SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended June 30, 1998

OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 0-19756

PROTEIN DESIGN LABS, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-3023969
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2375 Garcia Avenue
Mountain View, CA 94043
(Address of principal executive offices)
Telephone Number (650) 903-3700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and, (2) has been subject to such filing requirements for the past 90 days:

Yes [X] No [ ]

As of June 30, 1998, there were 18,527,590 shares of the Registrant's Common Stock outstanding.

PROTEIN DESIGN LABS, INC.

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PART I. FINANCIAL INFORMATION

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PROTEIN DESIGN LABS, INC.
STATEMENTS OF OPERATIONS
(unaudited)
(In thousands, except net loss per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1998	1997	1998	1997
Revenues:				
Revenue under agreements with third parties	$5,873	$2,500	$7,665	$4,791
Interest and other income	2,485	2,528	4,929	4,122
Total revenues	8,358	5,028	12,594	8,913
Costs and expenses:				
Research and development	7,327	6,309	13,734	12,813
General and administrative	1,959	1,550	3,801	3,021
Total costs and expenses	9,286	7,859	17,535	15,834
Net loss	($928)	($2,831)	($4,941)	($6,921)
Net loss per share	($0.05)	($0.16)	($0.27)	($0.41)
Shares used in computation of net loss per share(basic and diluted)	18,516	18,128	18,487	17,064

See accompanying notes

PROTEIN DESIGN LABS, INC.
BALANCE SHEETS
(In thousands, except par value per share)

	June 30, 1998	December 31, 1997
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$16,715	$9,266
Short-term investments	90,748	63,003
Other current assets	3,335	779
Total current assets	110,798	73,048
Property and equipment, net	13,349	9,996
Long-term investments	48,997	91,386
Other assets	579	596
	$173,723	$175,026
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$332	$475
Accrued compensation	929	833
Accrued clinical trials	1,218	1,434
Other accrued liabilities	1,868	2,212
Deferred revenue	3,129	1,604
Total current liabilities	7,476	6,558
Commitments		
Stockholders' equity:		
Preferred stock, par value $0.01 per share, 10,000 shares authorized; no shares issued and outstanding	--	--
Common stock, par value $0.01 per share, 40,000 shares authorized; 18,528 and 18,348 issued and outstanding at June 30, 1998 and December 31, 1997, respectively	185	183
Additional paid-in capital	230,012	227,093
Accumulated deficit	(64,323)	(59,382)
Unrealized gain on investments	373	574
Total stockholders' equity	166,247	168,468
	$173,723	$175,026

See accompanying notes

PROTEIN DESIGN LABS, INC.
STATEMENTS OF CASH FLOWS
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS
(unaudited)

(In thousands)

	Six Months Ended June 30,	
	1998	1997
Cash flows from operating activities:		
Net loss	($4,941)	($6,921)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,727	1,567
Other	(73)	(984)
Changes in assets and liabilities:		
Other current assets	(2,556)	140
Accounts payable	(144)	(553)
Accrued liabilities	(462)	133
Deferred revenue	1,525	--
Total adjustments	17	303
Net cash used in operating activities	(4,924)	(6,618)
Cash flows from investing activities:		
Purchases of short- and long-term investments	(61,979)	(182,219)
Maturities of short- and long-term investments	76,500	136,050
Capital expenditures	(5,084)	(1,900)
(Increase) decrease in other assets	16	(212)
Net cash provided by (used in) investing activities	9,453	(48,281)
Cash flows from financing activities:		
Proceeds from issuance of capital stock	2,920	69,718
Net cash provided by financing activities	2,920	69,718
Net increase in cash and cash equivalents	7,449	14,819
Cash and cash equivalents at beginning of period	9,266	14,141
Cash and cash equivalents at end of period	$16,715	$28,960

See accompanying notes

PROTEIN DESIGN LABS, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 1998

Summary of Significant Accounting Policies

Organization and Business

Since the Company's founding in 1986, a primary focus of its operations has been research and development. Achievement of successful research and development and commercialization of products derived from such efforts is subject to high levels of risk and significant resource commitments. The Company has a history of operating losses and expects to incur substantial additional expenses over at least the next few years as it continues to develop its proprietary products, devote significant resources to preclinical studies, clinical trials, and manufacturing and to defend its patents and other proprietary rights. The Company's revenues to date have consisted principally of research and development funding, licensing and signing fees and milestone payments from pharmaceutical companies under collaborative research and development, humanization, patent licensing and clinical supply agreements. These revenues may vary considerably from quarter to quarter and from year to year, and revenues in any period may not be predictive of revenues in any subsequent period, and variations may be significant depending on the terms of the particular agreements. In 1998, the Company began receiving royalties from sales of Zenapax. Royalties on sales of Zenapax are payable under exclusive license agreements with Hoffmann-La Roche Inc. and affiliates ("Roche"). The Company is dependent upon the further development, regulatory and marketing efforts of Roche with respect to Zenapax and there can be no assurance that Roche's further development, regulatory and marketing efforts will be successful, including, without limitation, if and when regulatory approvals in various countries may be obtained and whether or how quickly Zenapax might be adopted by the medical community. In addition, the Company recognizes royalty revenues when royalty reports are received from Roche and the Company's other collaborative partners. This method of recognizing royalty revenues from the Company's licensees, taken together with the unpredictable timing of payments of non-recurring licensing and signing fees and milestones under new and existing collaborative research and development, humanization, patent licensing and clinical supply agreements, may result in significant fluctuations in revenues in quarterly and annual periods.

Although the Company anticipates entering into new collaborative, humanization and patent licensing agreements from time to time, the Company presently does not anticipate realizing non-royalty revenue from its new and proposed collaborations and agreements at levels commensurate with the non-royalty revenue historically recognized under its older collaborations. Moreover, the Company anticipates that its operating expenses will continue to increase significantly as the Company increases its research and development, manufacturing, preclinical and clinical activity, and administrative and patent activities. Accordingly, in the absence of substantial revenues from new corporate collaborations or patent licensing agreements, significant royalties on sales of Zenapax and other products licensed under the Company's intellectual property rights, or other sources, the Company expects to incur substantial operating losses in the foreseeable future as certain of its earlier stage potential products move into later stage clinical development, as additional potential products are selected as clinical candidates for further development, as the Company invests in additional facilities or manufacturing capacity, as the Company defends or prosecutes its patents and patent applications and as the Company invests in research or acquires additional technologies or businesses.

Basis of Presentation and Responsibility for Quarterly Financial Statements

The balance sheet as of June 30, 1998 and the statements of operations and cash flows for the six month periods ended June 30, 1998 and 1997 are unaudited but include all adjustments (consisting 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. Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote information normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. The accompanying financial statements should be read in conjunction with the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended December 31, 1997. Results for any quarterly period are not necessarily indicative of results for any other quarterly period or for the entire year.

Cash Equivalents, Investments and Concentration of Credit Risk

The Company considers all highly liquid investments purchased with a maturity of three months or less at the date of acquisition to be cash equivalents. The "Other" adjustments line item in the Statements of Cash Flows represents the accretion of the book value of certain debt securities. The Company places its cash and short-term and long-term investments with high-credit-quality financial institutions and in securities of the U.S. government and U.S. government agencies and, by policy, limits the amount of credit exposure in any one financial instrument. To date, the Company has not experienced credit losses on investments in these instruments.

Revenue Recognition

Contract revenues from research and development are recorded as earned based on the performance requirements of the contracts. Revenues from achievement of milestone events are recognized when the funding party agrees that the scientific, clinical or regulatory results stipulated in the agreement have been met. Revenue recognized under certain clinical supply agreements is based upon the percentage of completion method. Deferred revenue arises principally due to the timing of cash payments received under research and development contracts.

The Company's collaborative, humanization and patent licensing agreements with third parties provide for the payment of royalties to the Company based on net sales of the licensed product under the agreement. Royalties, as reported to the Company, may include deductions for creditable amounts related to milestone payments previously received by the Company. The agreements generally provide for royalty payments to the Company following completion of each calendar quarter or semi-annual period and royalty revenue is recognized when royalty reports are received from the third party.

New Accounting Standards

Effective as of January 1, 1998, the Company adopted Financial Accounting Standards Board Statement No. 130, "Reporting Comprehensive Income" ("FAS 130"). FAS 130 establishes new rules for the reporting and display of comprehensive income (loss) and its components; however, the adoption of FAS 130 had no impact on the Company's net loss or stockholders' equity. FAS 130 requires unrealized gains and losses on the Company's available-for-sale securities, which prior to adoption were reported separately in stockholders' equity, to be included in other comprehensive income (loss). FAS 130 permits the disclosure of this information in notes to interim financial statements and the Company has elected this approach. For the three month periods ended June 30, 1998 and 1997, total comprehensive loss amounted to $1.0 million and $2.3 million, respectively. For the six month periods ended June 30, 1998 and 1997, total comprehensive loss amounted to $5.1 million and $6.7 million, respectively.

Effective December 31, 1997, the Company adopted Financial Accounting Standards Board Statement No. 128, "Earnings Per Share" ("FAS 128"). FAS 128 requires the presentation of basic earnings (loss) per share and diluted earnings (loss) per share, if more dilutive, for all periods presented. In accordance with FAS 128, net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share has not been presented as, due to the Company's net loss position, it is antidilutive. Had the Company been in a net income position, diluted earnings per share for the three months ended June 30, 1998 and 1997 would have included an additional 497,000 and 700,000 shares, respectively, related to the Company's outstanding stock options. Had the Company been in a net income position, diluted earnings per share

for the six months ended June 30, 1998 and 1997 would have included an additional 693,000 and 870,000 shares, respectively, related to the Company's outstanding stock options. The Company's previously reported net loss per share amounts conformed to FAS 128 and, accordingly, its adoption has no effect on these financial statements.

Management Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of management's estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. For example, the Company has a policy of recording expenses for clinical trials based upon pro rating estimated total costs of a clinical trial over the estimated length of the clinical trial and the number of patients anticipated to be enrolled in the trial. Expenses related to each patient are recognized ratably beginning upon entry into the trial and over the course of the trial. In the event of early termination of a clinical trial, management accrues an amount based on its estimate of the remaining non-cancellable obligations associated with the winding down of the clinical trial. These estimates and assumptions could differ significantly from the amounts which may actually be realized.

In 1997, Boehringer Mannheim GmbH ("Boehringer Mannheim") invoked the dispute resolution provisions under its collaborative research agreement to address the reimbursement of up to $2.0 million for the Phase II study of OST 577 for the treatment of chronic hepatitis B ("CHB") then being conducted by Boehringer Mannheim as well as certain legal expenses related to Boehringer Mannheim's participation in the Company's public offering in the first quarter of 1997. In March 1998, Roche acquired Corange Limited, the parent company of Boehringer Mannheim. The Company is unable to predict the outcome of this proceeding but in any event has estimated and recorded a liability with respect to this matter. The collaborative research agreement with Boehringer Mannheim provides for reimbursement from PDL of costs and expenses of up to $2.0 million for a Phase II study of OST 577 in the event certain conditions were met with respect to that study.

In June 1997, the Company entered into a Sponsored Research Agreement with Stanford University to provide aggregate funding and equipment support of up to $3.4 million over a period of 3 years for the laboratory of Stanley Falkow, Ph.D., a member of the Board of Directors and a Distinguished Investigator (consultant) of the Company. The funding arrangement provides the Company with certain exclusive rights to intellectual property resulting from the research efforts in Dr. Falkow's laboratory during the funding period. The Company expensed approximately $0.3 million in connection with this funding arrangement for the six month period ended June 30, 1998.

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

This Quarterly Report contains forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to those discussed in "Risk Factors" as well as those discussed elsewhere in this document and the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission for the year ended December 31, 1997.

OVERVIEW

Since the Company's founding in 1986, a primary focus of its operations has been research and development. Achievement of successful research and development and commercialization of products derived from such efforts is subject to high levels of risk and significant resource commitments. The Company has a history of operating losses and expects to incur substantial additional losses over at least the next few years, as it continues to develop its proprietary products, devote significant resources to preclinical studies, clinical trials, and manufacturing and to defend its patents and other proprietary rights. The Company's revenues to date have consisted principally of research and development funding, licensing and signing fees and milestone payments from

pharmaceutical, chemical and biotechnology companies under collaborative research and development and patent licensing and clinical supply agreements. These revenues may vary considerably from quarter to quarter and year to year. Revenues in any period may not be predictive of revenues in any subsequent period, and variations may be significant depending on the terms of the particular agreements. In 1998, the Company began receiving royalties from sales of Zenapaxr[R] by Hoffmann-La Roche Inc. and affiliates ("Roche"). Roche has rights to partially offset certain previously paid milestones and third party royalties against royalties payable to the Company with respect to Zenapax. The Company is dependent upon the further development, regulatory and marketing efforts of Roche with respect to Zenapax and there can be no assurance that Roche's further development, regulatory and marketing efforts will be successful, including, without limitation, if and when regulatory approvals in various countries may be obtained and whether or how quickly Zenapax might be adopted by the medical community. Royalties from Zenapax are reported to the Company on a quarterly basis for U.S. sales and on a semi-annual basis for sales outside of the U.S. The Company recognizes royalty revenues when royalty reports are received from Roche and the Company's other collaborative partners. This method of recognizing royalty revenues from the Company's licensees, taken together with Roche's rights to partially offset third party royalties and certain milestone payments and the unpredictable timing of payments of non-recurring licensing and signing fees, milestones and payments for manufacturing services under new and existing collaborative research and development and patent licensing and clinical supply agreements, is likely to result in significant fluctuations in revenues in quarterly and annual periods.

Although the Company anticipates entering into new collaborations and humanization and patent licensing agreements from time to time, the Company presently does not anticipate realizing non-royalty revenue from its new and proposed collaborations and agreements at levels commensurate with the non-royalty revenue recognized under its older collaborations. Moreover, the Company anticipates that its operating expenses will generally continue to increase significantly as the Company expands its business activities and advances potential products in clinical development, dedicates more resources to its research and development, manufacturing, preclinical and clinical activity, and administrative and patent activities. Accordingly, in the absence of substantial revenues from new corporate collaborations, humanization and patent licensing agreements, significant royalties on sales of Zenapax and other products licensed under the Company's intellectual property rights, or other sources, the Company expects to incur substantial operating losses in the foreseeable future as certain of its earlier stage potential products move into later stage clinical development, as additional potential products are selected as clinical candidates for further development, as the Company invests in additional facilities or manufacturing capacity, as the Company defends or prosecutes its patents and patent applications and as the Company invests in research or acquires additional technologies or businesses.

Contract revenues from research and development are recorded as earned based on the performance requirements of the contracts. Revenues from achievement of milestone events are recognized when the funding party agrees that the scientific, clinical or regulatory results stipulated in the agreement have been met. Revenue recognized under certain clinical supply agreements are based on the percentage of completion method. Deferred revenue arises principally due to timing of cash payments received under research and development contracts.

The Company's collaborative, humanization and patent licensing agreements with third parties provide for the payment of royalties to the Company based on net sales of the licensed product under the agreement. Royalties, as reported to the Company, may include deductions for creditable amounts related to milestone payments previously received by the Company. The agreements generally provide for royalty reports to the Company following completion of each calendar quarter or semi-annual period and royalty revenue is recognized when royalty reports are received from the third party.

RESULTS OF OPERATIONS

Three Months Ended June 30, 1998 and 1997

The Company's total revenues for the three months ended June 30, 1998 were $8.4 million as compared to $5.0 million in 1997. Total revenues recognized under agreements with third parties were $5.9 million in the second quarter of 1998 compared to $2.5 million in the comparable period in 1997. Interest and other income amounted to $2.5 million in the second quarters of both 1998 and 1997.

Revenues under agreements with third parties of $5.9 million for the three months ended June 30, 1998 consisted principally of licensing and signing fees, manufacturing services revenues under clinical supply agreements, milestone payments earned under licensing agreements, research and development reimbursement funding and royalties. In the second quarter of 1997, revenues under agreements with third parties consisted of $2.5 million of milestone payments earned under licensing agreements.

Total costs and expenses for the three months ended June 30, 1998 increased to $9.3 million from $7.9 million in the comparable period in 1997. The increase in costs was primarily due to the addition of staff in the Company's pharmaceutical research and development programs, administrative functions and associated expenses desirable to manage and support the Company's expanding operations.

Research and development expenses for the three month period ended June 30, 1998 increased to $7.3 million from $6.3 million in the comparable period in 1997. The increase in costs was primarily due to the addition of staff, the continuation of clinical trials, costs of conducting preclinical tests and expansion of research and pharmaceutical development capabilities, including support for both clinical development and manufacturing process development.

General and administrative expenses for the three months ended June 30, 1998 increased to $2.0 million from $1.6 million in the comparable period in 1997. These increases were primarily the result of increased staffing and associated expenses desirable to manage and support the Company's expanding operations.

Six Months Ended June 30, 1998 and 1997

The Company's total revenues for the six months ended June 30, 1998 were $12.6 million as compared to $8.9 million in 1997. Total revenues recognized under agreements with third parties were $7.7 million for the six months ended June 30, 1998 compared to $4.8 million in the comparable period in 1997. Interest and other income for the six months ended June 30, 1998 were $4.9 million compared to $4.1 million in the comparable period in 1997. This increase is primarily attributable to the increased interest earned on the Company's increased cash and cash equivalents balances as a result of the Company's follow-on public offering which was completed during the first quarter of 1997.

Revenues under agreements with third parties of $7.7 million for the six months ended June 30, 1998 consisted principally of licensing and signing fees, manufacturing services revenues under clinical supply agreements, milestone payments earned under licensing agreements, research and development reimbursement funding and royalties. In the comparable period of 1997, revenues under agreements with third parties consisted of $4.8 million of licensing and signing fees and milestone payments earned under licensing agreements.

Total costs and expenses for the six months ended June 30, 1998 increased to $17.5 million from $15.8 million in the comparable period in 1997. The increase in costs was primarily due to the addition of staff in the Company's pharmaceutical research and development programs, administrative functions and associated expenses desirable to manage and support the Company's expanding operations.

Research and development expenses for the six months ended June 30, 1998 increased to $13.7 million from $12.8 million in the comparable period in 1997. The increase in costs was primarily due to the addition of staff, the continuation of clinical trials, costs of conducting preclinical tests and expansion of research and pharmaceutical development capabilities, including support for both clinical development and manufacturing process development.

General and administrative expenses for the six months ended June 30, 1998 increased to $3.8 million from $3.0 million in the comparable period in 1997. These increases were primarily the result of increased staffing and associated expenses desirable to manage and support the Company's expanding operations.

LIQUIDITY AND CAPITAL RESOURCES

To date, the Company has financed its operations primarily through public and private placements of equity securities, research and development revenues and interest income on invested capital. At June 30, 1998, the Company had cash, cash equivalents and investments in the aggregate of $156.5 million, compared to $163.7 million at December 31,

1997.

In 1997, Boehringer Mannheim GmbH ("Boehringer Mannheim") invoked the dispute resolution provisions under its collaborative research agreement with the Company to address the reimbursement of up to $2.0 million for the Phase II study of OST 577 for the treatment of chronic hepatitis B ("CHB") then being conducted by Boehringer Mannheim as well as certain legal expenses related to Boehringer Mannheim's participation in the Company's public offering in the first quarter of 1997. In March 1998, Roche acquired Corange Limited, the parent company of Boehringer Mannheim. The Company is unable to predict the outcome of this proceeding but in any event has estimated and recorded a liability with respect to this matter. The collaborative research agreement with Boehringer Mannheim provides for reimbursement from PDL of costs and expenses of up to $2.0 million for a Phase II study of OST 577 in the event certain conditions were met with respect to that study.

As set forth in the Statements of Cash Flows, net cash used in operating activities was $4.9 million for the six months ended June 30, 1998 compared to $6.6 million in the same period in 1997. The decrease in 1998 was primarily due to the Company receiving research and development reimbursement funding in advance of the related work to be performed by the Company.

As set forth in the Statements of Cash Flows, net cash provided by investing activities for the six months ended June 30, 1998 was $9.5 million, resulting primarily from maturities of short-term investments. Net cash used in investing activities for the comparable period in 1997 was $48.3 million reflecting the purchase of short- and long-term investments.

The Company has entered into a twelve year lease of approximately 90,000 square feet for the relocation of its headquarters and research and development facilities to Fremont, California. The Company plans to invest approximately $13 million in order to make the facilities suitable for its operations. As set forth in the Statements of Cash Flows, capital expenditures increased to $5.1 million for the six months ended June 30, 1998 compared to $1.9 million in the comparable period in 1997, primarily from its investment in these facilities.

As set forth in the Statements of Cash Flows, net cash provided by financing activities for the six months ended June 30, 1998 was $2.9 million resulting primarily from the exercise of outstanding stock options. Net cash provided by financing activities for the comparable period in 1997 was $69.7 million. The 1997 amount resulted primarily from the completion of a public offering of 2.275 million shares of the Company's common stock in the first quarter of 1997.

The Company's future capital requirements will depend on numerous factors, including, among others, royalties from Roche's marketing of Zenapax; the ability of the Company to enter into additional collaborative, humanization and patent licensing arrangements; the progress of the Company's product candidates in clinical trials; the ability of the Company's licensees to obtain regulatory approval and successfully manufacture and market products licensed under the Company's patents; the continued or additional support by collaborative partners or other third parties of research and development efforts and clinical trials; enhancement of existing and investment in new research and development programs; the time required to gain regulatory approvals; the resources the Company devotes to self-funded products, manufacturing facilities and methods and advanced technologies; the ability of the Company to obtain and retain funding from third parties under collaborative agreements; the continued development of internal marketing and sales capabilities; the demand for the Company's potential products, if and when approved; potential acquisitions of technology, product candidates or businesses by the Company; and the costs of defending or prosecuting any patent opposition or litigation necessary to protect the Company's proprietary technology. In order to develop and commercialize its potential products the Company may need to raise substantial additional funds through equity or debt financings, collaborative arrangements, the use of sponsored research efforts or other means. No assurance can be given that such additional financing will be available on acceptable terms, if at all, and such financing may only be available on terms dilutive to existing stockholders. The Company believes that existing capital resources will be adequate to satisfy its capital needs through at least 2000.

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

The Company's 1998 Annual Meeting of Stockholders was held on June

19, 1998, at the Company's principal offices in Mountain View, California. Of the 18,512,081 shares outstanding as of the record date, 15,284,904 shares were present at the meeting or represented by proxies, representing approximately 82.5% of the total votes eligible to be cast.

At the meeting, the stockholders voted to re-elect three Class III directors of the Company to serve for a three-year term and until their successors are duly elected and qualified. The name of each Class III director elected at the Annual Meeting and the votes cast with respect to each such individual are set forth below.

	For	Withheld
Jurgen Drews	14,669,644	615,260
Laurence Jay Korn	15,194,459	90,445
Max Link	15,196,191	88,713

In addition, the stockholders voted to ratify the appointment of Ernst & Young LLP as the independent auditors of the Company for the fiscal year ending December 31, 1998. The votes cast are set forth below.

For	Against	Abstentions
15,263,916	12,071	8,917

PART II. OTHER INFORMATION

ITEM 5. OTHER INFORMATION - RISK FACTORS

This Quarterly Report contains, in addition to historical information, forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in forward-looking statements. Factors that may cause such a difference include those discussed in the material set forth under "Risk Factors" and elsewhere in this document and in the Company's Annual Report on Form 10-K for the year ending December 31, 1997.

History Of Losses; Future Profitability Uncertain. The Company has a history of operating losses and expects to incur substantial additional expenses with resulting quarterly losses over at least the next several years as it continues to develop its potential products, to invest in new research areas and to devote significant resources to preclinical studies, clinical trials and manufacturing. As of June 30, 1998, the Company had an accumulated deficit of approximately $64.3 million. The time and resource commitment required to achieve market success for any individual product is extensive and uncertain. No assurance can be given that the Company, its collaborative partners or licensees will successfully develop products, obtain required regulatory approvals, manufacture products at an acceptable cost and with appropriate quality, or successfully market such products.

The Company's revenues to date have consisted principally of research and development funding, licensing and signing fees and milestone and other payments from pharmaceutical, chemical and biotechnology companies under collaborative, humanization, patent licensing and clinical supply agreements. These revenues may vary considerably from quarter to quarter and from year to year, and revenues in any period may not be predictive of revenues in any subsequent period, and variations may be significant depending on the terms of the particular agreements. In addition, revenues from patent licensing arrangements and royalties are expected to vary considerably from quarter to quarter and from year to year, and revenues in any period may not be predictive of revenues in any subsequent period, with significant variations depending on the terms of the particular agreements. For example, revenues in each of the quarters of 1997 included several non-recurring payments in connection with new humanization, patent licensing and other research and development agreements, which payments resulted in significant variations in revenues in each of the quarters in 1997.

Hoffmann-La Roche Inc. and its affiliates ("Roche") have received regulatory approval to distribute Zenapax[R] in the U.S. and Switzerland. Zenapax, a product created by the Company, is licensed exclusively to Roche and the Company is dependent upon the efforts of Roche to obtain additional regulatory approvals and market Zenapax. The Company has begun receiving royalties in 1998 based on revenue from sales of Zenapax by Roche, with royalties based on U.S. sales paid to the Company on a quarterly basis and sales outside of the U.S. on a semi-annual basis. Roche has rights to partially offset third party royalties and certain previously paid milestones against royalties payable to the Company with respect to Zenapax. The Company recognizes royalty revenues

when royalty reports are received from its collaborative partners, including Roche. This method of accounting for royalty revenues from the Company's licensees, taken together with the unpredictable timing of payments of non-recurring licensing and signing fees, payments for manufacturing services and milestones under new and existing collaborative, humanization, patent licensing and clinical supply agreements, is likely to result in significant quarterly fluctuations in revenues in quarterly and annual periods. Thus, revenues in any period may not be predictive of revenues in any subsequent period, and variations may be significant depending on the terms of the particular agreements.

Although the Company anticipates entering into new collaborations from time to time, the Company presently does not anticipate continuing to realize non-royalty revenue from its new and proposed collaborations at levels commensurate with the revenue historically recognized under its older collaborations. Moreover, the Company anticipates that it will incur significant operating expenses as the Company increases its research and development, manufacturing, preclinical, clinical, marketing and administrative and patent activities. Accordingly, in the absence of substantial revenues from new corporate collaborations or patent licensing arrangements, royalties on sales of Zenapax or other products licensed under the Company's intellectual property rights or other sources, the Company expects to incur substantial operating losses in the foreseeable future as certain of its earlier stage potential products move into later stage clinical development, as additional potential products are selected as clinical candidates for further development, as the Company invests in new headquarters and additional laboratory and manufacturing facilities or capacity, as the Company defends or prosecutes its patents and patent applications, and as the Company invests in continuing and new research programs or acquires additional technologies, product candidates or businesses. For example, the Company expects to invest approximately $13 million related to the construction of its new headquarters facilities located in Fremont, California, which improvements will include the expansion of laboratory and development facilities. The amount of net losses and the time required to reach sustained profitability are highly uncertain. To achieve sustained profitable operations, the Company, alone or with its collaborative partners, must successfully discover, develop, manufacture, obtain regulatory approvals for and market potential products. No assurances can be given that the Company will be able to achieve or sustain profitability, and results are expected to fluctuate from quarter to quarter and year to year.

Dependence On Roche With Respect To Zenapax. Roche controls the development and marketing of Zenapax, the most advanced of the Company's products in development, and the Company is dependent upon the resources and activities of Roche to pursue commercialization of Zenapax in order for the Company to receive royalties or additional milestone payments from the marketing and development of this product. There can be no assurance that Roche's further development, regulatory and marketing efforts will be successful, including without limitation, whether or how quickly Zenapax might receive regulatory approvals in addition to those in the U.S. and Switzerland and how rapidly it might be adopted by the medical community. Moreover, Simulect[R], a product competitive with Zenapax, has recently been approved for marketing in the U.S. and Switzerland and there can be no assurance that Roche will successfully market and sell Zenapax against this and other available competitive products. In addition, there can be no assurance that other independently developed products of Roche, including CellCept[R], or others will not compete with or prevent Zenapax from achieving meaningful sales. Roche's development and marketing efforts for CellCept may result in delays or a relatively smaller resource commitment to product launch and support efforts than might otherwise be obtained for Zenapax if this potentially competitive product were not under development or being marketed.

Moreover, Zenapax is being tested in certain early stage clinical trials in autoimmune indications. There can be no assurance that Roche will continue or pursue additional clinical trials in these indications or that, even if the additional clinical trials are completed, Zenapax will be shown to be safe and efficacious, or that the clinical trials will result in approval to market Zenapax in these indications. Any adverse event or announcement related to Zenapax would have a material adverse effect on the business and financial condition of the Company.

Uncertainty Of Clinical Trial Results. Before obtaining regulatory approval for the commercial sale of any of its potential products, the Company must demonstrate through preclinical studies and clinical trials that the product is safe and efficacious for use in the clinical indication for which approval is sought. There can be no assurance that

the Company will be permitted to undertake or continue clinical trials for any of its potential products or, if permitted, that such products will be demonstrated to be safe and efficacious. Moreover, the results from preclinical studies and early-stage clinical trials may not be predictive of results that will be obtained in late-stage clinical trials. Thus, there can be no assurance that the Company's present or future clinical trials will demonstrate the safety and efficacy of any potential products or will result in approval to market products.

In advanced clinical development, numerous factors may be involved that may lead to different results in larger, late-stage clinical trials from those obtained in early-stage trials. For example, early-stage clinical trials usually involve a small number of patients, often at a single center, and thus may not accurately predict the actual results regarding safety and efficacy that may be demonstrated with a large number of patients in a late-stage multi-center clinical trial. Also, differences in the clinical trial design between early-stage and late-stage clinical trials may cause different results regarding the safety and efficacy of a product to be obtained. In addition, many early-stage trials are unblinded and based on qualitative evaluations by clinicians involved in the performance of the trial, whereas late-stage trials are generally required to be blinded in order to provide more objective data for assessing the safety and efficacy of the product. Moreover, preliminary results from early-stage trials may not be representative of results that may be obtained as the trial proceeds to completion.

The Company may at times elect to aggressively enter potential products into Phase I/II trials to determine preliminary efficacy in specific indications. In addition, in certain cases the Company has commenced clinical trials without conducting preclinical animal testing where an appropriate animal model does not exist. Similarly, the Company or its partners at times will conduct potentially pivotal Phase II/III or Phase III trials based on limited Phase I or Phase I/II data. As a result of these and other factors, the Company anticipates that only some of its potential products will show safety and efficacy in clinical trials and that the number of products that fail to show safety and efficacy may be significant.

Limited Experience With Clinical Trials; Risk Of Delay. The Company has conducted only a limited number of clinical trials to date. There can be no assurance that the Company will be able to successfully commence and complete all of its planned clinical trials without significant additional resources and expertise. In addition, there can be no assurance that the Company will meet its contemplated development schedule for any of its potential products. The inability of the Company or its collaborative partners to commence or continue clinical trials as currently planned, to complete the clinical trials on a timely basis or to demonstrate the safety and efficacy of its potential products, would have a material adverse effect on the business and financial condition of the Company.

The rate of completion of the Company's or its collaborators' clinical trials is significantly dependent upon, among other factors, the rate of patient enrollment. Patient enrollment is a function of many factors, including, among others, the size of the patient population, perceived risks and benefits of the drug under study, availability of competing therapies, access to reimbursement from insurance companies or government sources, design of the protocol, proximity of and access by patients to clinical sites, patient referral practices, eligibility criteria for the study in question and efforts of the sponsor of and clinical sites involved in the trial to facilitate timely enrollment in the trial. Delays in the planned rate of patient enrollment may result in increased costs and expenses in completion of the trial or may require the Company to undertake additional studies in order to obtain regulatory approval if the applicable standard of care changes in the therapeutic indication under study. These considerations may lead the Company to consider the termination of ongoing clinical trials or halting further development of a product for a particular indication.

Uncertainty Of Patents And Proprietary Technology; Opposition Proceedings. The Company's success is significantly dependent on its ability to obtain patent protection for its products and technologies and to preserve its trade secrets and operate without infringing on the proprietary rights of third parties. The Company files and prosecutes patent applications to protect its inventions. No assurance can be given that the Company's pending patent applications will result in the issuance of patents or that any patents will provide competitive advantages or will not be invalidated or circumvented by its competitors. Moreover, no assurance can be given that patents are not issued to, or patent applications have not been filed by, other companies which would have an adverse effect on the Company's ability to

use, manufacture or market its products or maintain its competitive position with respect to its products. Other companies obtaining patents claiming products or processes useful to the Company may bring infringement actions against the Company. As a result, the Company may be required to obtain licenses from others or not be able to use, manufacture or market its products. Such licenses may not be available on commercially reasonable terms, if at all.

Patents in the U.S. are issued to the party that is first to invent the claimed invention. Since patent applications in the U.S. are maintained in secrecy until patents issue, the Company cannot be certain that it was the first inventor of the inventions covered by its pending patent applications or that it was the first to file patent applications for such inventions. The patent positions of biotechnology firms generally are highly uncertain and involve complex legal and factual questions. No consistent policy has emerged regarding the breadth of claims in biotechnology patents, and patents of biotechnology products are uncertain so that even issued patents may later be modified or revoked by the U.S. Patent and Trademark Office ("PTO") or the courts in proceedings instituted by third parties. Moreover, the issuance of a patent in one country does not assure the issuance of a patent with similar claims in another country and claim interpretation and infringement laws vary among countries, so the extent of any patent protection may vary in different territories.

The Company has several patents and exclusive licenses covering its humanized and human antibody technology, respectively. With respect to its human antibody technology and antibodies, the Company has exclusively licensed certain patents from Novartis Pharmaceuticals Corporation ("Novartis") (formerly known as Sandoz Pharmaceuticals Corporation). With respect to its SMART antibody technology and antibodies, the Company has been issued fundamental patents by the European Patent Office ("EPO") and PTO. In addition, in June 1996 the Company was issued a U.S. patent covering Zenapax and certain related antibodies against the IL-2 receptor. The Company is also currently prosecuting other patent applications with the PTO and in other countries, including members of the European Patent Convention, Canada, Japan and Australia. The patent applications are directed to various aspects of the Company's SMART and human antibodies, antibody technology and other programs, and include claims relating to compositions of matter, methods of preparation and use of a number of the Company's compounds. However, the Company does not know whether any pending applications will result in the issuance of patents or whether such patents will provide protection of commercial significance. Further, there can be no assurance that the Company's patents will prevent others from developing competitive products using related technology.

With respect to its issued antibody humanization patents, the Company believes the patent claims cover Zenapax and, based on its review of the scientific literature, most humanized antibodies. The EPO (but not PTO) procedures provide for a nine-month opposition period in which other parties may submit arguments as to why the patent was incorrectly granted and should be withdrawn or limited. Eighteen notices of opposition and opposition briefs to the Company's European patent were filed during the opposition period, including filings by major pharmaceutical and biotechnology companies, which cited references and made arguments not considered by the EPO and PTO before grant of the respective patents. The Company recently filed its response to the briefs filed by these parties. The entire opposition process, including appeals, may take several years to complete, and during this lengthy process, the validity of the EPO patent will be at issue, which may limit the Company's ability to negotiate or collect royalties or to negotiate future collaborative research and development agreements based on this patent. The Company intends to vigorously defend the European and, if necessary, the U.S. patent; however, there can be no assurance that the Company will prevail in the opposition proceedings or any litigation contesting the validity or scope of these patents. If the outcome of the European opposition proceeding or any litigation involving the Company's antibody humanization patents were to be unfavorable, the Company's ability to collect royalties on licensed products and to license its patents relating to humanized antibodies may be materially adversely affected, which could have a material adverse affect on the business and financial conditions of the Company. In addition, such proceedings or litigation, or any other proceedings or litigation to protect the Company's intellectual property rights or defend against infringement claims by others, could result in substantial costs and a diversion of management's time and attention, which could have a material adverse effect on the business and financial condition of the Company.

A number of companies, universities and research institutions have

filed patent applications or received patents in the areas of antibodies and other fields relating to the Company's programs. Some of these applications or patents may be competitive with the Company's applications or contain claims that conflict with those made under the Company's patent applications or patents. Such conflict could prevent issuance of patents to the Company, provoke an interference with the Company's patents or result in a significant reduction in the scope or invalidation of the Company's patents, if issued. An interference is an administrative proceeding conducted by the PTO to determine the priority of invention and other matters relating to the decision to grant patents. Moreover, if patents are held by or issued to other parties that contain claims relating to the Company's products or processes, and such claims are ultimately determined to be valid, no assurance can be given that the Company would be able to obtain licenses to these patents at a reasonable cost, if at all, or to develop or obtain alternative technology.

The Company is aware that Celltech Limited ("Celltech") has been granted a patent by the EPO covering certain humanized antibodies, which PDL has opposed, and that Celltech has a pending application for a corresponding U.S. patent (the "U.S. Adair Patent Application"). Because U.S. patent applications are maintained in secrecy, the U.S. Adair Patent Application remains confidential. Accordingly, there can be no assurance that claims in such a patent or application would not cover any of the Company's SMART antibodies or be competitive with or conflict with claims in the Company's patents or patent applications. If the U.S. Adair Patent Application issues and if it is determined to be valid and to cover any of the Company's SMART antibodies, there can be no assurance that PDL would be able to obtain a license on commercially reasonable terms, if at all. If the claims of the U.S. Adair Patent Application conflict with claims in the Company's patents or patent applications, there can be no assurance that an interference would not be declared by the PTO, which could take several years to resolve and could involve significant expense to the Company. Also, such conflict could prevent issuance of additional patents to PDL relating to humanization of antibodies or result in a significant reduction in the scope or invalidation of the Company's patents, if issued. Moreover, uncertainty as to the validity or scope of patents issued to the Company relating generally to humanization of antibodies may limit the Company's ability to negotiate or collect royalties or to negotiate future collaborative research and development agreements based on these patents.

The Company has obtained a nonexclusive license under a patent held by Celltech (the "Boss Patent") relating to the Company's current process for producing SMART and human antibodies. An interference proceeding was declared in early 1991 by the PTO between the Boss Patent and a patent application filed by Genentech, Inc. ("Genentech") to which the Company does not have a license. The Company is not a party to this proceeding, and the timing and outcome of the proceeding or the scope of any patent that may be subsequently issued cannot be predicted. If the Genentech patent application were held to have priority over the Boss Patent, and if it were determined that the Company's processes and products were covered by a patent issuing from such patent application, the Company may be required to obtain a license under such patent or to significantly alter its processes or products. There can be no assurance that the Company would be able to successfully alter its processes or products to avoid infringing such patent or to obtain such a license on commercially reasonable terms, if at all, and the failure to do so could have a material adverse effect on the Company.

The Company is aware that Lonza Biologics, Inc. has a patent issued in Europe to which the Company does not have a license (although Roche has advised the Company that it has a license covering Zenapax), which may cover the process the Company uses to produce its potential products. If it were determined that the Company's processes were covered by such patent, the Company might be required to obtain a license under such patent or to significantly alter its processes or products, if necessary to manufacture or import its products in Europe. There can be no assurance that the Company would be able to successfully alter its processes or products to avoid infringing such patent or to obtain such a license on commercially reasonable terms, if at all, and the failure to do so could have a material adverse effect on the business and financial condition of the Company.

Also, Genentech has patents in the U.S. and Europe that relate to chimeric antibodies. Although the European patent was declared invalid by the EPO in the opposition process, Genentech has appealed that decision, thereby staying that decision. If Genentech were to assert that the Company's SMART antibodies infringe these patents, the Company might have to choose whether to seek a license or to challenge in court

the validity of such patents or Genentech's claim of infringement. There can be no assurance that the Company would be successful in either obtaining such a license on commercially reasonable terms, if at all, or that it would be successful in such a challenge of the Genentech patents, and the failure to do so could have a material adverse effect on the business and financial condition of the Company.

In addition to seeking the protection of patents and licenses, the Company also relies upon trade secrets, know-how and continuing technological innovation which it seeks to protect, in part, by confidentiality agreements with employees, consultants, suppliers and licensees. There can be no assurance that these agreements will not be breached, that the Company would have adequate remedies for any breach or that the Company's trade secrets will not otherwise become known, independently developed or patented by competitors.

Dependence On Collaborative Partners. The Company has collaborative agreements with several pharmaceutical or other companies to develop, manufacture and market certain potential products, which include Zenapax, the most advanced product of the Company. The Company granted its collaborative partners certain exclusive rights to commercialize the products covered by these collaborative agreements. In some cases, the Company is relying on its collaborative partners to conduct clinical trials, to compile and analyze the data received from such trials, to obtain regulatory approvals and, if approved, to manufacture and market these licensed products. As a result, the Company often has little or no control over the development and marketing of these potential products and little or no opportunity to review clinical data prior to or following public announcement.

The Company's collaborative research agreements are generally terminable by its partners on short notice. Suspension or termination of certain of the Company's current collaborative research agreements could have a material adverse effect on the Company's operations and could significantly delay the development of the affected products. Continued funding and participation by collaborative partners will depend on the timely achievement of research and development objectives by the Company, the retention of key personnel performing work under those agreements and the successful achievement of research or clinical trial goals, none of which can be assured, as well as on each collaborative partner's own financial, competitive, marketing and strategic considerations. Such considerations include, among other things, the commitment of management of the collaborative partners to the continued development of the licensed products, the relationships among the individuals responsible for the implementation and maintenance of the collaborative efforts, the relative advantages of alternative products being marketed or developed by the collaborators or by others, including their relative patent and proprietary technology positions, and their ability to manufacture potential products successfully. In this regard, Boehringer Mannheim GmbH ("Boehringer Mannheim") recently returned all rights to OST 577 to the Company. Although a Phase IIa clinical study involving this antibody has recently been initiated, the Company remains dependent upon Boehringer Mannheim to transfer technical data, existing clinical supplies and other regulatory information related to OST 577 to the Company or to the FDA in a timely manner in order to facilitate further development of OST 577. There can be no assurance that Boehringer Mannheim will continue to cooperate with the Company in providing such data, supplies or information in a timely manner. In addition, Boehringer Mannheim has invoked the dispute resolution provisions under its collaborative research agreement to address the reimbursement of up to $2.0 million for the Phase II study of OST 577 for the treatment of chronic hepatitis B ("CHB") conducted by Boehringer Mannheim. The Company is unable to predict the outcome of this proceeding but in any event has estimated and recorded a liability with respect to this matter.

Further, in March 1998 Roche acquired Corange Limited, the parent company of Boehringer Mannheim. The Company expects that Roche may terminate the various drug development programs of the Company and Boehringer Mannheim, including those for the SMART[Tm]Anti-L-Selectin Antibody and an antibody to an undisclosed cardiovascular target. The Company cannot predict the timing of Roche's determination to continue, modify or terminate the development program for these antibodies. In addition, Roche acquired 1,682,877 shares of the Company's common stock held by Corange which are no longer subject to contractual limitations on disposition.

The Company's ability to enter into new collaborations and the willingness of the Company's existing collaborators to continue development of the Company's potential products depends upon, among other things, the Company's patent position with respect to such

products. In this regard, the Company has been issued patents by PTO and EPO with claims that the Company believes, based on its survey of the scientific literature, cover most humanized antibodies. Eighteen notices of opposition and opposition briefs to the European patent have been filed with the EPO, and either or both patents may be further challenged through administrative or judicial proceedings. The Company has applied for similar patents in Japan and other countries. The Company has entered into several collaborations related to both the humanization and patent licensing of certain antibodies whereby it granted licenses to its patent rights relating to such antibodies, and the Company anticipates entering into additional collaborations and patent licensing agreements partially as a result of the Company's patent and patent applications with respect to humanized antibodies. As a result, the inability of the Company to successfully defend the opposition proceeding before the EPO or, if necessary, to defend patents granted by the PTO or EPO or to successfully prosecute the corresponding patent applications in Japan or other countries could adversely affect the ability of the Company to collect royalties on existing licensed products such as Zenapax, and enter into additional collaborations, humanization or patent licensing agreements and could therefore have a material adverse effect on the Company's business or financial condition.

Absence Of Manufacturing Experience. Of the products developed by the Company which are currently in clinical development, Roche is responsible for manufacturing Zenapax. If further development occurs, the Company intends to manufacture OST 577, the SMART M195 Antibody and the SMART Anti-CD3 Antibody as well as some or all of its other products in preclinical development. The Company currently leases approximately 47,000 square feet housing its manufacturing facilities in Plymouth, Minnesota. The Company intends to continue to manufacture potential products for use in preclinical and clinical trials using this manufacturing facility in accordance with standard procedures that comply with current Good Manufacturing Practices ("cGMP") and appropriate regulatory standards. The manufacture of sufficient quantities of antibody products in accordance with such standards is an expensive, time-consuming and complex process and is subject to a number of risks that could result in delays. For example, the Company has experienced some difficulties in the past in manufacturing certain potential products on a consistent basis. Production interruptions, if they occur, could significantly delay clinical development of potential products, reduce third party or clinical researcher interest and support of proposed clinical trials, and possibly delay commercialization of such products and impair their competitive position, which would have a material adverse effect on the business and financial condition of the Company.

The Company has no experience in manufacturing commercial quantities of its potential products and currently does not have sufficient capacity to manufacture its potential products on a commercial scale. In order to obtain regulatory approvals and to create capacity to produce its products for commercial sale at an acceptable cost, the Company will need to improve and expand its existing manufacturing capabilities, including demonstration to the FDA of its ability to manufacture its products using controlled, reproducible processes. Accordingly, the Company is evaluating plans to improve and expand the capacity of its current manufacturing facility. Such plans, if fully implemented, would result in substantial costs to the Company and may require a suspension of manufacturing operations during construction. There can be no assurance that construction delays would not occur, and any such delays could impair the Company's ability to produce adequate supplies of its potential products for clinical use or commercial sale on a timely basis. Further, there can be no assurance that the Company will successfully improve and expand its manufacturing capability sufficiently to obtain necessary regulatory approvals and to produce adequate commercial supplies of its potential products on a timely basis. Failure to do so could delay commercialization of such products and impair their competitive position, which could have a material adverse effect on the business or financial condition of the Company.

Uncertainties Resulting From Manufacturing Changes. Manufacturing of antibodies for use as therapeutics in compliance with regulatory requirements is complex, time-consuming and expensive. When certain changes are made in the manufacturing process, it is necessary to demonstrate to the FDA that the changes have not caused the resulting drug material to differ significantly from the drug material previously produced, if results of prior preclinical studies and clinical trials performed using the previously produced drug material are to be relied upon in regulatory filings. Such changes could include, for example, changing the cell line used to produce the antibody, changing the

fermentation or purification process or moving the production process to a new manufacturing plant. Depending upon the type and degree of differences between the newer and older drug material, various studies could be required to demonstrate that the newly produced drug material is sufficiently similar to the previously produced drug material, possibly requiring additional animal studies or human clinical trials. Manufacturing changes have been made or are likely to be made for the production of the Company's products currently in clinical development, in particular OST 577. There can be no assurance that such changes will not result in delays in development or regulatory approvals or, if occurring after regulatory approval, in reduction or interruption of commercial sales. In addition, manufacturing changes to its manufacturing facility may require the Company to shut down production for a period of time. There can be no assurance that the Company will be able to reinitiate production in a timely manner, if at all, following such shutdown. Delays as a result of manufacturing changes or shutdown of the manufacturing facility could have an adverse effect on the competitive position of those products and could have a material adverse effect on the business and financial condition of the Company.

Dependence On Suppliers. The Company is dependent on outside vendors for the supply of raw materials used to produce its product candidates. The Company currently qualifies only one or a few vendors for its source of certain raw materials. Therefore, once a supplier's materials have been selected for use in the Company's manufacturing process, the supplier in effect becomes a sole or limited source of such raw materials to the Company due to the extensive regulatory compliance procedures governing changes in manufacturing processes. Although the Company believes it could qualify alternative suppliers, there can be no assurance that the Company would not experience a disruption in manufacturing if it experienced a disruption in supply from any of these sources. Any significant interruption in the supply of any of the raw materials currently obtained from such sources, or the time and expense necessary to transition a replacement supplier's product into the Company's manufacturing process, could disrupt the Company's operations and have a material adverse effect on the business and financial condition of the Company. A problem or suspected problem with the quality of raw materials supplied could result in a suspension of clinical trials, notification of patients treated with products or product candidates produced using such materials, potential product liability claims, a recall of products or product candidates produced using such materials, and an interruption of supplies, any of which could have a material adverse effect on the business or financial condition of the Company.

Competition; Rapid Technological Change. The Company's potential products are intended to address a wide variety of disease conditions, including autoimmune diseases, inflammatory conditions, cancers and viral infections. Competition with respect to these disease conditions is intense and is expected to increase. This competition involves, among other things, successful research and development efforts, obtaining appropriate regulatory approvals, establishing and defending intellectual property rights, successful product manufacturing, marketing, distribution, market and physician acceptance, patient compliance, price and potentially securing eligibility for reimbursement or payment for the use of the Company's product. The Company believes its most significant competitors may be fully integrated pharmaceutical companies with substantial expertise in research and development, manufacturing, testing, obtaining regulatory approvals, marketing and securing eligibility for reimbursement or payment, and substantially greater financial and other resources than the Company. Smaller companies also may prove to be significant competitors, particularly through collaborative arrangements with large pharmaceutical companies. Furthermore, academic institutions, governmental agencies and other public and private research organizations conduct research, seek patent protection, and establish collaborative arrangements for product development, clinical development and marketing. These companies and institutions also compete with the Company in recruiting and retaining highly qualified personnel. The biotechnology and pharmaceutical industries are subject to rapid and substantial technological change. The Company's competitors may develop and introduce other technologies or approaches to accomplishing the intended purposes of the Company's products which may render the Company's technologies and products noncompetitive and obsolete.

In addition to currently marketed competitive drugs, the Company is aware of potential products in research or development by its competitors that address all of the diseases being targeted by the Company. These and other products may compete directly with the potential products being developed by the Company. In this regard, the Company is aware that potential competitors are developing antibodies or

other compounds for treating autoimmune diseases, inflammatory conditions, cancers and viral infections. In particular, a number of other companies have developed and will continue to develop human and humanized antibodies. In addition, protein design is being actively pursued at a number of academic and commercial organizations, and several companies have developed or may develop technologies that can compete with the Company's SMART and human antibody technologies. There can be no assurance that competitors will not succeed in more rapidly developing and marketing technologies and products that are more effective than the products being developed by the Company or that would render the Company's products or technology obsolete or noncompetitive. Further, there can be no assurance that the Company's collaborative partners will not independently develop products competitive with those licensed to such partners by the Company, thereby reducing the likelihood that the Company will receive revenues under its agreements with such partners.

Any potential product that the Company or its collaborative partners succeed in developing and obtaining regulatory approval for must then compete for market acceptance and market share. For certain of the Company's potential products, an important factor will be the timing of market introduction of competitive products. Accordingly, the relative speed with which the Company and its collaborative partners can develop products, complete the clinical testing and approval processes, and supply commercial quantities of the products to the market compared to competitive companies is expected to be an important determinant of market success. For example, Novartis has received approval to market Simulect, a product competitive with Zenapax, in the U.S. and Switzerland. Novartis has a significant marketing and sales force directed to the transplantation market and there can be no assurance that Roche will successfully market and sell Zenapax against this and other available products. With respect to the speed of development of OST 577, the Company is aware that other drugs such as lamivudine from Glaxo Wellcome plc are in advanced clinical development or have been submitted for approval in certain jurisdictions for the treatment of CHB by competitive companies that have significantly greater experience and resources in developing antiviral products than the Company. The Company's current clinical plans for OST 577 involve a study of the combination of OST 577 and nucleoside analogs such as lamivudine. The lack of availability of lamivudine or other drugs for the treatment of CHB could have a material adverse impact on the clinical development and commercial potential of OST 577.

Other competitive factors include the capabilities of the Company's collaborative partners, product efficacy and safety, timing and scope of regulatory approval, product availability, marketing and sales capabilities, reimbursement coverage, the amount of clinical benefit of the Company's products relative to their cost, method of administration, price and patent protection. There can be no assurance that the Company's competitors will not develop more efficacious or more affordable products, or achieve earlier product development completion, patent protection, regulatory approval or product commercialization than the Company. The occurrence of any of these events by the Company's competitors could have a material adverse effect on the business and financial condition of the Company.

Dependence on Key Personnel. The Company's success is dependent to a significant degree on its key management personnel. To be successful, the Company will have to retain its qualified clinical, manufacturing, scientific and management personnel. The Company faces competition for personnel from other companies, academic institutions, government entities and other organizations. There can be no assurance that the Company will be successful in hiring or retaining qualified personnel, and its failure to do so could have a material adverse effect on the business and financial condition of the Company.

Potential Volatility Of Stock Price. The market for the Company's securities is volatile and investment in these securities involves substantial risk. The market prices for securities of biotechnology companies (including the Company) have been highly volatile, and the stock market from time to time has experienced significant price and volume fluctuations that may be unrelated to the operating performance of particular companies. Factors such as disappointing sales of approved products, approval or introduction of competing products, results of clinical trials, delays in manufacturing or clinical trial plans, fluctuations in the Company's operating results, disputes or disagreements with collaborative partners, market reaction to announcements by other biotechnology or pharmaceutical companies, announcements of technological innovations or new commercial therapeutic products by the Company or its competitors, initiation, termination or modification of agreements with collaborative partners, failures or

unexpected delays in manufacturing or in obtaining regulatory approvals or FDA advisory panel recommendations, developments or disputes as to patent or other proprietary rights, loss of key personnel, litigation, public concern as to the safety of drugs developed by the Company, regulatory developments in either the U.S. or foreign countries (such as opinions, recommendations or statements by the FDA or FDA advisory panels, health care reform measures or proposals), market acceptance of products developed and marketed by the Company's collaborators, sales of the Company's common stock held by collaborative partners or insiders and general market conditions could result in the Company's failure to meet the expectations of securities analysts or investors. In such event, or in the event that adverse conditions prevail or are perceived to prevail with respect to the Company's business, the price of the Company's common stock would likely drop significantly. In the past, following significant drops in the price of a company's common stock, securities class action litigation has often been instituted against such a company. Such litigation against the Company could result in substantial costs and a diversion of management's attention and resources, which would have a material adverse effect on the Company's business and financial condition.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits - None

(b) No Reports on Form 8-K were filed during the quarter ended June 30, 1998.

SIGNATURE

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

Dated: August 13, 1998

PROTEIN DESIGN LABS, INC.
(Registrant)

/s/ Laurence Jay Korn

Laurence Jay Korn
Chief Executive Officer,
Chairperson of the Board
of Directors
(Principal Executive Officer)

/s/ Jon Saxe

Jon Saxe
President
(Chief Accounting Officer)

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION
FROM THE ACCOMPANYING FINANCIAL STATEMENTS AND IS QUA
ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENT

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DEC-31-1998
APR-01-1998
JUN-30-1998
16,715
90,748
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110,798
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173,723
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