

VIRALGENETICS



2290 Huntington Drive, Suite 100, San Marino, CA, 91108, Tel: (626) 334-5310, Fax: (626) 334-5324

February 2, 2012

Dear Fellow Shareholder

In 2011, each of our two major areas of business separately flourished in some subtle and not-so-subtle ways, while laying the foundation for what we hope are significant milestones this coming year. Last year we had the good fortune to see Viral Genetics' drug programs and our majority-owned VG Energy subsidiary's biofuel programs both move away from purely academic studies and towards **meaningful, real-world demonstrations that we believe may lead to monetization and revenue – possibly as soon as later this year**. There is truly no greater milestone for us and for you, as shareholders, to reach.

I wrote in last year's letter that we expected 2011 to be the year we transitioned to a clinical-stage company. In no small way did I expect this to be powered by the transition of our invaluable chief scientific advisor and inventor of both our licensed Metabolic Disruption technology (MDT) and Targeted Peptides technology (TPT) patent portfolios, Dr. M. Karen Newell-Rogers, to the very clinic-focused environment of Texas A&M University-affiliated Scott and White Hospital. We were a bit early with that forecast, but we are on track to hit and, as you will see below, exceed those targets in 2012.

2011 – Growth and New Challenges

All of these positive developments and new opportunities were accompanied by new challenges. There is no free lunch! Almost overnight we became **two** rapidly growing companies, while we were still managing the businesses with the same relatively small team of dedicated managers, advisors, researchers, and consultants. Within both our drug and biofuels programs, we added or significantly advanced entirely new projects:

- **new TPT and MDT drug candidates for new diseases;**
- **new patents for new drug candidates, including one – DCA – being studied in at least six third party clinical trials;**
- **new applications of MDT additives for biofuels, oils and other uses; and**
- **at least three of our own drug programs near ready for FDA review and needing new clinical advisors.**

Altogether – a series of fantastic positives bringing with them new demands. As many of our long-time shareholders know, we spent the better part of our history focused almost exclusively on developing an HIV/AIDS drug. As such, we built out our team of advisors and researchers to meet this need. Following the development of drug candidates for Lyme disease, various cancers, several infectious diseases and not to mention the launch of our VG Energy subsidiary, we found ourselves in need of a far wider base of expertise. In sum, we spent much of 2011 working to meet those demands and I think, as you will see, we have met many of them and are taking further steps needed to meet our exciting growth challenges.



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At the same time, the realities of managing this growth, and the hard realities of growing an emerging business in a capital-constrained environment meant that we delayed some of our 2011 milestone targets, including the initiation of our Scott and White cancer trial, submitting an IND for our HIV/AIDS drug, submitting a pre-IND for our Lyme disease drug, and completing scale-up testing of our biofuel additives. This was due to some unexpected, but positive, developments. That being said, I believe that after this update you will agree that each of these projects progressed in very positive ways setting us up for what we think could be the most important year in our combined companies' histories.

Biofuel Scale-Up Testing

Building on successful lab testing by Dr. Newell-Rogers and colleagues, and leveraging the guidance of our highly-valued advisor and renowned algae biofuel expert, John Sheehan, last year we began to reach out to potential commercial partners and for-hire testing firms to evaluate our MDT "lipid trigger" additives in larger-scale production environments. The idea was essentially that our additives increase the oil yields of algae by 300% or more in highly-controlled lab environments using strains of algae chosen by our team – a "plain vanilla" approach (we have since expanded to several other more specialized strains) – but what happens when you introduce MDT additives into operating industrial-scale production environments, use them on uniquely-developed strains of algae, or apply them to otherwise customized production approaches? The same approach also governs our development of other potential uses of MDT additives: e.g., augmentation of other high-value oils such as omega-3, or "reversing" the lipid trigger to augment sugar production. This led us to start testing with several potential commercial partners and to contract outside testing firms.

We originally expected to conclude portions of this testing with one provider, including "dose response testing" and scale-up studies within 2-3 months. Following successful preliminary results in the summer of 2011 that we announced previously, we decided to transition to new testing facilities to better protect and maintain our intellectual property rights during the ongoing product development and validation process. Protection of our intellectual property rights in this and other areas is critical to our long-term success – and has been a hallmark of management's direction all along.

Although we believe that existing testing is sufficient to support some commercial implementation at this time, additional testing and product development is ongoing and expected to continue at both contracted testing facilities and by potential commercial partners as we develop and refine MDT applications in this and other areas.

We are pursuing additional testing as a means of rounding out some additional specifics related to high-value end products of lipid (oils) production, and additional elements to position us at the high end of the value chain.



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In regard to VG Energy, our goal now is to locate those producers that would benefit from introducing our additives in to their process and who are ready to do so, and it is our extensive lab work that we expect to guide us in to these high value / high profitability markets.

We have encountered situations where a potential partners' method for enhancing yields using their own technology turned out to be incompatible on a molecular level with our additives because, for instance, genetic modifications to a yeast strain (yeast are used to produce certain nutritional oils) developed by them blocked uptake of our additives. Everyone has their own approach and part of what we are doing on this front is determining the partners whose approaches work best to synergize with ours. It is these companies with whom we want to partner and move toward commercial scalability and ultimately cash flow.

However, let me emphasize that **we do believe that existing testing is sufficient to support phasing in commercial implementation on some level were we to develop production capabilities of our own.** Although we may modify this strategy in the future, our team presently believes that that it is preferable to license and/or sell our additives to existing producers who have already made the large capital investment required and already have the management expertise, versus becoming a producer ourselves. **It is the same model as our drug development business – focus on the research and when ready for “real-world” testing and marketing, partner with the bigger players.**

Scott and White Cancer Clinical Trial

We had originally forecasted that patients would start enrolling and being treated with MDT compounds in conjunction with standard chemotherapy by the summer of 2011. Early study designs were for a relatively small group of patients in certain types of treatment-resistant cancers that we felt would respond favorably to the combination therapy both through enhancement of traditional therapies such as chemotherapy and through enhancement of the patient's own immune response to the cancer. As each cancer type showed or failed to show progress, we would modify the combination of treatments and/or add other types of cancer to the study. The study was of course to be performed at Scott and White Hospital, and was partially funded by a \$1.5 million anonymous grant to the hospital. This is still occurring, but as you will see, has potentially expanded in a significant way.

In the course of finalizing the study design, or “protocol”, a series of events took place that required us to delay enrollment including one of the study investigators transitioning to another academic institution, difficulties in sourcing other cancer drugs we wanted to combine with our compounds, and lastly – **and most critically – we met another well-respected oncologist at a second hospital who wanted to add his clinic as a second arm of the study while expanding the protocol to a possible Phase 1 or 2 design and increasing it to several dozen patients.**



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It is the nature of clinical trials that there is a tremendous amount of pre-planning and bureaucratic checks and balances throughout the process. This is the nature of the business – when you want to inject or give pills to patients, the threshold of safety has to be very high. The net effect of this is that we had to modify the documents being presented for approval – now at two institutions, whereas before it was just one – and proceed through the review process with the amended design. Once the individual hospitals approve a study protocol, then it is presented to the FDA. Usually in the case of physician-sponsored studies, like this one, approval to begin typically occurs fairly rapidly. These reviews are now underway.

We are now finalizing our arrangement and documentation with the second potential test site and new co-primary investigator. I say “potential” because until the ink is dry and the documents are signed, it is not appropriate to say otherwise. There is always the chance that it could fall through and I cannot assure you either way. That being said, I am confident we will proceed with the second site and hope to be in a position to speak more about it once approvals are out of the way. I believe this is a fast-moving series of developments and I ask for your continued patience for this very exciting and expanded project.

Once we are able to proceed with the expanded study, **we face the first real concrete prospect of human data from one of the drug candidates springing from our valued relationship with M. Karen Newell-Rogers, PhD, our lead scientific advisor.** This is a potentially major milestone as the four year-old relationship bears fruit for patients and for you, our shareholders.

HIV/AIDS – APi1177

In last year’s Annual Letter to Shareholders, we indicated that we had recently submitted a Pre-IND to the FDA for this drug candidate and were awaiting the agency’s review. We received their feedback which created a checklist of three main items that we spent much of 2011 working on.

The first, and most critical, step was finalizing a relationship with a manufacturer capable of producing APi1177 meeting “Good Laboratory Practices” or GLP standards for use in all future preclinical and animal studies. Following GLP manufacture would be the development of “Good Manufacturing Practices-”, or “GMP”, -quality product prior to use in humans.

Steps two and three were predicated on finalizing our GLP product. At the end of last year we attained a GLP product that we are now verifying. If it meets our researchers’ standards – specifically in its ability to displace ectopically-displayed CLIP (that is, Class II Invariant Chain Peptide on the outside of a cell) – then we can proceed with steps two and three: safety/toxicology and virology studies and development of a certain assay.



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We believe we are very near to wrapping up the GLP product development and will be in a position to proceed with the remaining pre-IND guidance. To this end, we have already identified the labs we will be using to conduct the step two and three testing.

We had hoped to submit a full IND for this drug candidate to the FDA by the end of 2011 and proceed with clinical trials as soon as this year. However, due to the time constraints of GLP development and the other challenges outlined earlier in my opening paragraphs, we did not meet that target. Assuming the acquisition of sufficient funding we believe we should be able to complete this pre-IND testing and file the full IND in 2012. This would put us in a position to possibly commence a clinical trial in late 2012, or 2013.

Lyme Disease – VGV-L

In last year's review, I discussed how we had developed a candidate for Lyme disease and hoped to bring it to the FDA under a pre-IND submission by the end of 2011. Well, we came pretty close to meeting this objective but were delayed in sourcing and finalizing arrangements with a "clinical lead" – that is, a physician who is focused on treating patients, and who will guide the clinical part of ongoing drug development including helping design and possibly oversee clinical trials. In the course of drug development, usually the early research is entirely lab-based. One is focused on "test tube" research (it's actually a LOT more complicated than that but I think this conveys the point). Once you get to the point where you've satisfied yourself that you have a compound that looks like it might actually help human beings – and not just the machines and test models used in the lab – you have to start figuring out things like: how much of this drug do I give to people based on what I know about how it works? What's the best route to dose people – injections or pills? If I wanted to perform a test (clinical trial) of this drug, how many people would I need, what kinds of people would be appropriate, where would I find them, and how I would I measure success?

Virtually all of these questions require the guidance of doctors that treat patients; in other words "clinicians." We were ready last year to find a clinician to step into this program and take it to the next step – clinical trial design and implementation. However between coordinating schedules, making introductions and presenting our data, let alone finding time from all the people involved, it was not until very recently that we neared finalization of securing a clinician to act as lead on this program. We expect to be able to discuss this in much more detail very soon, but I am very confident that we will be filing our pre-IND for our Lyme disease candidate this year.

What is very intriguing about Lyme as a potential opportunity for us as a company, and therefore for you as shareholders, is that **there really is nothing available out there right now for people with chronic Lyme**. When a person is bitten by a tick and is suspected of being infected with the *Borellia burgdorferi* bacteria suspected of causing Lyme (usually indicated by the tell-tale "target sign" inflammation at the bite), antibiotics can be given. They have mixed, but positive results in preventing further illness. However, there are many



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people who do not receive such treatment, often because they are not diagnosed with Lyme until much later when the illness has progressed and chronic symptoms start developing. It is also believed by many in the Lyme world that a significant number of cases go undiagnosed. **The bottom line is that this is what is referred to in our industry as a significant “unmet medical need”** – there are a lot of people suffering from this illness that do not have any realistic treatment options. While we have much work to do and success will be predicated on positive clinical trials, if we are successful, we should benefit from the dearth of options both in financial terms and in speedier regulatory review, not to mention the satisfaction of bringing relief to tens or hundreds of thousands or more people.

As always, we thank Tyme for Lime, Inc. and Turn the Corner Foundation for their research grants which have supported and continue to support Dr. Newell-Rogers’ work on the development of our Lyme candidate.

New Intellectual Property – DCA

In December 2011, a patent originally filed several years ago that falls within our licensed MDT portfolio was awarded that is **the first issued patent covering the use of dichloroacetic acid (“DCA”) in the treatment of cancer**. We believe that this patent is “foundational” to the use and study of DCA for cancer treatment, an area many other companies and research entities, both in the US and internationally, have been increasingly studying. **There are currently 6 FDA approved clinical trials in motion that have incorporated DCA into their drug regimen**. We intend to seek potential clinical trial or licensing opportunities for this patent and drug candidate this year.

Other VG Energy Developments

In August of 2011 we welcomed two distinguished business veterans to the board of directors of VG Energy, Inc., our majority-owned subsidiary: Michael Binnion, CA and David Odell, CA. Both Michael and David also invested in VG Energy in 2011 through private placement of common and preferred shares.

As a well-respected energy executive, investor and entrepreneur, including CEO and President of Questerre Inc., a Toronto Stock Exchange-listed \$160 million market cap oil and gas exploration company, Mr. Binnion is an invaluable addition to the VG Energy team. He has a deep understanding of the energy industry, including extensive knowledge on fossil fuel alternatives.

David Odell brings a wealth of experience in business operation and management, having founded and managed several companies in the real estate, IT and business development industries.



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I am confident that David and Michael will together bring to bear the degree of **professionalism, leadership, organization and sound corporate governance** that VG Energy's budding technology warrants and that they exemplify as we continue to develop this business.

Other Drug Program Developments

We were primarily focused on our oncology, HIV/AIDS and Lyme disease programs in 2011, but continued to move along our other candidates for Multiple Sclerosis, Staphylococcus and Streptococcus infection, and Sepsis.

In particular, as with our Lyme program, we reached a point in these programs where we are ready to bring in clinicians to guide the next phase of development, including and leading to pre-IND filings. While these pre-INDs are further off than our other programs, **we are making or finalizing arrangements with potential clinical leads for them** and have also begun seeking grant funding for some of the "proof of concept" research required to further validate and develop them. As a result, it is possible and, I believe, likely that we will be announcing additional developments concerning these programs during the coming year.

R&D Team

In last year's letter, I talked about the additions made to Dr. Newell-Rogers' team, including research and support staff. While our Georgetown lab ended up being extraneous due to a move by Dr. Newell-Rogers' team to a facility at Scott and White, **the expanded team really began to bear fruit last year and 2012 looks to be no different.** Led by Dr. Newell-Rogers, this group was responsible for much of the work done behind the scenes to support and ultimately expand the Scott and White cancer study, to further develop MDT additives for biofuel and other applications, to advance the development of GLP-grade APi1177, to file and analyze the pre-IND response for APi1177, to near filing of the pre-IND for our Lyme candidate, to submit several grant applications, and much more.

Corporate and Financial Updates

Our goal is to raise \$2,000,000 to \$3,000,000 to achieve our 2012 goals including those of VG Energy. It is expected that this will be in the form of sales of equity or debt securities of the Company or VG Energy, **although we are now legitimately envisioning the possibility of commercial partnering particularly on the VG Energy side and are hopeful that we can possibly attain licensing revenue or possibly commence generating revenues as early as later this year.** This is obviously conditional on successful testing by us and potential partners, which we can of course provide no assurance of. We also continue to sponsor or support applications for grant funding of research supporting the development of our products.



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We recently filed our quarterly report for the period ending September 30, 2011 and we are now working to complete the 2011 annual report by late March or early April.

The Company also began a program early last year to enhance its shareholder communications through regular updates, fact sheets, a PowerPoint presentation on its website, and an email distribution list.

It has been a challenge for our relatively small team to manage these processes in a timely manner with two operating companies and the rapid growth we have seen in the past 18 months. This was exacerbated by the temporary loss for half of last year of one of the personnel involved in this area.

Our team is now back at full strength and we have augmented it in some other areas, particularly on the VG Energy side, which I believe will allow us to better meet these goals this year. **We understand that communications with the market and you, our shareholders, is in a real way the lifeblood of the company and we have made that a priority going forward.**

Team of Advisors

The world and Viral Genetics suffered a loss this past year with the death of Dr. Baruch Blumberg. Dr. Blumberg was a pioneer in the study and treatment of Hepatitis B, having won the Nobel prize related to his work on the virus. He was instrumental in assisting our research team as they explored the potential of a drug candidate for Hep-B based on our licensed Targeted Peptide technology (TPT).

Our team of advisors remains an important aspect of our business. Please refer to our website for more information.

Expanded Coverage

Viral Genetics continues to receive research coverage from Boston-based Research 2.0 and Zacks "Small Cap Investment Research" group. We believe that this coverage will increase our exposure and enable us to get our story out to a broader array of news organizations and potential investors. Their reports are available on our website, free of charge.

Closing Notes

Many shareholders have asked me about future dilution to the number of shares that are outstanding. It is important to understand that we are a pre-revenue company at this stage, and we are still developing and testing products. We believe that the testing and development we are doing may result in commercialization of one or more of those products, which could include novel drugs for the multi-billion dollar cancer and HIV/AIDS markets, possibly a



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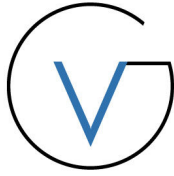
unique treatment for Lyme Disease sufferers, or additives that we believe are capable of transforming the economics of the production of combustible fuel based on oil derived from algae, which currently cannot compete with fossil fuels – an **enormous market opportunity**.

At the same time, until we are completed with development and testing, and are actually selling these products or, more likely, obtain licensing or royalty revenue from at least one (ideally both and more than one of each) drug company or biofuel producer, we are dependent on obtaining outside capital from investors to fund our operations, including research and development. We run as lean a ship as we can, and we use stock- and option-based compensation to limit our cash burn rate, as well as to line up our team member's incentives with yours as shareholders. That said, raising capital from investors usually means selling and issuing new shares or debt convertible to shares. Until we are able to rely on cash flow from commercialization on some level, we will continue to rely on cash flow from investors. **It is our belief that the magnitude of the potential opportunities we are pursuing, while not without risk, are so large that dilution will be mitigated if we succeed.**

I also know that many shareholders wish we would issue more regular updates, and some of you have said that there are times when it seems as though nothing is occurring. The fact is that sometimes there are lulls in what we can say about our business. Our work consists of moving forward a handful of very complex technology development projects, and there is often a great deal of lead time and paperwork prior to moving from step to step. Usually, the actual testing and development we are performing takes only a few days or weeks to conduct, but the pre-planning, analysis and follow up testing generated by early testing can extend for much longer – particularly on the drug side. **The bottom line is that we are not just trying to conduct our business, we are trying to do it *right* and to the highest standard possible.** That is why for example we have sourced the highest-quality advisors we could, including Nobel laureates, and that is why we sometimes take longer to identify working partners.

Nevertheless, I can understand how in between completion of major steps of our various projects it would be nice for you, as shareholders, to hear that, if nothing else, “everything is still on track.” To that end, **I have directed that a monthly letter to shareholders will be made available on our website going forward, and announced by press release each month.** Some months may consist of short notes that “things are on track”, while others will update you on the progress of our research and product development. My hope is that between these updates, our renewed and expanded team, and our other communications efforts – all grounded in continued growth and success – we can maintain and build your confidence and support.

Sincerely,



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Haig Keledjian
President
Viral Genetics, Inc.
VG Energy, Inc.



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About Viral Genetics, Inc.

San Marino, California-based Viral Genetics discovers drug therapies from two platform technologies based on over 60 patents: Metabolic Disruption (MDT) and Targeted Peptides (TPT). Founded in 1994, the biotech company is researching treatments for HIV/AIDS, Lyme Disease, Strep, Staph and drug resistant cancer. A majority-owned subsidiary, VG Energy (www.vgenergy.net), is dedicated to exploring biofuel and agricultural applications for the MDT platform. For more information, visit www.viralgenetics.com.

About VG Energy

VG Energy Inc. is an alternative energy and agricultural biotech company that is a majority-owned subsidiary of Viral Genetics Inc. Using its Metabolic Disruption Technology (MDT), Viral Genetics' cancer research led to discoveries with major consequences in a wide variety of other industries, including production of biofuel and vegetable oils. VG Energy holds the exclusive worldwide license to the MDT patent rights for use in the increase of production of various plant-derived oils from algae and seeds. Application of MDT technology to the biofuel industry could potentially allow it to overcome its major obstacle in the area of production efficiency: namely, an increase in production yields leading to feasible economic returns on investment, allowing renewable biodiesel to be competitive with fossil fuels. For more information, please visit www.vgenergy.net.

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS:

This news release contains forward-looking statements that involve risks and uncertainties associated with financial projections, budgets, milestone timelines, clinical development, regulatory approvals, and other risks described by Viral Genetics, Inc. from time to time in its periodic reports, including statements about its VG Energy, Inc. subsidiary. None of Viral Genetics' drug compounds are approved by the US Food and Drug Administration or by any comparable regulatory agencies elsewhere in the world, nor are any non-pharmaceutical products of VG Energy, Inc. commercialized. While Viral Genetics believes that the forward-looking statements and underlying assumptions reasonable, any of the assumptions could be inaccurate, including, but not limited to, the ability of Viral Genetics to establish the efficacy of any of its drug therapies in the treatment of any disease or health condition, the development of studies and strategies leading to commercialization of those drug compounds in the United States, the obtaining of funding required to carry out the development plan, the completion of studies and tests on time or at all, the successful outcome of such studies or tests, or the successful commercialization of VG Energy, Inc.'s non-pharmaceutical products. Therefore, there can be no assurance that the forward-looking statements included in this release will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the forward-looking statements should not be regarded as a representation by Viral Genetics or any other person that the objectives and plans of Viral Genetics will be achieved.