

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 1998

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-19125

ISIS PHARMACEUTICALS, INC.

-----  
(Exact name of registrant as specified in its charter)

Delaware

33-0336973

-----  
(State or other jurisdiction of incorporation  
or organization)

-----  
(I.R.S. Employer  
Identification No.)

2292 Faraday Avenue, Carlsbad, CA 92008

-----  
(Address of principal executive offices, including zip code)

(760) 931-9200

-----  
(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 for such shorter period that the  
registrant was required to file such reports), and (2) has been subject to such  
filing requirements for the past 90 days.

(1) Yes  No  (2) Yes  No

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

Common stock \$.001 par value

26,822,237 shares

-----  
(Class)

-----  
(Outstanding at May 1, 1998)

## PART I FINANCIAL INFORMATION

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(in thousands, except share data)

ASSETS

	March 31, 1998 ----- (Unaudited)	December 31, 1997 ----- (Note)
Current assets:		
Cash and cash equivalents	\$ 27,786	\$ 38,102
Short-term investments	41,746	48,684
Prepaid expenses and other current assets	2,312	2,364
Total current assets	71,844	89,150
Property, plant and equipment, net	19,093	18,785
Patent costs, net	7,959	7,485
Deposits and other assets	2,422	2,461
	-----	-----
	\$ 101,318	\$ 117,881
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,200	\$ 2,843
Accrued payroll and related expenses	1,095	2,242
Accrued liabilities	4,744	4,347
Deferred contract revenues	10,705	14,893
Current portion of long term debt and capital lease obligations	2,239	2,252
Total current liabilities	19,983	26,577
Long-term debt and capital lease obligations, less current portion	56,696	56,452
Stockholders' equity:		
Common stock, \$.001 par value; 50,000,000 shares authorized, 26,797,000 shares and 26,655,000 shares issued and outstanding at March 31, 1998 and December 31, 1997, respectively	27	27
Additional paid-in capital	189,883	188,793
Unrealized gain on investments	389	165
Accumulated deficit	(165,660)	(154,133)
Total stockholders' equity	24,639	34,852
	-----	-----
	\$ 101,318	\$ 117,881
	=====	=====

Note: The balance sheet at December 31, 1997 has been derived from the audited financial statements at that date.

See accompanying notes.

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ISIS PHARMACEUTICALS, INC.  
CONDENSED STATEMENTS OF OPERATIONS  
(in thousands, except for per share amounts)  
(UNAUDITED)

	Three months ended March 31,	
	1998	1997
	-----	-----
Revenue:		
Research and development revenues under collaborative agreements	\$ 5,840	\$ 4,626
Interest income	1,055	947
	-----	-----

	6,895	5,573
Expenses:		
Research and development	14,859	11,786
General and administrative	1,858	1,707
Interest expense	1,704	634
	-----	-----
	18,421	14,127
	-----	-----
Net loss	\$ (11,526)	\$ (8,554)
	=====	=====
Basic and diluted net loss per share	\$ (.43)	\$ (.33)
	=====	=====
Shares used in computing basic and diluted net loss per share	26,740	26,278
	=====	=====

See accompanying notes.

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ISIS PHARMACEUTICALS, INC.  
CONDENSED STATEMENTS OF CASH FLOWS  
(in thousands)  
(UNAUDITED)

	Three months ended March 31,	
	1998	1997
	-----	-----
Cash used in operations:	\$ (17,182)	\$ (3,711)
Investing activities:		
Short-term investments	6,938	(4,604)
Property and equipment	(1,071)	(2,678)
Other assets	(322)	(268)
	-----	-----
Net cash provided from (used in) investing activities	5,545	(7,550)
	-----	-----
Financing activities:		
Net proceeds from issuance of common stock	1,090	1,136
Proceeds from long-term borrowings	903	--
Principal payments on debt and capital lease obligations	(672)	(708)
	-----	-----
Net cash provided from financing activities	1,321	428
	-----	-----
Net decrease in cash and cash equivalents	(10,316)	(10,833)
Cash and cash equivalents at beginning of period	38,102	37,082
	-----	-----
Cash and cash equivalents at end of period	\$ 27,786	\$ 26,249
	=====	=====
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Interest paid	\$ 335	\$ 240
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES		
Additions to capital lease obligations for acquisitions of property, plant and equipment	\$ --	\$ 386

See accompanying notes.

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ISIS PHARMACEUTICALS, INC.

NOTES TO FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The unaudited interim financial statements for the three months ended March 31, 1998 and 1997 have been prepared on the same basis as the Company's audited financial statements for the year ended December 31, 1997. The financial statements include all adjustments (consisting only of normal recurring adjustments) which the Company considers necessary for a fair presentation of the financial position at such dates and the operating results and cash flows for those periods. Results for the interim periods are not necessarily indicative of the results for the entire year. For more complete financial information, these financial statements, and notes thereto, should be read in conjunction with the audited financial statements for the year ended December 31, 1997 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission.

2. SUBSEQUENT EVENTS

In April 1998, the Company filed a New Drug Application ("NDA") with the U.S. Food and Drug Administration for fomivirsen, a drug to treat CMV retinitis. As a result of this NDA filing, the Company received a \$5 million milestone payment from CIBA Vision.

On May 1, 1998, the Company completed a follow-on \$15 million private debt financing. This financing was a follow-on to the Company's October 1997 \$25 million private debt financing and has the same terms. The debt, which is not convertible, will mature on November 1, 2007, and bears interest at 14% per annum. No payments of either principal or interest are required until February 1, 2003. Thereafter, interest must be paid quarterly until the end of the loan. No principal payments are required until maturity. In conjunction with this transaction, Isis issued warrants to the lender to purchase 300,000 shares of common stock at a price of \$25 per share.

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

In addition to historical information contained in this Report, this Report contains forward-looking statements regarding the Company's business and products and their projected prospects and qualities as well as the Company's relationships with its corporate partners. Such statements are subject to certain risks and uncertainties, particularly those inherent in the process of discovering, developing and commercializing drugs that are safe and effective for use as human therapeutics, and the endeavor of building a business around such potential products. Actual results could differ materially from those discussed in this Form 10-Q. As a result, the reader should not place undue reliance on these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Isis' Annual Report on Form 10-K for the year ended December 31, 1997 which is on file with the U.S. Securities and Exchange Commission, a copy of which is available from the Company.

Since its inception in January 1989, almost all of the Company's resources have been devoted to its research, drug discovery and drug development programs. The Company is not yet profitable and expects to continue to have operating losses for the next several years. Isis' revenue comes from collaborative research and development agreements with pharmaceutical companies, research grants and interest income. The revenue from the collaboration

increases the amount of research and development activity that the Company is able to fund and offsets a portion of its research and development costs. To date, Isis has not received any significant revenue from the sale of products.

#### RESULTS OF OPERATIONS

The Company's revenue from collaborative research and development agreements was \$5.8 million for the quarter ended March 31, 1998, compared with \$4.6 million for the same period in 1997, a 26% increase. The revenue increase was primarily due to the increasing level of development activity supported by our corporate partners. The Company also had interest income totaling \$1.1 million for the quarter compared with \$0.9 million for the same period in 1997. This increase in interest income was primarily due to higher average investment balances in the quarter ended March 31, 1998.

Research and development expenses increased 26% to \$14.9 million for first quarter of 1998 from \$11.8 million for the same period in 1997. The overall increase in research and development expenses was driven by the cost of preclinical and clinical activities to support the increasing number of compounds in clinical trials. We expect that research and development expenses will continue to increase as compounds continue to advance in clinical development.

General and administrative expenses increased 9% to \$1.86 million for the quarter ended March 31, 1998, from \$1.71 million for the same period in 1997. This increase in general and administrative expense is related to additional staffing in general and administrative functions required to support the growth in research and development. We expect that general and administrative expenses will continue to increase in the future to support our growing research and development efforts.

Interest expense increased to \$1.7 million for the first quarter of 1998 from \$0.6 million in the first quarter of 1997. This increase in interest expense is principally due to the interest cost related to the \$25 million private debt financing completed in the fourth quarter of 1997.

During the quarter ended March 31, 1998, the Company recorded a net loss of \$11.5 million, or \$.43 per share, compared with \$8.6 million, or \$.33 per share, for the same period in 1997. We expect that operating losses will increase for several more years as research and development activities grow. Operating losses may fluctuate from quarter to quarter because of differences in the timing of revenue and expense recognition.

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The Company believes that inflation and changing prices have not had a material effect on its operations to date.

#### LIQUIDITY AND CAPITAL RESOURCES

Isis has financed its operations with revenue from contract research and development, through the sale of equity securities and the issuance of long-term debt. From its inception through March 31, 1998, Isis has earned approximately \$111 million in revenue from contract research and development. The Company has also raised net proceeds of approximately \$180 million from the sale of equity securities since it was founded. In 1996 and 1997, Isis borrowed approximately \$47.6 million under long-term debt arrangements to finance a portion of its operations.

As of March 31, 1998, the Company had cash, cash equivalents and short-term investments totaling \$69.5 million and working capital of \$51.9 million. In comparison, the Company had cash, cash equivalents and short-term investments of \$86.8 million and working capital of \$62.6 million as of December 31, 1997. The decreases in cash and working capital during the quarter resulted from the funding of operating losses, investments in capital equipment and principal payments on debt and capital lease obligations.

The Company's collaborative agreement with Boehringer Ingelheim provides Isis with a \$40 million line of credit. This line of credit is available under certain circumstances and is to be used to support the collaboration cell adhesion programs. As of March 31, 1998, the outstanding balance under this line of was \$22.6 million.

In October 1997, Isis borrowed \$25 million in a private transaction. The loan bears interest at 14% per annum and must be repaid on November 1, 2007. No payments of either principal or interest are required during the first five years of the loan. After the first five years, interest must be paid quarterly. No principal payments are required until November 1, 2007. Because interest is deferred during the first five years, the principal balance will accrue to a total of \$50 million on November 1, 2002. In conjunction with this transaction, Isis issued warrants to purchase 500,000 shares of common stock at a price of \$25 per share. The warrants expire on November 1, 2004. On May 1, 1998, the Company completed a \$15 million follow-on debt financing on the same terms. See Note 2 to the Financial Statements, "Subsequent events."

The Company had long-term debt and capital lease obligations at March 31, 1998 totaling \$56.7 million, versus \$56.5 million at December 31, 1997. This increase was due to the accrual of interest on the ten-year described above, partially offset by principal repayments on existing obligations. We expect that capital lease obligations will increase over time to fund capital equipment acquisitions required for the Company's growing business. We will continue to use lease financing as long as the terms remain commercially attractive. We believe that the Company's existing cash, cash equivalents and short-term investments, combined with interest income, contract revenue and the \$15 million proceeds of the May 1, 1998 debt financing will be sufficient to meet its anticipated requirements for at least two years.

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#### PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not party to any legal proceedings.

ITEM 2. CHANGES IN SECURITIES

Not applicable.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

None.

b. Reports on Form 8-K

The Company filed no reports on Form 8-K during the quarter ended March 31, 1998.

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ISIS PHARMACEUTICALS, INC.

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.

ISIS PHARMACEUTICALS, INC.  
(Registrant)

Date: May 8, 1998

By: /S/ STANLEY T. CROOKE

-----  
Stanley T. Crooke, M.D., Ph.D.  
Chairman of the Board and Chief  
Executive Officer  
(Principal Executive Officer)

Date: May 8, 1998

By: /S/ B. LYNNE PARSHALL

-----  
B. Lynne Parshall  
Executive Vice President and Chief  
Financial Officer  
(Principal Financial Officer)



<ARTICLE> 5

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION DERIVED FROM THE COMPANY'S CONDENSED BALANCE SHEET AS OF MARCH 31, 1998 (UNAUDITED) AND CONDENSED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED MARCH 31, 1998 (UNAUDITED) AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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