Evaluate Vantage

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Cypress risks deepening disquiet with another spending spree

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One could be forgiven for thinking it rather provocative that a board under fire for an apparently misguided license deal should go straight out and strike two more. Perhaps a sign of single mindedness is exactly the message that Cypress Bioscience is trying to send to its activist hedgefund shareholder, Ramius.

After Cypress' share price halved in value to $2.16 in the wake of a licensing deal over BioLineRx's antipsychotic CYP-1020 (BL-1020) in June, Ramius ramped up its vociferous calls for change and offered to buy the company for $4 per share, rather than see more money wasted (*Ramius fires warning shot across Cypress's bow, July 20, 2010*). Rather than negotiate, Cypress has bought rights to two early-stage projects, Alexza Pharmaceuticals' Staccato nicotine drug delivery platform, and autism drug carbetocin from Marina Biotech. Some analysts reckon these deals signal Cypress' intention to press ahead unabated. The question for shareholders is whether this is a viable vision for the future.

Lots of cash and little assets

Cypress has licensed the smoking cessation technology and phase I autism drug, in deals potentially worth $6m and $27.75m, respectively, to grow its central nervous system (CNS) focused portfolio. Analysts from Roth Capital estimate the company could spend about $17m developing the Staccato technology, and maybe $2m for carbotecin, over the next two years.

At the end of June, Cypress had $106m in cash. It receives a royalty stream from Forest Laboratories for the fibromyalgia candidate Savella, predicted to bring in $17m this year, climbing to $81m in 2016. It also has two diagnostic services, which last year cost more to run than the income they generated.

So, the California firm has the recently in-licensed assets and a pile of cash. With no other obvious reason to acquire, Ramius appears to believe it knows how all that money could be better spent.

With a current market cap of $132m, removing the cash from this valuation gives an unspectacular $26m enterprise value. The stock market also appears to hold little faith in current management.

Fuelling dissent

The question for shareholders is whether to ride out this saga. Analysts at Roth reckon the shares could be worth $5 or more, and that even if these latest two deals amount to nothing but a waste of expenditure, it would only equate to a 50 cent per share erosion of value.

It does seem unlikely that an acquisition could happen at the current offe. At the very least the largest shareholder, Wellington Management with a 14% stake, would be unhappy with $4 per share.

However, of greater concern is the dissent that this apparently nonchalant move could cause amongst the remaining Cypress shareholders.

"[Cypress'] actions reminds us of the foreign tourist who simply speaks louder when not being understood by the native population," Scott Henry, an analyst at Roth Capital, wrote in a research note yesterday. "At some point, shareholders and management must get on the same page - which is looking less likely without changes to one side or the other."

Ramius has asked to meet with the Cypress board, adding that it would consider raising its proposed takeover bid if allowed limited due diligence, or if some of the risk of the CYP-1020 deal could be offset by bringing in a third party to cover half of its development costs. The Cypress board has offered no indication that it plans to hold such a meeting.

As it stands, Cypress bosses have essentially said they know what is best for the company. The 41% decline in its stock price this year suggests investors do not agree. Something has to give.

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