. This patent has been opposed by two companies. We intend to respond to the oppositions in a timely manner.

A European patent issued to us in 2003 with broad claims related to gene-based, extra-tumoral delivery of any cytokines for the treatment of cancer. Delivery can be either free from or formulated with transfection-facilitating materials such as cationic lipids or polymers. Cytokines are proteins such as interleukins and interferons which regulate specific cell functions, and typically are used to stimulate an immune response against cancer cells. Three companies have opposed this patent. We intend to respond to the oppositions in a timely manner.

We have licensed from the University of Michigan rights to various U.S. and international patents related to injection of DNA-based therapeutics into tumors that, for example, provide additional protection for Allovectin-7® and Leuvectin®. Included in this license is a European patent granted in March 2002. We have received notice from the EPO that one company filed an opposition in December 2002 alleging both formal and substantive grounds for revocation, and that the opposition was declared admissible in February 2003. We filed a rebuttal response to the opposition in a timely manner and are awaiting further action by the EPO.

In the ordinary course of business, we may become a party to lawsuits involving various matters. We are unaware of any such lawsuits presently pending against us, except as noted above, and none of which, individually or in the aggregate, is deemed to be material to our financial condition.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit Number	Description of Document
3.1(i)(1)	Restated Certificate of Incorporation.
3.1(ii)(1)	Amended and Restated Bylaws.
4.1(1)	Specimen Common Stock Certificate.
4.2(2)	Rights Agreement dated as of March 20, 1995, between the Company and First Interstate Bank of California.
10.34(3)	Amendment dated March 17, 2004, to Employment Agreement dated November 28, 2000, between the Company and Vijay B. Samant.
10.35	Lease Agreement dated March 19, 2004, between the Company and Banc of America Leasing and Capital, LLC.
31.1	Certification of Vijay B. Samant, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Martha J. Demski, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Vijay B. Samant, Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Martha J. Demski, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(1) Incorporated by reference to the exhibit of the same number filed with the Company's Registration Statement on Form S-3 (No. 33-95812) filed on August 15, 1995.

(2) Incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1994.

(3) Incorporated by reference to the exhibit of the same number to the Company's Current Report on Form 8-K filed on March 24, 2004.

(b) Reports on Form 8-K

On February 10, 2004, we filed a Form 8-K to disclose our press release of financial results for the three months and year ended December 31, 2003.

On March 24, 2004, we filed a Form 8-K to disclose various matters relating to the public offering of 3,379,000 shares of our common stock under our shelf

registration with the SEC, as well as an amendment to our employment agreement with Vijay B. Samant and an opposition of a European patent we hold.

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.

Vical Incorporated

Date: May 10, 2004

By: /s/ MARTHA J. DEMSKI
Martha J. Demski
Vice President and Chief Financial Officer
(on behalf of the registrant and as the
registrant's Principal Financial and Accounting Officer)

Bank of America

Banc of America Leasing & Capital, LLC | **Lease Intended as Security** | **Lease Number 07489-00600**

This Lease Intended as Security (this "Agreement") dated as of March 19, 2004, between **Banc of America Leasing & Capital, LLC** ("Lessor"), a Delaware limited liability company having an office at 2059 Northlake Parkway, 4 South, Tucker, GA 30084, and Vical Incorporated ("Lessee"), a Delaware corporation, having its chief executive office at 10390 Pacific Center Court , San Diego, California 92121.

1. Lease Agreement; Schedules. Subject to the terms and conditions hereof, Lessor shall lease to Lessee, and Lessee shall lease from Lessor, the items of personal property (collectively with all attachments and accessories thereto, the "Units") described in one or more schedules (each, a "Schedule"; each Schedule, together with this Agreement as it pertains thereto, a "Lease") which incorporate by reference this Agreement. Each Schedule shall constitute a separate and independent lease and contractual obligation of Lessee. Upon delivery and acceptance by Lessee of each Unit, Lessee shall execute and deliver the Schedule relating to the Unit, with all information required on the Schedule fully completed, identifying and accepting the Unit.

2. Term of Lease; Rentals. The lease term with respect to any Unit shall consist of an "Interim Term" (if any) and a "Base Term" as specified in the Schedule covering such Unit. Lessee shall pay rent for the Interim Term ("Interim Rent") and for the Base Term ("Base Rent") as specified in the applicable Schedule.

3. Net Lease; Disclaimer of Warranties. Each Lease is a net lease. All costs, expenses and other liabilities associated with the Units shall be borne solely by Lessee. Lessee's obligation to pay rent and all other obligations under any Lease are absolute and unconditional, and not subject to any abatement, deferment, reduction, setoff, defense, counterclaim or recoupment for any reason whatsoever. No Lease shall terminate, except as expressly provided herein, nor shall the obligations of Lessee be affected, by reason of any defect or damage to, or any destruction, loss, theft, forfeiture, governmental requisition or obsolescence of any Unit, regardless of cause. Lessee acknowledges that Lessor is not a merchant or manufacturer, or agent of any such person, or engaged in the sale or distribution of the Units, and has not made, and does not hereby make, any representation or warranty as to merchantability, performance, condition, fitness or suitability for Lessee's purposes of any of the Units, or make any other representation or warranty with respect to the Units. Lessor shall not be liable to the Lessee for, nor shall Lessee's obligations under any Lease be affected by, any loss, claim, liability, cost, damage or expense of any kind caused, or alleged to be caused, directly or indirectly, by any Unit, or by any inadequacy of the Unit for any purpose, or by any defect in, the use or maintenance of, any repairs, servicing or adjustments of, or any interruption or loss of service or use of, any Unit, or any loss of business, profits, consequential or other damage of any nature. Lessor hereby transfers and assigns to Lessee, to the extent allowable by law, for and during the lease term of each Schedule, a non-exclusive interest in the Unit warranties, if any, of the manufacturer, and hereby authorizes Lessee, when there exists no Event of Default, to enforce such warranties and to obtain at its own expense the customary services furnished by the manufacturer in connection with the Units.

4. Use, Maintenance, Location. Lessee shall use, operate, protect and maintain the Units in good operating order, repair, condition and appearance, and in compliance with all applicable insurance policies, laws, ordinances, rules, regulations and manufacturer's recommended procedures, and shall maintain comprehensive records regarding the Units. The Units shall be used solely for commercial or business purposes, and not for any consumer, personal, home, or family purpose, and shall not be abandoned. Lessee shall not, through modifications, alterations or otherwise, impair the value or originally intended function of any Unit without Lessor's prior consent. Any replacement or substitution of parts, improvements, upgrades, or additions to the Units made by Lessee shall become subject to the Lease and title shall vest in Lessor, except that if no Event of Default exists, Lessee may at its expense remove improvements or additions provided by Lessee that can be readily removed without impairing the value and function of the Unit. If requested by Lessor, Lessee shall cause each Unit to be plainly marked to disclose Lessor's ownership, as specified by Lessor. Lessee shall not change the location or base of any Unit specified in its Schedule without Lessor's prior consent. Lessee shall notify Lessor at least 30 days before changing the location of its chief executive office.

5. Loss and Damage. Lessee assumes all risk of, and shall promptly notify Lessor of any occurrence of, any damage to or loss, theft, confiscation or destruction of (together, "Casualty") each Unit from any cause whatsoever from the date the Unit is shipped by the vendor or manufacturer or otherwise made available to Lessee ("Shipment Date"). If any Unit suffers a Casualty from the Shipment Date until the Acceptance Date, Lessee shall pay Lessor any sum required to be paid under any Progress Payment Agreement entered into between

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Lessor and Lessee in relation to such Unit. If any Unit suffers a Casualty on or after its Acceptance Date, Lessee shall, if the Casualty is damage that is reparable in the judgment of Lessee, at Lessees option either: (i) at its own expense promptly place the same in good repair, condition or working order or (ii) pay the Balance Due with respect thereto, and if the Unit is lost, stolen, confiscated, destroyed or damaged beyond repair ("Total Loss"), on the rent payment date following such occurrence (or, if none, within 30 days) pay Lessor the Balance Due therefor, together with all other amounts owing under the Lease with respect to the Unit. The "Balance Due" for each Unit is, after the Acceptance Date and before the Base Date for such Unit, Lessor's Cost in respect of such Unit, together with all Interim Rent accrued to the date of payment and all other amounts owing under the Lease, and thereafter, the sum of (i) the present value, as of such payment date, of the entire unpaid balance of all Base Rent for such Unit that would otherwise have accrued under the Lease from such payment date to the end of its scheduled Base Term and (ii) the present value, as of such payment date, of the Purchase Amount therefor as specified in the applicable Schedule, in each case, discounted at the implicit rate for the Lease reasonably determined by Lessor. Upon such payment, (a) the Lease of such Unit shall terminate and Lessee thereupon shall become entitled to possession of such Unit and (b) Lessee shall become entitled to proceeds of insurance maintained by Lessee. If less than all Units in the applicable Schedule suffer Total Loss, the remaining Base Rent under the Schedule shall be reduced as reasonably calculated by Lessor and notified to Lessee.

6. Insurance. Lessee, at its own expense, shall keep each Unit insured against all risks for the value of the Unit and in no event for less than the Balance Due for the Unit, and shall maintain public liability insurance against such risks and for such amounts as Lessor may require. All such insurance shall be in such form and with such companies as Lessor shall approve, shall specify Lessor and Lessee as insureds and shall provide that such insurance may not be canceled as to Lessor or altered in any way that would affect the interest of Lessor without at least 30 days' prior written notice to Lessor (10 days' in the case of nonpayment of premium). All insurance shall be primary, without right of contribution from any other insurance carried by Lessor, shall contain waiver of subrogation and "breach of warranty" provisions satisfactory to Lessor, shall provide that all amounts payable by reason of loss or damage to the Units shall be payable to Lessee (unless an Event of Default has occurred and is continuing, in which case all such amounts shall be payable to Lessor), and shall contain such other endorsements as Lessor may reasonably require. Lessee shall provide Lessor with evidence satisfactory to Lessor of the required insurance upon the execution of any Schedule and promptly upon any renewal of any required policy.

7. Indemnities. (a) Lessee shall indemnify Lessor, its successors and assigns and their respective officers, directors, employees, agents and affiliates ("Indemnified Persons") against all claims, liabilities, losses and expenses whatsoever (except those directly and primarily caused by the Indemnified Person's gross negligence or willful misconduct), including reasonable attorneys' fees and allocated costs of internal counsel (together, "Attorney Costs"), in any way relating to or arising out of this Agreement, the Units or the Leases at any time, or the ordering, acquisition, rejection, installation, possession, maintenance, use, ownership, condition, destruction, return, or disposition of the Units, including such matters based in negligence and strict liability in tort, environmental liability, statutory liability, or infringement.

(b) Lessee shall pay or reimburse Lessor and its successors and assigns on demand for, and indemnify and hold harmless Lessor from, all taxes, assessments, fees and other governmental charges paid or required to be paid by Lessor or Lessee in any way arising out of or related to the Units or the Leases, before, during or after the lease term,

including foreign, Federal, state, county and municipal fees, taxes and assessments, and property, value-added, sales, use, gross receipts, excise, stamp and documentary taxes, and all related penalties, fines, additions to tax, and interest charges (together, "Impositions"), excluding only Federal and state taxes based on Lessors net income, unless such taxes are in lieu of any Imposition Lessee would otherwise be required to pay hereunder. Lessee shall timely pay any Imposition for which Lessee is primarily responsible under law and any other Imposition not payable or not paid by Lessor, but Lessee shall have no obligation to pay any such Imposition that Lessee is contesting in good faith and by appropriate legal proceedings, the nonpayment of which does not, in the opinion of Lessor, result in a material risk of adverse effect on the title, property, use, disposition or other rights of Lessor with respect to the Units. Lessee shall furnish on Lessor's request proof of payment of any Imposition paid by Lessee.

8. Return of Units. Upon any termination or expiration of the lease term with respect to any Unit, subject to any Lessee purchase of the Unit pursuant to the applicable Schedule, Lessee shall, at its own expense, prepare and adequately protect the Unit for shipment and either surrender it to Lessor in place or, if instructed by Lessor, ship the Unit to Lessor, freight and insurance pre-paid, at a place reasonably designated by Lessor, in the condition required under Section 4 hereof, subject to reasonable wear and tear from proper usage, and in condition required under the applicable Schedule, and able to be put into immediate service and to perform at manufacturer's rated levels (if any) for equipment of like age, together with all related manuals, documents and records. If Lessee does not so surrender or return a Unit to Lessor, in addition to all other rights and remedies available, at Lessor's election, such Unit shall continue to be subject to all the terms and conditions of the Lease, with rent and other charges continuing to accrue and be payable under the Lease with respect to such Unit until it is so surrendered or returned to Lessor, except that Base Rent shall accrue, payable on demand, at the rate of 150% of the rate applicable in the last period for which Base Rent was payable.

9. Early Termination. (a) Upon any rent payment date relating to a Lease, and no less than 30 days' irrevocable notice to Lessor, from and after the expiry of one-half of the applicable Base Term, provided no Event of Default exists, Lessee shall have the option to terminate the Lease with respect to all and not less than all Units covered thereby by purchasing the Units "as is and where is" without warranties or representations of any kind, express or implied, for a purchase price equal to the Balance Due plus all other amounts owing with respect to the Units, plus early termination charges in the amount set forth in paragraph (b) below. The purchase price of the Units and any early

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termination charge shall be paid in immediately available funds at the time of exercising such option.

(b) Upon any termination of the Lease before the scheduled expiration of the Base Term, due to the exercise of any early termination option, a Casualty or a default, in addition to all other amounts to be paid by Lessee, Lessee shall pay Lessor an amount (the "Make-Whole"), equal to the greater of (A) the amount (not less than zero) that must be added thereto in order that the Make-Whole plus the Balance Due on the early termination date is equal to the sum of the present values (using discount rates per annum for each obligation equal to the Formula Yield (as defined below) as of the early termination date of (x) all remaining installments of Base Rent and (y) the Purchase Amount (collectively, the "Discounted Payments"), or (B) an amount equal to 2% times the Balance Due. "Formula Yield" for each obligation shall mean, as of any date of determination, the rate, as published by Telerate Systems, Inc. or other source, for United States Government Treasury obligations of maturities corresponding to the weighted average life, rounded to the second decimal place, of the Discounted Payments. If no maturity exactly corresponds to such rounded weighted average life for such obligation, yields of the two most closely corresponding published maturities shall be calculated pursuant to the foregoing sentence and the Formula Yield shall be interpolated from such yields on a straight-line basis.

10. Lessee Representations and Agreements. Lessee represents, warrants and agrees as follows:

(a) Lessee has duly authorized the execution, delivery and performance of this Agreement, each Schedule, and all other documents contemplated hereby, which are, or upon signing, will be, binding on Lessee and do not contravene any other instrument or agreement to which Lessee is party.

(b) Lessor has and shall at all times continue to have a perfected security interest in the Units and the other Collateral, subject to no prior liens or security interests, to secure the obligations specified in Section 17(g) of this Agreement.

(c) In order to secure Lessee's payment and performance of all obligations under this Agreement, Lessee shall provide to Lessor (and maintain) a first-priority perfected security interest in cash (or cash equivalent) collateral, pursuant to that certain Security Agreement dated and substance satisfactory to Lessor, in an amount equal to: (i) one hundred percent (100%) of the aggregate Lessor's Cost of all Units leased hereunder, or portion thereof, with respect to which (and to the extent) Lessee has placed money market mutual funds in the "Account" (as defined in the Security Agreement) as security therefor, and (ii) one hundred five percent (105%) of the aggregate Lessor's Cost of all Units leased hereunder, or portion thereof, with respect to which (and to the extent) Lessee has placed United States treasuries and/or United States government agency securities in the Account as security therefor (in the aggregate, the "Cash Collateral Amount") as such amount may be hereafter amended from time to time pursuant to the Security Agreement. If and to the extent Lessee places money market mutual funds in the Account, Lessee covenants and agrees not to convert the same to either of the other two permitted forms of cash collateral (United States government agency securities and United States treasuries). The foregoing shall not be construed to prohibit Lessee from directing funds from matured United States government agency securities or United States treasuries in the Account to money 6.government agency securities. Six (6) months following the Base Date of the first Schedule hereunder, and semi-annually thereafter, Lessee may request in writing that Lessor release a portion of the cash collateral to reduce the Cash Collateral Amount. Lessor may in its sole but reasonable discretion either refuse or grant the request to reduce the Cash Collateral Amount.

(d) In the event Lessee's "Liquid Assets" (as defined hereinbelow) shall at any time fall below Forty Five Million Dollars ($45,000,000), Lessee shall provide (and maintain at all times), within ten (10) business days thereafter, as security for Lessee's obligations hereunder, an irrevocable letter of credit in an amount equal to the Cash Collateral Amount, in a form and issued by a bank acceptable to Lessor, whereupon Lessor shall release its security interest in the cash collateral required in Subsection (c) hereinabove. "Liquid Assets", for purposes of the foregoing, shall mean, Lessee's unrestricted and unencumbered:

(i) cash and certificates of deposit;

(ii) U.S. treasury bills and other obligations of the federal government; and

(iii) readily marketable securities (including commercial paper, but excluding restricted stock and stock subject to the provisions of Rule 144 of the Securities and Exchange Commission).

11. Personal Property. The Units shall remain personal property at all times, notwithstanding the manner in which they may be attached or affixed to realty, and title shall at all times continue in Lessor. Lessee shall obtain and record such instruments and take such steps as may be necessary (a) to prevent any person from acquiring any right or lien in or on any Unit, whether by reason of such Unit being deemed to be attached to real or other property, or otherwise, and (b) to ensure Lessor's right of access to and removal of the Unit, in accordance with the Lease.

12. Default and Remedies. (a) Each of the following is an "Event of Default" hereunder and under any and all Leases then in effect: (1) Lessee fails to pay when due any installment of rent or other sum owing by Lessee under any Lease; (2) Lessee fails to maintain insurance in respect of any Unit as required herein, or sells, leases, subleases, assigns, conveys, encumbers, or suffers to exist any lien or charge against, any Unit without Lessor's prior consent, or any Unit is subjected to levy, seizure or attachment; (3) Lessee fails to comply

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with the provisions of Section 10(c), and such failure is not cured within two (2) business days following receipt by Lessee of written notice thereof from the Lessor; (4) Lessee fails to comply with the provisions of Section 10(d); (5) Lessee fails to perform and comply with any other covenant or obligation under any Lease, or any progress payment, assignment, security or other agreement related to any Lease or Unit (together, "Related Agreements") and, if curable, such failure continues for 30 days after written notice thereof by Lessor to Lessee; (6) any representation, warranty or other written statement made to Lessor in connection with this Agreement, any Lease, Related

Agreement, or any guaranty, by Lessee or any person providing such guaranty ("Guarantor"), including financial statements, proves to have been incorrect in any material respect when made; (7) Lessee (x) enters into any merger or consolidation with, or sells or transfers all, substantially all or any substantial portion of its assets to, or enters into any partnership or joint venture other than in the ordinary course of business with, any entity, without the prior written consent of Lessor, which consent may be withheld for any valid credit or business consideration Lessor reasonably deems important, (y) dissolves, liquidates or ceases or suspends the conduct of business, or ceases to maintain its existence, or (z) enters into or suffers any transaction or series of transactions as a result of which Lessee is directly or indirectly controlled by persons or entities not affiliates of Lessee as of the date of this Agreement, without the prior written consent of Lessor, which consent may be withheld for any valid credit or business consideration Lessor reasonably deems important; (8) Lessee undertakes any general assignment for the benefit of creditors or commences any voluntary case or proceeding for relief under the Bankruptcy Code, or any other law for the relief of debtors, or takes any action to authorize or implement any of the foregoing; (9) the filing of any petition or application against Lessee under any law for the relief of debtors, including proceedings under the Bankruptcy Code, or for the subjection of property of Lessee to the control of any court, receiver or agency for the benefit of creditors if such petition or application is consented to by Lessee or not dismissed within 60 days from the date of filing; (10) any payment default or other event of default occurs under any other bilateral or multi-lateral lease, or credit, or other agreement or instrument to which Lessee and Lessor or any affiliate of Lessor are now or hereafter party; (11) the repudiation of or breach or default under any guaranty relating to any Lease; or (12) the occurrence of any event described in clauses (7), (8), (9), or (10) of this Section with reference to "any Guarantor" in lieu of "Lessee".

(b) Upon the occurrence of an Event of Default, and in addition to all other rights and remedies provided herein or under law, all of which rights and remedies are cumulative and not exclusive, Lessor may: (i) proceed by appropriate court action or actions, either at law or in equity, to enforce performance by Lessee of the applicable covenants under any or all Leases, and (ii) terminate any and all Leases, whereupon (A) Lessee's right to retain possession and use of the Units shall cease, unless and until the Balance Due is paid, (B) the aggregate Balance Due, together with all other amounts owing under the Leases shall be immediately due and payable, and (C) Lessor may pursue any and all remedies available to it under applicable law, including as a secured party under the Uniform Commercial Code. Lessor may also recover from Lessee all Attorney Costs incurred by Lessor in connection with any enforcement or attempted enforcement of any Lease.

(c) The exercise or partial exercise of, or failure to exercise, any remedy shall not restrict Lessor from further exercise of that remedy or any other remedy otherwise available. To the extent permitted by applicable law, Lessee waives any right to require Lessor to sell, release or otherwise use or dispose of any Units or otherwise mitigate Lessor's damages, or that may otherwise limit or modify any of Lessor's rights or remedies.

13. Assignment, Etc. (a) Lessor (and any subsequent assignee) may assign or transfer any or all of Lessor's interest in any Lease, Unit or rentals therefrom without notice to Lessee. Lessee agrees that the rights of any assignee shall not be affected by any breach or default of Lessor or of any prior assignee. Lessee further agrees that (i) no such assignee shall be required to assume any of the obligations of Lessor under any Lease except the obligation in respect of the application of any insurance monies received by such assignee, as provided above, and the obligation of non-interference as provided below, and (ii) any assignee expressly assuming the obligations of Lessor shall thereupon be responsible for Lessor's duties under the applicable Lease accruing after any such assignment and Lessor shall be released from such duties. Lessor may disclose to any potential or actual assignee or transferee any information regarding Lessee, any Guarantor and their affiliates.

(b) Lessee shall not assign, pledge, hypothecate or in any way dispose of all or any part of its rights or obligations under any Lease, or enter into any sublease of any Unit, without Lessor's prior consent.

14. Financial and Other Data. (a) During the term of any Lease, Lessee shall (i) maintain books and records in accordance with generally accepted accounting principles ("GAAP") and prudent business practice, (ii) from and after Lessee ceases to be a publicly-traded company, promptly and in no event later than 120 days after each fiscal year end furnish Lessor annual audited financial statements of Lessee and of any Guarantor, prepared in accordance with GAAP consistently applied, together with an unqualified opinion of an independent auditor, and (iii) at Lessor's request, furnish Lessor all other financial information and reports reasonably requested by Lessor at any time, provided the provision of such information would not violate any applicable law or regulation. Lessee shall furnish such other information as Lessor may reasonably request at any time concerning Lessee, any Guarantor and their respective affairs, or any Unit. Lessee shall promptly notify Lessor of any Event of Default or event or circumstance which, with notice, lapse of time or both, would be an Event of Default.

(b) Lessee represents and warrants that all information furnished and to be furnished by Lessee or any Guarantor to Lessor is accurate, and that all financial statements Lessee or any Guarantor has furnished and hereafter may furnish to Lessor reasonably reflect and will reflect, as of their respective dates, results of the operations and the financial condition of Lessee, such Guarantor or other entity they purport to cover.

(c) Credit and other information regarding Lessee, any Guarantor or their affiliates may be shared by Lessor with its affiliates and agents.

15. Inspection; Non-Interference. (a) Lessor, its agents and employees shall have the right to enter any property where any Unit is located and inspect any Unit, together with its related maintenance and repair records, at any reasonable time and upon reasonable prior written notice. Such right shall not impose any obligation on Lessor.

(b) So long as no Event of Default exists, Lessor shall not, and each direct or indirect assignee or transferee of Lessor agrees that it shall not, interfere with the rights of use and enjoyment of the Units by Lessee.

16. Other Charges; Application. If Lessee fails to pay within ten days of the date due any amount of regularly scheduled Interim Rent or Base Rent, Lessee shall pay a late charge equal to five percent (5%) of the amount not timely paid. Lessee shall pay interest at the per annum rate equal to the lesser of (a) 15% or (b) the highest rate permitted by applicable law ("Default Rate") on (i) any sum other than regularly scheduled Interim Rent and Base Rent owing under any Lease and not paid when due, and (ii) any amount required to be paid upon termination of any Lease under Section 11 hereof. Payments received under any Lease will be applied, first, to interest, fees and other amounts owing, other than Interim Rent or Base Rent, then to Interim Rent or Base Rent, in order of Acceptance Date.

17.Miscellaneous. (a) Lessee's indemnity and reimbursement obligations, including under Section 7, shall survive the termination or cancellation of any Lease or this Agreement.

(b) At Lessor's request, Lessee shall execute, deliver, file, and record such financing statements and other documents, agreements and instruments as Lessor shall reasonably deem necessary or advisable to protect Lessor's interest in the Units and to effectuate the purposes of any Lease and the Related Agreements. Lessee hereby irrevocably appoints Lessor as Lessee's agent and attorney-in-fact for Lessee, coupled with an interest, (i) to execute, deliver, file, or record any such item, and to take such action for Lessee and in Lessee's name, place and stead, and (ii) to enforce claims relating to the Units against insurers, vendors and other persons, and to make, adjust, compromise, settle, and receive payment under such claims; without any obligation to do so.

(c) Time is of the essence.

(d) The invalidity of any portion of this Agreement, any Schedule or Related Agreement shall not affect the force and effect of the remaining valid portions thereof. The term "including" is not limiting. The term "affiliate" includes any entity controlling, controlled by or under common control with the referent entity; "control" includes the ownership of 25% or more of the voting stock of any entity. The term "guaranty" includes any guaranty, surety instrument, indemnity, "keep-well" agreement, or other instrument or arrangement providing third party credit support to Lessor relating to any Lease or Unit.

(e) This Agreement, the Schedules, any approval letter by Lessor in relation hereto and any replacement or successor letter thereto (together, the "Approval Letter") and the Related Agreements, constitute the entire agreement between the parties with respect to the leasing of the Units. Any amendment to such documents must be made in writing and signed by the parties hereto or thereto. Such documents may be executed in one or more counterparts. Where multiple counterpart originals of any Schedule exist, only the counterpart marked "Lessor's Copy" shall be deemed chattel paper and evidence a monetary obligation of Lessee.

(f) All demands, notices, requests, consents, waivers and other communications under the Agreement, any Lease, the Approval Letter, or any Related Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or three business days after being deposited in the mail, first class postage prepaid, or the business day after delivery to an express carrier, charges prepaid, or when sent by facsimile transmission (with electronic confirmation of receipt), addressed to each party at the address or fax number set forth below the signature of such party on the signature page, or at such other address or fax number as may hereafter be furnished in writing by such party to the other.

(g) (i) To secure the payment and performance of its obligations under the Lease relating to such Unit and the repayment of any advances, with interest and fees, made by Lessor on account of the Unit, and (ii) as a separate grant of security, to secure the payment and performance of its obligations under all other Leases owing by Lessee to Lessor, in each case, now existing or hereafter arising, Lessee hereby grants to Lessor a security interest in all Lessee's right, title and interest in and to each Unit, together with (A) all attachments, accessories and accessions to, and substitutions and replacements for, the Unit, (B) all rights to chattel paper arising from the Unit, (C) all insurance, warranty and other claims against third parties with respect to the Unit (including claims for rent upon any lease of the Unit), (D) all software used in connection therewith, (E) all proceeds of any of the foregoing, including insurance proceeds, and (F)all books and records pertaining to any of the foregoing, in each case, now existing or hereafter arising and including, with respect to clause (ii) of this subsection, Units as to which Lessee has satisfied its end of term purchase obligation under the applicable Schedule (together, the "Collateral").

(h) To the extent specified in any Approval Letter, Lessee shall reimburse Lessor upon demand for reasonable costs and expenses incurred by Lessor in connection with the execution and delivery of this Agreement and the other documents contemplated hereby. Lessee shall reimburse Lessor on demand for all reasonable costs and expenses, including Attorney Costs, incurred in connection with any amendment

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of any Lease or related document requested by Lessee, or any waiver.

(i) This Agreement, each Schedule and (unless otherwise specified therein) the Related Agreements shall be governed by and construed according to the internal laws of the State of California, to the non-exclusive jurisdiction of the courts of which, and the Federal courts located therein, the parties hereto submit.

(j) Lessor and Lessee each waive trial by jury in any action, proceeding or counterclaim brought by either against the other on any matter however arising out of or in any way connected with any Lease on the Units.

In Witness Whereof, Lessor and Lessee have executed this Agreement as of the date first above written.

Banc of America Leasing & Capital, LLC (Lessor)	Vical Incorporated (Lessee)
By: /s/ CAROL JONES	By: /s/ MARTHA J. DEMSKI
Printed Name: Carol Jones	Printed Name: Martha J. Demski
Title: Vice President	Title: Vice President and CFO
Address: 2059 Northlake Parkway, 4 South Tucker, Georgia 30084	Address: 10390 Pacific Center Court San Diego, CA 92121
Facsimile: (770)270-8635	Facsimile:

SECURITY AGREEMENT
(Securities)
Dated as of March 19, 2004

1. Grant of Security Interest. As security for any and all Indebtedness (as defined below) of VICAL INCORPORATED ("Pledgor"), Pledgor hereby irrevocably and unconditionally grants a security interest in and assigns and transfers to BANC OF AMERICA LEASING & CAPITAL, LLC ("Lessor") all property referred to in Exhibit A attached hereto (the "Collateral").

2. Indebtedness. "Indebtedness" means all debts, obligations or liabilities now or hereafter existing or incurred, absolute or contingent of Pledgor or any one or more of them to Lessor, whether voluntary or involuntary, whether due or not due, or whether incurred directly or indirectly , arising out of the Schedules (the "Schedules") now or hereafter entered into under that certain Lease Intended as Security No. 07489-00600 dated as of March 19, 2004 (and any extensions, amendments, modifications or supplements thereto) by and between Lessor, as lessor, and Pledgor, as lessee (the Schedules and the Lease Intended as Security as it pertains thereto, collectively, the "Lease"). Unless otherwise agreed in writing, "Indebtedness" shall not include such debts, obligations or liabilities which are or may hereafter be "consumer credit" subject to the disclosure requirements of the Federal Truth-in-Lending law or any regulation promulgated thereunder.

3. Trading or Substitution of Collateral. Unless otherwise agreed by Lessor in any lease agreement or otherwise, Lessor shall be under no obligation to permit any trading, redemption, exchange, distribution or substitution of the Collateral or to permit the release of any Collateral or the proceeds thereof until the Indebtedness has been paid in full.

4. Pledgor's Covenants. Pledgor covenants and warrants that unless compliance is waived by Lessor in writing:

(a) All of the Collateral consists of and will continue to consist of only cash and/or cash equivalents as described in Exhibit A. Pledgor owns the Collateral free and clear of any and all liens, encumbrances, or interests of any third parties other than the security interest of Lessor, and will keep the Collateral free of all liens, claims, security interests and encumbrances of any kind or nature except the security interest of Lessor.

(b) Pledgor will at all times maintain Collateral of a character and value satisfactory to Lessor.

(c) Pledgor shall take all actions necessary from time to time to maintain the first priority and perfection of said security interest and shall not take any actions that would alter, impair or eliminate said priority or perfection.

(d) Pledgor agrees to pay prior to delinquency all taxes, charges, liens and assessments against the Collateral, and upon the failure of Pledgor

to do so, Lessor at its option may pay any of them and shall be the sole judge of the legality or validity thereof and the amount necessary to discharge the same.

5. Powers of Lessor. At any time, without notice, and at the expense of Pledgor, Lessor in its name or in the name of Pledgor may, but shall not be obligated to:

(a) Collect by legal proceedings or otherwise, endorse, receive and receipt for all dividends, interest, principal payments and other sums now or hereafter payable upon or on account of the Collateral.

(b) Make any compromise or settlement it deems desirable or proper with reference to the Collateral.

(c) Insure, process and preserve the Collateral.

(d) Participate in any recapitalization, reclassification, reorganization, consolidation, redemption, stock split, merger or liquidation of any issuer of securities which constitute Collateral, and in connection therewith may deposit or surrender control of the Collateral, accept money or other property in exchange for the Collateral, and take such action as it deems proper in connection therewith, and any money or property received on account of or in exchange for the Collateral shall be applied to the Indebtedness or held by Lessor thereafter as Collateral pursuant to the provisions hereof.

(e) Cause Collateral to be transferred to its name or to the name of its nominee or the name of a depository or its nominee.

(f) Obtain from any custodian or bailee holding the Collateral any and all information with respect to the Collateral, without any further consent of or notice to Pledgor.

(g) Exercise as to the Collateral all the rights, powers and remedies of an owner necessary to exercise its rights under this paragraph, but prior to any Event of Default under this Security Agreement, Lessor shall not vote any securities constituting Collateral except as instructed by Pledgor.

Pledgor hereby appoints Lessor its attorney-in-fact to carry out any of the powers granted by this paragraph.

6. Events of Default. Any one or more of the following shall be a default hereunder ("Event of Default"):

(a) Pledgor fails to pay any Indebtedness when due, or breaches any other term of any agreement evidencing the Indebtedness, subject to any applicable notice and cure period provided in the Lease.

(b) Pledgor breaches any term, provision, warranty or representation in any material manner under this Security Agreement, subject to any applicable notice and cure period provided in the Lease.

(c) Any custodian, receiver or trustee is appointed to take possession, custody or control of all or a substantial portion of the property of the Pledgor or of any guarantor of any Indebtedness.

(d) The Pledgor, or any guarantor of any Indebtedness becomes insolvent, or is generally not paying or admits in writing its inability to pay its debts as they become due, fails in business, makes a general assignment for the benefit of creditors, dies, becomes incompetent, or commences any case, proceeding or other action under any bankruptcy or other law for the relief of, or relating to, debtors.

(e) Any case, proceeding or other action is commenced against the Pledgor or any guarantor of any Indebtedness under any bankruptcy or other law for the relief of, or relating to, debtors.

(f) Any involuntary lien of any kind or character attaches to any Collateral.

7. Remedies. If an Event of Default occurs, Lessor may do any one or more of the following:

(a) Declare any Indebtedness immediately due and payable, without notice or demand.

(b) Exercise as to any or all of the Collateral all the rights, powers and remedies of an owner (including the right to vote any securities constituting Collateral).

(c) Enforce the security interest given hereunder pursuant to the Uniform Commercial Code and any other applicable law.

(d) Sell all or any part of the Collateral at public or private sale, without demand, advertisement or notice, in such manner and order as Lessor may elect. Lessor may purchase the Collateral for its own account at any such sale. Pledgor acknowledges that Collateral may be sold at a loss to Pledgor, and that, in such event, Lessor shall have no liability or responsibility to Pledgor for such loss.

(e) Enforce the security interest of Lessor in any deposit account which is part of the Collateral by applying such account to the Indebtedness.

(f) Exercise any other remedy provided under this Security Agreement or by any applicable law. Pledgor acknowledges that all such rights and remedies are cumulative, and the exercise of any right or remedy shall not preclude the further exercise of any other right or remedy.

8. Waivers. Lessor shall be under no duty or obligation whatsoever (a) to make or give any presentment, demands for performances, notices of nonperformance, protests, notices of protest or notices of dishonor in connection with any obligations or evidences of indebtedness held by Lessor as Collateral, or in connection with any obligation or evidences of indebtedness which constitute in whole or in part the Indebtedness, or (b) to give Pledgor notice of, or to exercise, any subscription rights or privileges, any rights or privileges to exchange, convert or redeem or any other rights or privileges relating to or affecting any Collateral.

9. Additional Waivers. Pledgor waives any right to require Lessor to (a) proceed against any person, or (b) proceed against or exhaust any collateral, and waives any defense arising by reason of the cessation from any cause whatsoever of the liability of Pledgor or any other person. Until the Indebtedness is paid in full, Pledgor waives any right of subrogation, reimbursement, indemnification, and contribution (contractual, statutory or otherwise), including without limitation any claim or right of subrogation under the Bankruptcy Code (Title 11 of the U.S. Code) or any successor statute, arising from the existence or performance of this Security Agreement, and Pledgor waives any right to enforce any remedy which Lessor now has or may hereafter have against Pledgor or against any other person and waives any benefit of and any right to participate in any Collateral or security whatsoever now or hereafter held by Lessor.

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10. Return of Collateral. Lessor may at any time deliver the Collateral or any part thereof to Pledgor and the receipt of Pledgor shall be a complete and full acquittance for the Collateral so delivered, and Lessor shall thereafter be discharged from any liability or responsibility therefor.

11. Transfer of Collateral. Upon the transfer of all or any part of the Indebtedness, Lessor may transfer all or any part of the Collateral and shall be fully discharged thereafter from all liability and responsibility with respect to such Collateral so transferred, and the transferee shall be vested with all the rights and powers of Lessor hereunder with respect to such Collateral so transferred; but with respect to any Collateral not so transferred Lessor shall retain all rights and powers hereby given.

12. Continuing Agreement. This is a continuing Security Agreement and all the rights, powers and remedies hereunder shall apply to all Indebtedness of Pledgor or any one or more of them to Lessor, including that arising under successive transactions which shall either continue the Indebtedness, increase or decrease it, or from time to time create new Indebtedness after all or any prior Indebtedness has been satisfied, and notwithstanding the death, incapacity, cessation of business, dissolution or bankruptcy of Pledgor or any one or more of them, or any other event or proceeding affecting Pledgor or any one or more of them.

13. Continuing Powers. Until all Indebtedness shall have been paid in full, the power of sale and all other rights, powers and remedies granted to Lessor hereunder shall continue to exist and may be exercised by Lessor at the time specified hereunder irrespective of the fact that the Indebtedness or any part thereof may have become barred by any statute of limitations, or that the personal liability of Pledgor or any one or more of them may have ceased. Pledgor waives the benefit of any statute of limitations as applied to this Security Agreement.

14. Custody of Collateral. Lessor may, in its discretion, hold some or all of the Collateral in an account with a custody unit of Bank of America National Association ("BANA"). Pledgor shall reimburse BANA for the usual custody charges and expenses of BANA's custody unit, but shall not duplicate any such charges currently being paid by Pledgor. Lessor may, in its sole discretion, retain the Collateral in physical form or with a depository. Lessor shall not be required to segregate the Collateral from other securities owned by third parties. Pledgor agrees to be bound by the rules, procedures, practices, liens and assessments of each depository used by Lessor. Lessor shall not be liable for any loss to the Collateral resulting from acts of God, war, civil commotion, fire, earthquake, or other disaster beyond the reasonable control of Lessor, or for any other loss or damage to the Collateral unless shown to have arisen from Lessor's intentional misconduct or lack of reasonable care.

15. Intentionally Deleted.

16. Custody of Collateral at Bailee. If permitted by Lessor, some or all of the Collateral may be held at a broker or other bailee (the "Bailee"). Pledgor shall pay to Bailee any charges or costs imposed by the Bailee. Pledgor at no time shall request that Bailee release any Collateral to Pledgor, except as expressly permitted by Lessor. Lessor may, at any time, require Bailee to do any or all of the following: (a) disburse any or all of the Collateral to Lessor; (b) allow Lessor (and not Pledgor) to exercise any rights relating to the Collateral; (c) sell some or all of the Collateral and remit the sales proceeds (less Bailee's normal sales charge) to Lessor; and (d) buy and sell Collateral only upon the instructions of Lessor (and not Pledgor).

17. Indemnity Regarding Bailee. If Lessor permits any of the Collateral to be maintained at a Bailee, Pledgor hereby agrees to indemnify, defend and hold harmless Lessor, its successors and assigns and its

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directors, officers, employees and agents, from and against any and all losses, liabilities, damages, obligations, deficiencies, payments, costs and expenses (including, without limitation, costs and expenses of any and all actions, suits, proceedings, arbitrations, demands, assessments, judgments, settlements, compromises relating thereto and reasonable attorneys' fees and disbursements in connection therewith, and including allocated costs of in-house counsel) sustained or incurred by Lessor or any other indemnitee in any way arising from or related to Lessor's actions with respect to Bailee as contemplated herein or contemplated by any agreement with or notice to Bailee, except such as are due to Lessor's willful misconduct or gross negligence.

18. Costs. All advances, charges, costs and expenses, including reasonable attorneys' fees, incurred or paid by Lessor in exercising any right, power or remedy conferred by this Security Agreement or in the enforcement thereof, and including the charges and expenses of Lessor's custody unit or of any Bailee, shall become a part of the Indebtedness secured hereunder and shall be paid to Lessor by Pledgor immediately and without demand, with interest thereon at an annual rate equal to the highest rate of interest of any Indebtedness secured by this Security Agreement (or, if there is no such interest rate, at the maximum interest rate permitted by law for interest on judgments).

19. Intentionally Deleted.

20. Miscellaneous.

(a) Any waiver, express or implied, of any provision hereunder and any delay or failure by Lessor to enforce any provision shall not preclude Lessor from enforcing any such provision thereafter.

(b) Pledgor shall, at the request of Lessor, execute such other agreements, documents, instruments, or financing statements in connection with this Security Agreement as Lessor may reasonably deem necessary. Pledgor hereby appoints Lessor as its attorney-in-fact with full power and authority to (i) sign any financing statements which must be executed or filed to perfect or continue perfected our security interest in the Collateral, and (ii) file any such financing statements by electronic means with or without a signature as authorized or required by applicable law or filing procedures.

(c) This Security Agreement shall be governed by and construed according to the laws of the State of Georgia, to the jurisdiction of which the parties hereto submit.

(d) All terms not defined herein are used as set forth in the Uniform Commercial Code.

(e) This Security Agreement shall benefit Lessor's successors and assigns and shall bind Pledgor's successors and assigns.

(f) Pledgor shall immediately deliver to Lessor (or the Bailee, if any) any Collateral now or hereafter in Pledgor's possession.

(g) In all cases where more than one party executes this Security Agreement, all words used herein in the singular shall be deemed to have been used in the plural where the context and construction so require, and the obligations and undertakings hereunder are joint and several.

21. Maintenance of Collateral. As of March 19, 2004, the value of the Collateral is in excess of $1,755,373.00 ("Cash Collateral Amount"). Pledgor shall have the right to manage investments with respect to the Collateral but no withdrawal from any account constituting the Collateral shall be made without the Lessor's prior written consent. In the event that the value of the Collateral at any time falls below the Cash Collateral Amount, the Pledgor shall immediately deliver to the Lessor such additional cash (which shall become part of the Collateral) in an amount necessary to cover such shortfall.

In Witness Whereof, Pledgor has executed this Security Agreement (by its duly authorized officer, if Pledgor is not an individual) as of March 25, 2004.

Pledgor:

Vical Incorporated

By: /s/ MARTHA J. DEMSKI

Name: Martha J. Demski

Title: Vice President and CFO

Pledgor's Location (residence, if Pledgor is an individual; chief executive office, if Pledgor is not an individual):

10390 Pacific Center Court
Street Address

San Diego, CA 92121
City State Zip

The Pledgor's Taxpayer Identification Number (TIN) to be used for tax reporting purposes with respect to the Collateral is ###-##-####.

(Check if applicable):

☐ The Pledgor is not a citizen or a resident of the United States; is not a legal entity organized under the laws of the United States: and is not doing business in the United States.

Exhibit A to Security Agreement
Description of Collateral

(a) All of the United States government agency securities, United States treasuries and money market mutual funds now or hereafter held in that certain Enhanced Cash Account No. 0650093 maintained with Bank of America, National Association and all successor and replacement accounts (the "Account").

(b) All rollovers, renewals or reinvestments of any of the foregoing property.

(c) All stock or conversion rights, rights to subscribe, liquidation dividends or preferences, stock dividends, dividends, rights to interest, interest payments, dividends paid in stock, new securities or other property which Pledgor (or any one or more Pledgor) is or may hereafter become entitled to receive on account of any of the foregoing property.

(d) The proceeds, increase and products of any of the foregoing or replacements thereof or substitutions therefor.

PROGRESS PAYMENT AGREEMENT
Dated March 19, 2004

Reference is made to Lease Intended as SecurityNumber 07489-00600 dated March 19, 2004 (the "Lease Agreement"), between Banc of America Leasing & Capital, LLC ("Lessor") and Vical Incorporated ("Lessee"). Capitalized terms not otherwise defined herein have the meanings specified in the Lease Agreement or the pro forma Schedule delivered to Lessee under cover of the Approval Letter relating to such Lease Agreement.

Lessee may request from time to time that Lessor lease to Lessee under the Lease Agreement the items of equipment described in letters, schedules, purchase orders or purchase agreement assignments executed and delivered to Lessor by Lessee ("Units") and that Lessor purchase such Units from manufacturers or vendors designated by Lessee. Such manufacturers or vendors may require advance payments, progress payments or full payment (collectively, "Advances") for such Units prior to the delivery and acceptance of such Units by Lessee. To induce Lessor to make such Advances for such Units, Lessor and Lessee agree as follows:

1. Lessee shall execute and deliver to Lessor a request for advance, in form satisfactory to Lessor, describing the amount of the Advance and the applicable Units ("Request for Advance").

2. All Units purchased by Lessor pursuant to the provisions hereof will be Lessor's property and, immediately upon the delivery and written acceptance of the same by Lessee and execution and delivery of a Schedule relating thereto, and satisfaction of all other conditions to funding of the Lease specified in the Approval Letter, will be Units leased under the Lease Agreement and such Schedule.

3. Lessor shall be under no obligation to fund any Advance relating to a Unit unless (a) there has occurred no Event of Default under the Lease Agreement, or any event that with notice, lapse of time, or both, would be such an Event of Default; (b) no Material Adverse Change has occurred since December 31, 2002, in Lessor's judgment as to Lessee or as to any Guarantor that is required under the Approval Letter; (c) Lessee has delivered to Lessor, duly signed, in form satisfactory to Lessor, (i) a Request for Advance relating to the Advance, (ii) a Lease Agreement, (iii) the Approval Letter, (iv) any guaranty required by the Approval Letter, (v) a Purchase Agreement Assignment relating to the applicable Unit, and (vi) any other documents reasonably required by Lessor, and (d) all other applicable conditions precedent (if any) specified in the Approval Letter have been satisfied.

4. Interest on all Advances shall accrue from the date of the Advance until the earlier of the date repaid or the date the applicable Interim Term or, if none, Base Term, relating to the Unit that is the subject of such Advance, begins, at a fluctuating rate per annum equal to the **LIBOR Index plus 1.75%**, such interest to be paid within ten (10) days of the date Lessor's invoice therefor is sent to the Lessee in accordance with the notice provision in the Lease Agreement. "LIBOR Index" shall mean the per annum rate of interest equal to the "average of interbank offered rates for dollar deposits in the London market based on quotations of sixteen major banks" for a term of thirty days as published in The Wall Street Journal under a heading entitled "Money Rates London Interbank Offered Rates (LIBOR)"

(or any future or substitute heading) on the first day of the month preceding the month in which the Advance occurs.

5. Lessor may demand immediate repayment of any outstanding Advance, together with accrued interest, if and at such time as (a) the Interim Term or, if none, Base Term, in respect of the Unit that is the subject of the Advance does not commence by the earlier of (i) the end of the Utilization Period specified in the Approval Letter or (ii) 10 days after the date such Unit is delivered to and accepted by Lessee; or (b) there occurs prior to the beginning of its Interim Term or, if none, Base Term, a Casualty as to the Unit that is the subject of the Advance. Lessor may demand immediate repayment of all outstanding Advances, together with interest at the Default Rate if (A) there occurs any Material Adverse Change as to Lessee or any Guarantor; (B) there occurs any Event of Default under the Lease Agreement, or (C) Lessee fails to make any payment as and when required hereunder.

6. This Agreement shall be governed by and construed in accordance with the internal laws of the State of California.

Vical Incorporated (Lessee)

By: /s/ MARTHA J. DEMSKI

Printed Name: Martha J. Demski

Title: Vice President and CFO

Accepted at as of the date first above written.

BANC OF AMERICA LEASING & CAPITAL, LLC
(Lessor)

By: /s/ CAROL JONES

Printed Name: Carol Jones

Title: Vice President

Bank of America

March 19, 2004

Banc of America
Leasing & Capital, LLC
2059 Northlake Parkway, 4th Floor
Tucker, GA 30084

Vical Incorporated
10390 Pacific Center Court
San Diego, CA 92121
Attn: Glen Medwid

Tel 770-270-8400

Re: The proposal letter issued by Banc of America Leasing & Capital, LLC to Vical Inc. dated December 23, 2003 (the "Proposal Letter")

Dear Mr. Medwid:

Subject to the terms and conditions set forth in the Proposal Letter and in this letter, Banc of America Leasing & Capital, LLC ("BALC") is pleased to confirm its willingness to extend term financing (the "Lease" or "Leases") to Vical Incorporated ("Lessee") in an amount not to exceed $8,500,000.

DOCUMENTATION: Lessee shall execute and deliver all documents and satisfy all conditions required by BALC.

EXPIRATION DATE: The transactions described herein must close on or before December 15, 2004, or BALC shall have no further obligation hereunder or under any of the documentation relating to such transaction.

REVISED CONDITIONS TO PROPOSAL LETTER:

Additional Cash Collateral: Cash Collateral must be held at Bank of America, N.A. Release of excess collateral on a semi-annual basis must be requested in writing by the Lessee. It will not be released automatically.

Soft Costs: The percentage of soft cost at any given time during the life of the approval cannot exceed 50% of the total amount financed up to that time.

PREVAILING CONDITIONS: The terms and conditions of the Proposal Letter, by reference, are incorporated herein. If there is a discrepancy between the terms and conditions of the Proposal Letter and this commitment, the terms and conditions of this commitment shall prevail.

The commitment of BALC to enter into this transaction is based on the current business, management, and financial condition of Lessee and the Guarantors. Accordingly, such commitment shall be subject to the condition that there will be no material adverse change in or damage to the business, current management, or financial condition of Lessee or the Guarantors as determined in BALC's sole discretion.

This letter is subject to the internal laws of the State of California, is intended solely for the benefit of Lessee, and may be amended only in a writing signed by BALC and Lessee.

All of the foregoing is intended as a general statement of understanding and not as a definitive contract. The written agreements and related documents which will subsequently be executed and delivered between Lessee and BALC will take precedence over and supersede this commitment in its entirety and will control all aspects of the Lease(s).

Please acknowledge your acceptance of the terms and conditions of this commitment and return it to my attention no later than ten (10) business days after the date of this letter. If BALC is not in receipt of your acceptance by that date, the commitment set forth herein will terminate. My address is:

Banc of America Leasing & Capital, LLC
2059 Northlake Parkway, 4th Floor
Tucker, GA 30084-4431

Thank you for allowing Banc of America Leasing & Capital, LLC to make this financing facility available to you. If you have any questions, please do not hesitate to call me at (770) 270-8468.

Sincerely,

/s/ CAROL JONES
Carol T. Jones
Vice President

cc: Paul Nolta, Vice President

Vical Incorporated hereby agrees to the terms and conditions set forth herein.

By: /s/ MARTHA J. DEMSKI

Printed Name: Martha J. Demski

Title: Vice President and CFO

Paul L. Nolta
Vice President

Commercial Markets

Banc of America
Leasing and Capital Group

CA6-137-02-02

675 Anton Blvd., 2nd Floor
Costa Mesa, CA 92626
Tel 714-850-6533
Fax 714-850-6586
Paul.L.Nolta@bankofamerica.com

SUMMARY OF TERMS AND CONDITIONS

Date:	December 23, 2003
Lessee:	Vical, Inc.
Lessor:	Banc of America Leasing & Capital, LLC or its designee
Equipment Description:	Various office and lab equipment
Lessor's Cost:	An amount not to exceed $8,500,000 which may with Lessor's prior consent include soft costs such as freight, installation and taxes paid up-front by Lessor not exceeding 50% of the Lessor's Cost, but may not exceed the Fair Market Value of the Equipment. Lessor's cost for used Equipment may be subject to verification by an independent third party appraiser at Lessee's expense.
Lease Structure:	This lease is a lease intended as security transaction; all tax benefits will remain with Lessee; the lease will be a net financial lease, and all expenses, including (but not limited to) insurance, maintenance, and taxes, will be for the account of Lessee. Lessee will grant, and will represent and warrant that Lessor will obtain, a first priority perfected security interest in the Equipment.
Additional Collateral:	This facility will be 100% cash secured by a financial instrument to be agreed upon by both parties. Excess collateral will be released on a trailing semi-annual basis as principal is paid down.
Term:	Term for both hard assets and soft costs will be thirty-six (36) months. Payments will be made monthly, in arrears.

Amortization:	A) Thirty-six month amortization for all soft costs

B) Forty-eight month amortization for all hard assets

Rate: Fixed = 2.63%
Floating = 1.95%

The Rate shall be subject to adjustment ("Rental Adjustment") as set forth hereinafter:

Rate Adjustment for fixed rate option: The rate shall be increased or decreased on or prior to the Lease Commencement Date for any change in the two year constant maturity as published by Bloomberg Market Rates as follows: The rate shall be adjusted to reflect the difference between the yield of the two year Treasury as of December 18, 2003 (equivalent to 1.80%) and the yield on or closest to the projected Lease Commencement Date under the Lease as determined by Lessor.

Rental Adjustment for floating rate option: The Rate will be decreased or increased by one basis point for each basis point change in the LIBOR Index. "LIBOR Index" shall mean the per annum rate of interest equal to the "average of interbank offered rates for dollar deposits in the London market based on quotations of five major banks" for a term of one month as published in *The Wall Street Journal* under a heading entitled "Money Rates London Interbank Offered Rates (LIBOR)" or any future or substitute heading acceptable to Lessor (the LIBOR Index as of December 18, 2003 was 1.15%). A change, if any, in the LIBOR Index shall be determined by reference to the LIBOR Index published on the first publication day of the month preceding the month in which such Adjustment Date falls.

End of Term Options: At the expiration of the Lease Term, Lessee will purchase all (but not less than all) of the soft assets for $1.00 and all (but not less than all) of the hard assets for the then outstanding principal balance.

Expenses: Lessee agrees to reimburse Lessor for all costs and expenses including UCC filing and search fees and legal costs incurred by Lessor in committing and closing the Lease.

Lease Documents: Lease documents will be in a form and substance satisfactory to Lessor and its counsel.

Utilization Period Expiration Date: The latest date for any funding will be December 15, 2004.

Compliance: All financial institutions are required by Federal Law to obtain, verify and record information that identifies each customer who opens an account with us. When you open an account with us, we will ask you for your name, address and other information that will allow us to identify you, such as documents evidencing legal status and formation, taxpayer identification number and date of birth (if applicable).

Covenants: (a) Cross-default with any present Bank of America facilities.

(b) Lessee must maintain unrestricted cash balances of $45,000,000 for any one quarter or issue a letter of credit for the benefit of Lessor drawn from a financial institution acceptable to the Lessor for the then outstanding amount. Upon receipt of the letter of credit, Lessor will release the balance of the financial instrument held as Additional Collateral to the Lessee.

Non-Utilization Fee: If for any reason (provided this transaction receives final approval of Lessor) the Lessee fails to request funding for at least 75% of the total Lessor's Cost, Lessee shall promptly pay to Lessor a Non-Utilization Fee equal to 1% of any difference between the Lessor's Cost and the total cost of the Equipment actually accepted or financed under the transaction.

This Term Sheet includes only a brief description of the principal terms of the Proposed Transaction, and is intended for discussion purposes only. Please understand this proposal is not a commitment or offer to loan funds, and does not create any obligation for Lender. Lender will not be responsible or liable for any damages, consequential or otherwise, that may be incurred or alleged by any person or entity, including Borrower, as a result of this Term Sheet. Lender will notify you in writing of its decision if Borrower agrees to proceed with the Proposed Transaction after completing its review and analysis.

Glen, thank you for the opportunity to be of service and I look forward to a favorable response to the above proposal. If you are in agreement with the terms and conditions enclosed, please sign and date this proposal and return it to my attention at:

Banc of America Leasing
ATT: Paul Nolta
675 Anton Boulevard, 2nd Floor
Costa Mesa, CA 92626

Sincerely,

/s/ PAUL NOLTA
Paul Nolta
Vice President
Banc of America Leasing & Capital, LLC

Vical, Inc.

By: /s/ MARTHA J. DEMSKI

Title: CFO

Date: 12/23/03

Please choose one of the following:

Fixed Rate Option: ☒

Floating Rate Option: ☐

EXHIBIT 31.1

CERTIFICATION

I, Vijay B. Samant, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vical Incorporated;

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 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)) 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) 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

   c) 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 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: May 10, 2004

/s/ VIJAY B. SAMANT
Vijay B. Samant
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

I, Martha J. Demski, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vical Incorporated;

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 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)) 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) 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

   c) 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 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: May 10, 2004

/s/ MARTHA J. DEMSKI
Martha J. Demski
Vice President and Chief Financial Officer

Exhibit 32.1

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

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350, as adopted), Vijay B. Samant, the Chief Executive Officer of Vical Incorporated (the "Company"), hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: May 10, 2004

/s/ VIJAY B. SAMANT
Vijay B. Samant
Chief Executive Officer

THIS CERTIFICATION "ACCOMPANIES" THE FORM 10-Q TO WHICH IT RELATES, IS NOT DEEMED FILED WITH THE SEC AND IS NOT TO BE INCORPORATED BY REFERENCE INTO ANY FILING OF THE COMPANY 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 THE FORM 10-Q), IRRESPECTIVE OF ANY GENERAL INCORPORATION LANGUAGE CONTAINED IN SUCH FILING. A SIGNED ORIGINAL OF THIS CERTIFICATION HAS BEEN PROVIDED TO THE COMPANY AND WILL BE RETAINED BY THE COMPANY AND FURNISHED TO THE SECURITIES AND EXCHANGE COMMISSION OR ITS STAFF UPON REQUEST.

Exhibit 32.2

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

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350, as adopted), Martha J. Demski, the Chief Financial Officer of Vical Incorporated (the "Company"), hereby certifies that, to the best of her knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended March 31, 2004, to which this Certification is attached as Exhibit 32.2 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition of the Company at the end of the period covered by the Periodic Report and results of operations of the Company for the period covered by the Periodic Report.

Dated: May 10, 2004

/s/ MARTHA J. DEMSKI
Martha J. Demski
Chief Financial Officer

THIS CERTIFICATION "ACCOMPANIES" THE FORM 10-Q TO WHICH IT RELATES, IS NOT DEEMED FILED WITH THE SEC AND IS NOT TO BE INCORPORATED BY REFERENCE INTO ANY FILING OF THE COMPANY 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 THE FORM 10-Q), IRRESPECTIVE OF ANY GENERAL INCORPORATION LANGUAGE CONTAINED IN SUCH FILING. A SIGNED ORIGINAL OF THIS CERTIFICATION HAS BEEN PROVIDED TO THE COMPANY AND WILL BE RETAINED BY THE COMPANY AND FURNISHED TO THE SECURITIES AND EXCHANGE COMMISSION OR ITS STAFF UPON REQUEST.