

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, 1998

or

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

Commission File Number: 0-21088

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.)

9373 Towne Centre Dr., Suite 100, San Diego, California

92121

-----  
(Address of principal executive offices)

(Zip code)

(619) 453-9900

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

Not Applicable

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

Class	Outstanding at March 31, 1998
-----	-----
Common Stock, \$.01 par value	15,771,712

VICAL INCORPORATED

FORM 10-Q

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\* No information provided due to inapplicability of item.

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

VICAL INCORPORATED  
BALANCE SHEETS

<TABLE>  
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	March 31, 1998	December 31, 1997
	----- (Unaudited) <C>	----- <C>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 12,638,810	\$ 12,157,149
Marketable securities - available-for-sale	32,548,039	33,397,482
Receivables and other	1,486,520	1,566,532
	-----	-----
Total current assets	46,673,369	47,121,163
	-----	-----
Property and Equipment:		
Equipment	4,878,400	4,966,955
Leasehold improvements	1,558,554	1,587,554
	-----	-----
	6,436,954	6,554,509
Less-accumulated depreciation and amortization	(4,419,398)	(4,334,224)
	-----	-----
	2,017,556	2,220,285
	-----	-----
Patent costs, net of accumulated amortization	1,275,379	1,247,059
Other assets	137,011	102,500
	-----	-----
	\$ 50,103,315	\$ 50,691,007
	-----	-----
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable and accrued expenses	\$ 1,574,400	\$ 1,424,603
Current portion of capital lease obligations	459,181	448,261
Current portion of notes payable	213,773	213,773
Deferred revenue	-	178,261
	-----	-----
Total current liabilities	2,247,354	2,264,898
	-----	-----
Long-Term Obligations:		
Long-term obligations under capital leases	821,656	911,794
Notes payable	213,773	320,660
	-----	-----
Total long-term obligations	1,035,429	1,232,454
	-----	-----
Stockholders' Equity:		

Preferred stock, \$.01 par value--5,000,000 shares authorized-- none outstanding	-	-
Common stock, \$.01 par value--40,000,000 shares authorized-- 15,771,712 and 15,731,316 shares issued and outstanding at March 31, 1998, and December 31, 1997, respectively	157,717	157,313
Additional paid-in capital	77,616,237	77,267,971
Accumulated other comprehensive income	23,303	24,028
Accumulated deficit	(30,976,725)	(30,255,657)
Total stockholders' equity	46,820,532	47,193,655
Total Liabilities and Stockholders' Equity	\$ 50,103,315	\$ 50,691,007

</TABLE>

See accompanying notes.

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VICAL INCORPORATED  
STATEMENTS OF OPERATIONS  
(UNAUDITED)

<TABLE>  
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	Three months ended March 31,	
	1998	1997
<S>	<C>	<C>
Revenues:		
License/royalty revenue	\$ 2,531,975	\$ 324,880
Contract revenue	200,360	801,575
	2,732,335	1,126,455
Expenses:		
Research and development	3,094,838	2,794,434
General and administrative	967,066	896,590
	4,061,904	3,691,024
Loss from operations	(1,329,569)	(2,564,569)
Interest income	651,725	610,077
Interest expense	43,224	47,716
Net loss	\$ (721,068)	\$ (2,002,208)
Net loss per share (basic and diluted--Note 2)	\$ (.05)	\$ (.13)
Weighted average shares used in computing net loss per share (Note 2)	15,753,191	15,422,895

</TABLE>

See accompanying notes.

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VICAL INCORPORATED  
STATEMENTS OF CASH FLOWS  
(UNAUDITED)

<TABLE>  
<CAPTION>

	Three months ended March 31,	
	1998	1997
<S>	<C>	<C>
OPERATING ACTIVITIES:		
Net loss	\$ (721,068)	\$ (2,002,208)
Adjustments to reconcile net loss to net cash provided from (used in) operating activities:		
Depreciation and amortization	236,382	218,140

Change in operating assets and liabilities:		
Receivables and other	80,012	(232,343)
Accounts payable and accrued expenses	149,797	(264,541)
Deferred revenue	(178,261)	(278,261)
	-----	-----
Net cash used in operating activities	(433,138)	(2,559,213)
	-----	-----
INVESTING ACTIVITIES:		
Marketable securities	848,718	(247,579)
Capital expenditures	(2,246)	(311,891)
Deposits and other	(5,511)	204,105
Patent expenditures	(41,188)	(40,911)
	-----	-----
Net cash provided from (used in) investment activities	799,773	(396,276)
	-----	-----
FINANCING ACTIVITIES:		
Principal payments under capital lease obligations	(126,757)	(117,848)
Payments on notes payable	(106,887)	-
Issuance of common stock, net	348,670	114,777
	-----	-----
Net cash provided from (used in) financing activities	115,026	(3,071)
	-----	-----
Net increase (decrease) in cash and cash equivalents	481,661	(2,958,560)
Cash and cash equivalents at beginning of period	12,157,149	12,609,277
	-----	-----
Cash and cash equivalents at end of period	\$12,638,810	\$ 9,650,717
	-----	-----
Supplemental Disclosure of Non-cash Investing and Financing Activities:		
Equipment acquired under capital leases	\$ 47,539	\$ 115,969
	-----	-----
	-----	-----

</TABLE>

See accompanying notes.

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VICAL INCORPORATED  
NOTES TO FINANCIAL STATEMENTS

March 31, 1998  
(unaudited)

1. ORGANIZATION AND BASIS OF PRESENTATION

ORGANIZATION

Vical was incorporated in April 1987 and has devoted substantially all of its resources since that time to its research and development programs. The Company is currently focusing its resources on the development of its direct gene transfer and related technologies.

BASIS OF PRESENTATION

The information contained herein has been prepared in accordance with instructions for Form 10-Q. The information at March 31, 1998, and for the three month periods ended March 31, 1998 and 1997, is unaudited. In the opinion of management, the information reflects all adjustments necessary to make the results of operations for the interim periods a fair statement of such operations. 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 generally accepted accounting principles 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. For a presentation including all disclosures required by generally accepted accounting principles, these financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 1997, included in the Vical Incorporated Form 10-K filed with the Securities and Exchange Commission.

2. NET LOSS PER SHARE

Net loss per share (basic and diluted) for the three month periods ended March 31, 1998 and 1997, has been computed using the weighted average number of common shares outstanding during the period. Diluted loss per share does not include any assumed exercise of stock options as the effect

would be antidilutive.

### 3. COMPREHENSIVE INCOME

The Company implemented Statement of Financial Accounting Standards No. 130 "Comprehensive Income" effective January 1, 1998. This statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. Accordingly, in addition to reporting net income (loss) under the current rules, the Company is required to display the impact of any unrealized gain or loss on marketable securities as a component of comprehensive income and to display an amount representing total comprehensive income for each period presented. In interim financial results, this information is allowed to be presented in the notes to the financial statements. For the three month periods ended March 31, 1998 and 1997, other comprehensive loss was \$725 and \$117,436, respectively, and total comprehensive loss was \$721,793 and \$2,119,644, respectively.

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

### OVERVIEW

Vical was incorporated in April 1987 and has devoted substantially all of its resources since that time to research and development programs. The Company is focusing on the development of its direct gene transfer and related technologies. Currently, the Company is developing cancer product candidates primarily internally, while developing infectious disease vaccine product candidates primarily in collaboration with corporate partners Merck & Co., Inc. ("Merck") and Pasteur Merieux Connaught ("PMC"), and developing product candidates for metabolic disorders primarily in collaboration with corporate partners Merck and Rhone-Poulenc Rorer Pharmaceuticals Inc. ("RPR"). To date, the Company has not received revenues from the sale of products. The Company expects to incur substantial operating losses for at least the next several years, due primarily to expansion of its research and development programs and the cost of preclinical studies and clinical trials. As of March 31, 1998, the Company's accumulated deficit was approximately \$31.0 million.

Vical has formulated ALLOVECTIN-7, a complex containing the gene encoding a particular human histocompatibility antigen, HLA-B7, and a lipid material to facilitate gene uptake. After direct injection of ALLOVECTIN-7 into a tumor, the Company believes that the HLA-B7 gene will cause the tumor cells to produce the HLA-B7 antigen. This gene expression may then trigger a potent cellular immune response against the tumor cells.

Vical has conducted several Phase I/II clinical trials and a multi-center Phase II clinical trial with ALLOVECTIN-7 in patients with advanced metastatic melanoma and other cancers. The Company concluded, based on Phase I/II trial results, that ALLOVECTIN-7 was well-tolerated, and that gene transfer and expression were detectable in the majority of patients, with measurable tumor shrinkage observed in 13 of 36 patients with advanced metastatic melanoma. The Company believes Phase II results confirmed the potential efficacy of ALLOVECTIN-7 in treating melanoma patients, particularly those in whom tumors had not yet metastasized to internal organs.

In 1996, Vical commenced additional multi-center Phase II clinical testing of ALLOVECTIN-7 in approximately 50 advanced melanoma patients. The Company expects to initiate further clinical trials in 1998 to support product license approval submissions.

Results from another Phase I/II trial of ALLOVECTIN-7 suggested potential efficacy in certain patients with unresectable head and neck cancer. A multi-center Phase II trial with ALLOVECTIN-7 in approximately 25 patients with unresectable head and neck cancer began in September 1997.

Vical is developing its second gene-based product candidate, LEUVECTIN, also intended for direct injection into tumor lesions of cancer patients. LEUVECTIN contains a gene that encodes the potent immunostimulator IL-2 and a lipid material to facilitate gene uptake. The Company expects that LEUVECTIN, when injected into tumors, will cause the malignant cells to produce and secrete IL-2 in the vicinity of the tumor, stimulating the patient's immune system to attack and destroy tumor cells. Because LEUVECTIN is designed to deliver IL-2 only at the site of tumor lesions, the Company believes that it may provide similar efficacy with fewer side effects than systemic IL-2 therapy.

Upon completion of Phase I/II clinical trials designed primarily to test the safety of LEUVECTIN at varying dosage levels and to assess IL-2 gene transfer and expression, the Company initiated additional multi-center Phase I/II clinical testing of higher doses of LEUVECTIN in approximately 45 patients with advanced

melanoma, renal cell carcinoma, and soft-tissue sarcoma. Of the 11 renal cell carcinoma patients initially evaluable in the LEUVECTIN trials, 2 patients achieved objective clinical partial responses persisting for more than six and nine months, respectively, and 2 achieved stable disease. Responses appear to be dose-related, and no serious treatment-related adverse events were reported, even at the highest doses tested. The Company expects to initiate further clinical trials in renal cell carcinoma patients in 1998. In June 1997, the Company initiated a Phase I/II clinical trial with LEUVECTIN in approximately 18 prostate cancer patients.

In collaboration with Dr. Ronald Levy of Stanford University Medical Center, the Company is developing a naked DNA anti-idiotypic vaccine, VAXID, against low-grade non-Hodgkin's B-cell lymphoma. VAXID is a DNA plasmid that encodes the patient-specific idiotype of the B-cell tumor immunoglobulin. The Company believes that immunization of post-chemotherapy patients with VAXID could result in the elimination of residual disease and the prevention of the relapse of disease. In October 1997, a Phase I/II clinical trial of VAXID began at the Stanford University Medical Center under the direction of Dr. Levy.

In July 1997, the Company and PMC began a Phase I clinical trial of an experimental naked DNA vaccine against the parasite that causes malaria. The Company and PMC sponsored the trial under their Research, Collaboration and License Agreement. The trial was conducted by the U.S. Naval Medical Research Institute and the U.S. Army Medical Research Institute of Infectious Diseases. Preliminary results from approximately 20 human participants in the trial indicate that the vaccine was well-tolerated and safe. Preliminary analysis of specimens from trial participants suggested a good cellular immune response with features that the physicians conducting the trial believe may be important in preventing the disease.

In September 1997, the Company entered into an agreement granting Merck the rights to use the Company's naked DNA technology to deliver certain growth factors as potential treatments for a range of applications including revascularization. In October 1997, the Company entered into an agreement granting RPR an exclusive worldwide license to use the Company's patented naked DNA gene delivery technology to develop certain gene therapy products for potential treatment of neurodegenerative diseases which involve the loss of nerve cell function. In November 1997, the Company entered into an agreement granting Merck certain rights to develop and market therapeutic vaccines against the human immunodeficiency virus and hepatitis B virus using the Company's patented naked DNA technology. In February 1998, Vical entered into a license agreement allowing Centocor, Inc. to use Vical's naked DNA technology to develop gene-based vaccines for the treatment of certain types of cancer.

There can be no assurance that the Company's product candidates will prove to be safe and effective in clinical trials or that any commercially successful products will ultimately be developed by the Company.

This Form 10-Q contains, in addition to historical information, forward-looking statements. When used in this discussion, the words "expects," "anticipated" and similar expressions are intended to identify forward-looking statements. Such statements are subject to certain risks and uncertainties, including whether the Company's product candidates will be shown to be safe or efficacious in clinical trials, whether the Company's corporate collaborations will be successful, and whether the Company's product candidates will ultimately be successfully developed or receive necessary regulatory approvals and other matters discussed in Item 1 under the caption "Risk Factors" in the Company's Form 10-K for the year ended December 31, 1997, filed with the Securities and Exchange Commission, which could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date hereof. The Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

#### RESULTS OF OPERATIONS

Revenues were \$2,732,000 for the quarter ended March 31, 1998. License revenue consisted primarily of an initial payment of \$2,000,000 from Centocor, Inc. ("Centocor") for a license agreement entered into in February 1998 allowing Centocor to use the Company's technology to develop and market certain gene-based vaccines for the potential treatment of certain types of cancer. Additionally, Centocor paid the Company \$200,000 for reimbursement of certain patent costs under the license agreement. License revenue also included \$178,000 of amortization of deferred license revenue from the PMC and Merial agreements, and royalty revenue of \$153,000. 1998 contract revenue of \$200,000 represented reimbursement from PMC of costs associated with the development of a potential DNA-based malaria vaccine. Revenues for the quarter ended March 31, 1997, were \$1,126,000 and consisted of amortization of deferred license revenue

of \$178,000 derived from the PMC and Merial agreements, contract revenues totaling \$802,000 from PMC and a Department of Defense grant, and royalties amounting to \$147,000.

The Company's total operating expenses for the quarter ended March 31, 1998, were \$4,062,000 compared with \$3,691,000 for the first quarter of 1997.

Research and development expenses increased to \$3,095,000 for the three months ended March 31, 1998, from \$2,794,000 for the same period in 1997. This increase in research and development expenses was generally due to increased clinical trial costs and royalties due to the Wisconsin Alumni Research Foundation on the license agreement signed with Centocor, partially offset by lower spending on external research.

General and administrative expenses increased to \$967,000 for the three months ended March 31, 1998, from \$897,000 for the same period in 1997. The increase is attributable to increasing operational expenses within the administrative area in support of the Company's expanding research and development activities.

Investment income increased to \$652,000 for the quarter ended March 31, 1998, from \$610,000 for the same quarter of 1997, primarily as a result of higher rates of return on investments.

Net loss per share (basic and diluted) for the three months ended March 31, 1998, was \$.05 per share compared with a net loss per share of \$.13 for the same quarter of 1997. The Company expects to incur losses throughout the remainder of 1998 and to report a net loss for the year ended December 31, 1998.

#### LIQUIDITY AND CAPITAL RESOURCES

Since its inception, Vical has financed its operations primarily through private placements of preferred stock, three public offerings of common stock, revenues from collaborative agreements and the investment by Merck for shares of Vical common stock. As of March 31, 1998, the Company had working capital of approximately \$44.4 million compared with \$44.9 million at December 31, 1997. Cash and marketable securities totaled approximately \$45.2 million at March 31, 1998, compared with \$45.6 million at December 31, 1997.

The Company expects to incur substantial additional research and development expense including continued increases in personnel costs and costs related to preclinical testing and clinical trials. The Company's future capital requirements will depend on many factors, including continued scientific progress in its 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 and scale-up, and commercialization activities and arrangements. The Company intends to seek additional funding through research and development relationships with suitable potential corporate collaborators or

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through public or private financing. There can be no assurance that additional funding will be available on favorable terms, if at all.

If additional funding is not available, Vical anticipates that its available cash and existing sources of funding will be adequate to satisfy its operating needs through 1999.

#### YEAR 2000 ISSUES

The Company is currently developing a plan to insure that its systems and software infrastructure are Year 2000 compliant. Key financial, information and operational systems will be assessed and plans will be developed to address required systems modifications. Given the relatively small size of the Company's systems and the predominantly new hardware, software and operating systems, management does not anticipate any significant delays in becoming Year 2000 compliant. However, the Company is unable to control whether its current and future strategic partners' systems are Year 2000 compliant. To the extent that strategic partners would be unable to procure clinical materials or services provided by the Company, or otherwise manage their clinical trials and research and development activities, or to pay invoices owed to the Company, or to the extent that suppliers are unable to manufacture and ship materials or provide requested contract services, the Company's operations could be affected. However, at this time management has no reason to believe that Year 2000 changes will have a material impact on the Company's business, financial condition or results of operations.

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1. Exhibits

EXHIBIT 27 Financial Data Schedule

2. Reports on Form 8-K

None

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VICAL INCORPORATED

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed in its behalf by the undersigned thereunto duly authorized.

Vical Incorporated

Date: May 11, 1998

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)

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EXHIBIT NUMBER -----	DESCRIPTION OF DOCUMENT -----
1. Exhibit 27	Financial Data Schedule

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE STATEMENTS OF OPERATIONS AND BALANCE SHEETS FOR THE THREE MONTHS ENDED MARCH 31, 1998, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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