07/01 1:59P (DJ) Once A Darling, Cytogen Now Tests Investors' Patience

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By Jennifer Fron Mauer

NEW YORK (Dow Jones)--Most shareholders went to Cytogen Corp.'s (CYTO) annual meeting two weeks ago to confront management about the company's sub-$1 stock price.

Bob Wegner had a different agenda.

In the middle of this tense gathering, during which shareholders grilled Cytogen executives for two hours without a break, Wegner held the room in spellbound silence. He had come to tell the story of how Cytogen's bone cancer pain product, Quadramet, helped his beloved wife.

The 61-year-old man spoke for more than 10 minutes, at times choking back tears, about how Mary Stamulakis-Wegner, 48, had battled breast cancer 14 years ago, and how the disease returned in 1993. He recounted how, by 1996, the cancer had spread to her bones, and how his once-vibrant wife began suffering from debilitating pain caused by tumors growing inside her bones.

Wegner said he had heard about Quadramet from his pharmacist, who was friendly with a Cytogen shareholder who knew about a new drug that could eliminate pain caused by cancer in the bones.

It took Wegner several months to find the drug, as well as a doctor who would administer it to his wife. Two weeks after her first dose, Stamulakis-Wegner was swimming and horseback riding again - "almost back to her normal self."

Wegner's story ended with a plea: "This product is great. Why don't more people know about it?"

That seems to be the big question on everyone's mind - indeed, the nearly 200 shareholders at the annual meeting burst into applause after Wegner's acute query. Many had hoped Quadramet would make Cytogen a household name.

What's also baffling is that Cytogen has three products approved for marketing in the U.S., making it elite among biotech companies. Most of the country's 1,300 biotech concerns never even get one product approved, let alone three.

<u>And yet, Cytogen has a market capitalization of less than $50 million - one-fifth the average market cap of a biotech company with products in late-stage development, according to Michael Becker, an investment executive with Wayne Hummer Investments LLC in Chicago who has invested in Cytogen for his clients.</u>

"It's a 100-year-old story of brilliant scientists who can't run the business side," one investor said.

Indeed, Cytogen seems to be a classic example of the biotech company that can't quite make the jump from research concern to commercial entity. And of a stock that long ago fell from grace in the financial community.

The darling of Wall Street in the late 1980s and early 1990s, Cytogen's recent history has been described as a comedy of errors.

Critics say the company has made a series of marketing and financial mistakes, culminating in December with a highly dilutive, floorless convertible preferred deal that some blame for pushing the stock to new lows.

One might expect shareholders to be irate about the money they've lost - $100 invested in Cytogen 1992 was worth just $7.39 as of Dec. 31, 1997, according to Cytogen's latest proxy statement filed with the Securities and Exchange Commission.

There are those who criticize management from the anonymity of online chat rooms. But the majority have long since given up hoping to get their money back. These are the shareholders who bought into the Princeton, N.J., company because they believed in the product.

Many have seen first-hand what Quadramet can do. Wegner himself used one week's vacation pay to buy 100 Cytogen shares. "It has brought back life to my wife, given her a quality of life she deserves," he said. "Maybe it can help someone else."

These shareholders also said they want to see what they believe is an amazing drug help as many cancer victims as possible. To this end, they pass around stories of patients like Stamulakis-Wegner - for whom Quadramet has worked wonders - and of Shannon Blaco, a St. Louis teenager who was able to return to school after taking Quadramet.

They tell about a study in Europe that, based on initial findings, seems to indicate that women suffering from breast cancer live longer when treated with high doses of the pain-killing drug. And there's a story about a 90-year-old New Jersey man who had just about every cancer treatment available, and still was in so much pain that he couldn't walk. After one dose of Quadramet he was back on his feet.

But such testimonies haven't kept Cytogen from teetering on the edge of existence. Earlier this year, accounting firm Arthur Andersen LLP questioned the company's ability to continue as a going concern without additional funding. Now, Cytogen's stock is in serious straits: It's been hovering below $1 for the past three weeks, putting it at risk of being delisted from the Nasdaq National Market.

Cytogen was founded in 1980 by Dr. Thomas McKearn, a physician and scientist who is said to have been one of the pioneers in the use of monoclonal antibodies. These antibodies are specially targeted versions of proteins generated by the human body to respond to viruses or other threats. Cytogen went public in 1986, selling shares for $13 in its initial offering.

The company's first product - and first big mistake, according to critics - came more than 10 years after the company's founding, with OncoScint, a monoclonal antibody based imaging agent used to detect colorectal and ovarian cancers.

When the product received marketing approval in December 1992, Cytogen's shares soared 17% to $22.25. Analysts expected sales in the U.S. to be about $22 million in 1993, and $50 million in 1994. They said at the time the product could eventually have an annual U.S. sales of about $240 million.

But OncoScint never lived up to the hype. Physicians had trouble reading the tests. In the end they saw little value in a product that couldn't help them decide on the next course of therapy, according to Graham May, Cytogen's vice president of medical affairs. Cytogen doesn't really even market OncoScint anymore, he said. Revenues hover around $1 million a year.

A little wiser, Cytogen changed its strategy when it launched its second imaging agent, ProstaScint in February 1997. In order to use the product, which can detect whether prostate cancer has spread throughout the body, nuclear medicine imaging centers have to go through a lengthy accreditation process. A backlog in that process slowed the ramp-up of sales at the onset, Cytogen said in a filing with the SEC. In the first year, ProstaScint's sales reached just $8.5 million. Company estimates have put potential annual sales at about $50 million.

Critics said Cytogen's second mistake came when it chose DuPont Merck Pharmaceutical Co. as its marketing partner for Quadramet. The tiny biotech concern was hoping to leverage the marketing power of the major pharmaceutical company. In 1994, they signed a lucrative agreement under which DuPont Merck said it would make and market Quadramet, guaranteeing generous minimum payments to Cytogen.

But by 1997, when Quadramet received FDA approval, DuPont Merck had all but lost interest in the drug.

"I think the focus of our company changed through that time period," said Richard Dolighan, president of DuPont Merck's radiopharmaceutical division. Increasingly, DuPont Merck's sales-force turned its attention to marketing its own products, such as Cardiolite, a heart-imaging agent, he said. Without strong marketing support, Quadramet's sales have languished far below expectations. Last year, at the Alex Brown Health Care Conference, company officials optimistically predicted Quadramet could be a billion-dollar-a-year drug. More recent estimates paint a more modest picture of a $100-million-a-year product. In 1997 Cytogen received just $5.9 million in royalty payments from DuPont Merck. The drug has never has sales above the minimum royalty payments described in the deal.

In May, DuPont Co. (DD) and Merck & Co. (MRK) said they would dissolve their 7-year-old joint venture. Soon after, Cytogen decided to end the agreement. It is now looking for a more suitable marketing partner.

All the while, Cytogen has continued to spent money at a rapid rate. Spending an average of about $30 million a year, the company has burned through nearly $300 million since its inception. Like most biotechs, Cytogen has historically relied on the issuance of stock to raise money. Cytogen's shares outstanding have more than doubled since 1994, to more than 52.6 million shares.

"They've always spent too much money," according to T.J. Madison, who twice served as Cytogen's chief financial officer and abruptly left last September in a battle over company strategy. With him went Quaker Capital Management, the investment banking firm that had raised about $40 million for Cytogen in the last four to five years.

With product revenues inadequate to fund its steep spending habits and continued chronic losses, Cytogen found itself desperate for cash in December 1997. It was then that the company committed its third major mistake, critics said.

Out of options, executives settled for a floorless convertible preferred deal in which the stock was convertible at a floating ratio based on the common stock's price. Because there's no fixed minimum conversion price, the lower the stock price is when the investor wants to convert, the more shares the investor gets.

"We had no choice, we needed the money," said John Bagalay, Cytogen's acting chief executive, president and financial chief.

Such deals are often referred to as toxic or death-spiral convertibles because they offer incentives for unethical investors to drive down the share price by shorting the stock, according to Marcus Robbins, editor of the Red Chip Review. When a big short position is taken in a thinly traded stock, the price generally falls.

Indeed that appears to have been what happened with Cytogen. Short interest in the stock stood at 397,182 in December, just before the deal was made, according to Nasdaq. By January it had grown to 1.2 million. It soared as high as 3.6 million in April before declining to 2.1 million in June.

During that time, Cytogen's shares have fallen below $1 a share, from about $3 in December. More than 90% of those shares already have been converted, according to Angela Bitting, Cytogen's spokeswoman.

The result is that Cytogen's stock is currently trading like that of a company the market expects will go bankrupt. Even news last week that it had received approval to market Quadramet in Canada failed to push the price above the $1 mark.

The company is being led by John Bagalay, a man with a venture capital background. Some investors are skeptical of CEO Bagalay, noting he has served or is serving on the boards of four companies that have been delisted from Nasdaq: Wave Systems Corp. (WAVX), Hymedix Inc. (HYMX), Seragen Inc. (SRGN) and Cellcor Inc., acquired by Cytogen in 1995.

Still, few are ready to pronounce Cytogen dead.

If the company can attract a new experienced chief executive, select an appropriate marketing partner for Quadramet, show that it can make money from its three approved products and find partners or buyers for the other technologies it has in development, even its critics think Cytogen could get back on track.

Barring that, some predict Cytogen could get snapped up by an interested buyer. Though Bagalay said he has not put the company up for sale and no one is trying to buy it, he added that "anything is for sale at the right price." For Cytogen, he said that would be north of $6 a share.

A month ago, former financial chief Madison and three others submitted a proposal to Cytogen's board that included up to $20 million in financing and a chief executive with experience working for both big pharmaceutical and biotech companies.

When Cytogen responded by asking for details of the financing deal so it could consider the proposal along with other proposals it has received, Madison took that as a rejection.

Bagalay, who joined the company as a director in 1995 when Cytogen bought Cellcor, said Cytogen has looked at several financing proposals since the beginning of the year, but wants to hold off doing any deal while the company puts some key pieces in place.

Over the next year the company plans to concentrate on finding a new chief executive with the "right entrepreneurial attitude for a biotech company," and a marketing partner for Quadramet, preferably one that can reach oncologists and urologists who are the primary care givers of the drugs target patients, Bagalay said.

Cytogen plans to sell its Cellcor unit. Until recently, Cytogen had been developing Cellcor's autologous lymphocyte therapy, or ALT, for treating advanced kidney cancer, but lacks the funding to bring the product to market, Bagalay said. The company also plans to end its Targon joint venture with Elan Corp. (ELAN), which had been formed to develop cancer therapies. In addition, Cytogen will review its various other development projects, including its Genetic Diversity Library technology, to determine whether they fit into Cytogen's future plans.

This is all in an attempt to change Cytogen's focus from a research company to a commercial enterprise, Bagalay said. To that end, Cytogen will increase its marketing spending and cut what it spends on research and development in 1998. Cytogen will also cut its burn rate to $1.1 million a month.

"I can't do anything about the past other than put my hands on decisions that will take the company forward," Bagalay said.

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