NeXstar seeks better valuation through disintegration

On August 19, NeXstar Pharmaceuticals (Boulder, CO) announced the potential spin-off of its drug-discovery operations, and the resignation of NeXstar president and CEO, Patrick Mahaffy. A spin-off would disassemble the company into two publicly traded entities, effectively undoing the original 1995 merger that Mahaffy instigated. While some are busy blaming either the fickle state of the market or poor company leadership for NeXstar's demise, others suggest NeXstar is now extremely undervalued, making it a prize purchase.

NeXstar was created in 1995 by the merger of Vestar and Nexagen. Patrick Mahaffy (who became president of NeXstar) merged Nexagen's combinatorial chemistry technology with Vestar's liposomal drug-delivery technology in a deal intended to build a fully integrated pharmaceutical company. The merger came during a string of acquisitions of combinatorial chemistry companies by pharmaceutical firms (*Bio/Technology* 13:310), and Mahaffy was quoted at the time as saying "the old model [corporate collaborations between pharmaceutical and combinatorial chemistry companies] was somewhat naïve."

NeXstar currently has two products on the market (AmBisome, a liposomal antifungal agent; and DaunoXome, a liposomal anticancer agent), and three under development: [MiKasome, a liposomal antibiotic; VEGF-Inhibitor, an angioinhibitor aptamer; and NX 211, a cancer product (topoisomerse 1 inhibitor) that NeXstar acquired from GlaxoWellcome]. Since Nexagen, NeXstar has continued to develop the SELEX process—an RNA/DNA-based combinatorial chemistry technology—which it licensed in part to GlaxoWellcome (London) on May 27 in a $10 million equity investment. And on August 17, NeXstar sold 51% of its products technology division to a subsidiary of the chemical company, SKW Trostberg (Trostberg, Germany), forming Proligo LLC, in a deal that could be worth $38.5 million.

Although NeXstar was on the verge of being profitable, the evaluation was apparently the result of pressure from impatient shareholders, keen for NeXstar to turn profitable and become an earnings-driven organization. (Spinning off the drug-discovery arm could save it around $20 million a year, according to Larry Gold, NeXstar chairman and CSO.)

"From a shareholder perspective we have always attracted two distinct shareholder groups," says Mike Hart, NeXstar CFO, who says that it was never really clear to shareholders what the benefits were of merging Vestar and Nexagen in the first place. "It has been very very difficult for us to get what we considered the appropriate valuation in the market place because the pure technology players liked the [combinatorial] side of the business, but the earnings side liked AmBisome and the other products in the pipeline."

"We got a situation where the stock market was focused on the earnings power of the combined company which, because we were investing in discovery research, was clearly lower than would otherwise be," says James Thomas, managing director of EM Warburg, Pincus & Co., LLC (New York), which owns 30% of NeXstar. "We misjudged the market's willingness to finance a fully integrated pharmaceutical company."

David Webber agrees. "From an investment point of view, the company was never able to bring forward the full value of the assets it had created." The combinatorial side of the company has not managed to generated what he calls "validation of the value" because "there haven't been any really big partnerships or other types of affiliations formed about the SELEX technology."

Some might attribute this to Mahaffy's leadership. "Nexstar's management has wanted to keep control—a proprietorship—of as much of the value of SELEX technology as it could, says Webber, "and that has probably made them reluctant to do deals that might have been available." Unfortunately, "the way that certainly investors look at it is that if SELEX really works then there should have been some partnerships."

Webber says that once a company has developed its first drugs and brought them to market, it finds it enters a new realm in which it gets valued by the market in a different way, "more along the lines of a pharmaceutical company—based on current and near-term performances and very concrete measurable yardsticks—and less like a biotech company."

So who will replace Mahaffy? "I think on the operating side of the business we would be looking for a seasoned pharmaceutical executive who has had a significant amount of deal-making experience," says Hart. Webber agrees: "I think for the NeXstar part they need someone with pharmaceutical industry line experience, someone who has gone out there and run a large division."

Although one analyst suggested that Mahaffy might have been "doing some learning on the job," Edward Hemmelgarn, president of Shaker Investments (Shaker Heights, OH) points out that NeXstar's recent moves have been strong: The deal with Glaxo was "a very good move," he says, while the agreement with SKW Trostberg was "a wonderful deal."

"My own personal perspective is that NeXstar is being split up to make it easier to sell," says Hemmelgarn, "AmBisome is extremely profitable and is a real prize for any company to buy." He thinks there are any number of buyers that could strip away some of the duplicate sales force costs and administration costs to make it even more profitable. "Frankly, I will be surprised if they don't get an attractive offer because it is a very attractive buy." Thomas confirms NeXstar has had offers, pointing out that the company has a $100 million a year product sales. "There are almost no biotech companies other than the top eight that can say that."

As regards to timing, a possible bid is mostly likely following confirmation of the spin off and the release of phase II data on MiKasome for treatment of complicated urinary tract infections—both expected in October.

Emma Dorey

Japanese abandon domestic trials

A growing number of Japanese pharmaceutical companies are carrying out clinical trials of new drugs in Europe rather than in Japan, where regulations are notoriously rigorous and testing more expensive, according to a report released in August by the Japan External Trade Organization (JETRO; Tokyo). JETRO's survey of 64 Japanese drug companies, all carrying out some kind of activity in Europe, reflects a major decline in Japan's domestic drug industry over the last couple of years as more firms seek ventures outside Japan in order to cut development costs and establish a base from which to exploit overseas markets.

Forty-seven new drugs were approved in Japan in 1994, while 24 were approved in 1996, and only 15 in 1997. Japanese firms are currently in the process of testing or awaiting approval of 70 new drugs in Europe (of which 45.5% are in phase I) and a total of 56 new drugs in the United States.

Factors contributing to slower clinical trials in Japan include the abolition of the drug price