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Capstone attempts to 'put' shareholders first

Evaluate Vantage

Novel plan or publicity stunt? Capstone Therapeutics is proposing a ‘put right’ option for its shareholders whereby the company will be forced to return as much cash as possible to its investors as of June 30, 2011, providing a safety net of sorts for shareholders if Capstone’s anti-scarring agent, AZX100, fails in phase II trials, results from which are due before mid-2011.

As ever, the devil is likely to be in the detail of the ‘put right’ scheme which will be proposed at the company’s annual meeting of stockholders in May. In announcing the plan last month, the company listed a number of events which would invalidate the ‘put rights’ raising the question as to whether they could ever be exercised; after all, if a majority of shareholders exercised these rights Capstone’s very survival would be in jeopardy. Either way, the company has certainly raised the stakes on the already risky bet that is AZX100.

Scar removal challenge

AZX100 is a synthetic peptide with smooth muscle relaxation and anti-fibrosis properties. Capstone is currently conducting three phase II trials of the product in dermal and keloid scar reduction.

Two trials testing AZX100’s ability to prevent or reduce re-growth of surgically removed keloid scars will complete in the next six months with results due by the end of the year.

The third trial, to prevent or reduce scars caused by trocars used during arthroscopic shoulder surgery, is due to complete in December with results presumably available in the first half of 2011.

Therefore, before the ‘put right’ exercise date of June 30, 2011, investors should be in a pretty decent position to make their decision. If the results are positive, the assumption and theory is that Capstone’s share price will have surged well beyond its current value of around $1, with the prospect of further gains from a licensing or company acquisition, making shareholders keen to hold onto their shares and forego the ‘put right’.

Conversely, if AZX100 fails to deliver positive data the shares are likely to become worthless, making the option of extracting cash from the company an increasingly attractive one.

Deal or no deal?

As of the end of December Capstone had $35m in cash, only slightly below the company’s current market capitalisation of $42m. The company has guided a cash burn of $13m for 2010 and assuming a similar burn rate in the first half of 2011, the company would have around $16m to return to its shareholders, or 39 cents per share. This is likely to be significantly higher than the market value of Capstone’s shares if AZX100 disappoints, although the costs of liquidating the company if it comes to this would still need to be subtracted from this pay out.

Given Renovo’s trials and tribulations in developing Juvista to reduce scarring, the market clearly remains sceptical about AZX100’s chances of success.

In terms of potential events that could invalidate the ‘put right’ option, the company lists, “partnering, commercial, investment, capital raising or other transaction that the Company's Board of Directors determines to be material to the Company”. Clearly a number of loopholes exist.

As such, the ‘put right’ scheme may well be a novel plan but will it ever be exercised in reality?