CYTOGEN

Statement of
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Senate Committee on Small Business & Entrepreneurship
Hearing on "The Impact of Stock Option Expensing on Small Businesses"
April 28, 2004

Madam Chair Snowe, Ranking Member Kerry, and Members of the Committee:

My name is Chris Schnittker and I am the Senior Vice President and Chief Financial Officer of Cytogen Corporation.

Thank you for the opportunity to participate in this hearing on the impact of stock options expensing on small businesses. The following is my written statement, which I respectfully request to be entered into the public record.

I am here today on behalf of my company and millions of other public and private small businesses that stand to be seriously impacted by the proposed accounting rules set forth by the Financial Accounting Standards Board in their recent exposure draft on "Share-Based Payment", better known as the accounting standard which will require stock option expensing.

First, allow me to provide a brief description of my company and how it relates to this hearing. Cytogen Corporation is a small, publicly-held biopharmaceutical company located in Princeton, New Jersey, the heart of the East Coast pharmaceutical corridor. We currently have about 65 employees most of whom are dedicated to selling and marketing our two lead oncology products, Quadramet™, a therapeutic radiopharmaceutical to palliate metastatic cancer pain, and ProstaScint®, a monoclonal antibody-based molecular imaging agent used to image the extent and spread of prostate cancer. We are also developing Combidex®, a molecular imaging agent which is currently under review by the FDA, and we support a research and development joint venture to develop prostate cancer therapies based on our prostate-specific membrane antigen, or PSMA, technology. Clearly, each addresses serious and substantial unmet medical needs of cancer patients and the physicians who serve them.

Cytogen relies on the dedication and drive of our Board of Directors, officers and employees to advance its reach on our currently-marketed products and to progress its other product candidates through the long and expensive process of drug research and development. To this end, we have chosen a compensation program for our employees which includes stock option grants and participation in an employee stock purchase program. Our stock option program is a broad-based one, granting stock options to every employee of the company – from our CEO, to my department's staff accountants, to each

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of the company's administrative assistants. We believe such a program best aligns the interests of all employees with that of the company and its outside shareholders – improving shareholder value – boosts productivity, and allows each and every employee to own a part of our success. I would suggest it also allows them to feel some of the pain of an unsuccessful business or a market downturn, with underwater stock options plaguing our industry during the past few years. At the company level, stock-based compensation allow us to attract, retain and motivate highly qualified personnel – many of whom are courted by the larger pharmaceutical companies that surround us in our region. From the window of our offices in Princeton, which literally sits in the shadow of a top-five pharmaceutical company's R&D facilities, I often watch their corporate helicopter deliver people from their New York City offices for meetings – a trip that probably takes at best 20 minutes. This is the same trip that my CEO and I have done several times a week by car or train, which often can take upwards of 3 hours each way. I certainly do not begrudge this company it's success – in fact, in certain aspects of our business, they are a critical business partner of ours. But I do hope that someday Cytogen has access to that level of capital where private aircraft is a necessity, rather than a distant luxury. As we are both competitors for the same intellectual capital in the oncology drug development arena, clearly much of the deck is stacked against a company like Cytogen because of its size and resource constraints. The promise of stock-based compensation among the smaller company's employees may help to level this playing field to some degree.

Further on our employee compensation model, as the cash outlays for employee health insurance programs and defined benefit pension plans increase exponentially, we, and most other small or start-up companies, look to non-cash compensation to supplement cash compensation so as to retain and motivate our employees. In order to compete with large pharmaceutical companies, we need to be able to offer meaningful equity compensation in lieu of the larger cash salaries, bonus programs and other perks offered by other employers in our industry. I am afraid that, with the expensing of stock options, small businesses will be denied yet another form of compensation to level the playing field with its larger counterparts in the industry. We may investigate the same moves made by other companies towards restricted stock grants or performance-based stock options, but each carries with them a complexity that can be difficult for small companies to administer and equally difficult for rank-and-file employees to understand and, perhaps more importantly, believe in their value. Even with these new compensation methods, I hope we will be able to keep the critical ownership and entrepreneurial spirit alive across all employees at Cytogen.

One of my responsibilities as a Chief Financial Officer is to budget and plan for our future growth but also to allocate our scarce capital resources, both human and financial, in the pursuit of our corporate goals. The appropriate mix of cash-based versus equity-based compensation for our employees is just one of these decisions. Clearly, the current market has told us that companies who have not yet set a clear course towards a sustainable and profitable business model will not survive. This initiative is especially challenging in the biotechnology industry with our 10-year-plus drug development

timelines, disappointments or delays inherent to research, and the enormous capital required to progress that research in a timely way. Cytogen has made several conscious choices over the last few years on its march towards sustainable profitability. These include rationalizing its own internal cell signaling R&D efforts in 2002, which resulted in the laying-off of nearly 75% of its R&D workforce, and controlling the growth of its in-house sales force in support of its growing product base. In previous years, my company has also outsourced its manufacturing efforts for both of its lead products with major pharmaceutical companies, when GMP-quality manufacturing became too costly for a small biotechnology company, at the same time forfeiting a degree of control over our own destiny. We have also further rationalized our investment in R&D by the formation of a joint venture with another public company to share the costs, and decidedly the rewards, of developing our proprietary PSMA technology. The market has rewarded us to some degree for these changes, rising from a market capitalization (defined as the number of common shares outstanding multiplied by quoted market price) of just under $30 million in late 2002 to a current market capitalization of $230 million – a greater than 600% improvement in shareholder value. But there is still work to be done.

The FASB's proposals on options expensing are being handed to Cytogen at a very critical juncture in our history. If adopted, we would need to work these charges into our profitability model before we can determine the true "cost" of our option programs and how we will continue to support them in the future. The results of our initial option valuations, the implementation of the proposed binomial valuation methods and the costs of consultants or software to produce these valuations certainly give us reason to consider the course of discontinuing our broad-based stock option program or reducing the amount of options we grant within that program. We would certainly not be the first company I have read about since this issue began its progress through rulemaking to amend, curtail or eliminate its broad-based employee stock option program. These costs, coupled with the burgeoning costs of recent requirements of the Sarbanes-Oxley Act of 2002 and corporate governance initiatives implemented by NASDAQ, will hit smaller businesses harder than larger, well-established entities. The irony, to some degree, is that many companies are considering doing away with stock options at a time when, as a result of the market rebound over the past few months, they are once again a substantial motivating factor for our employees. Rationalizing this program at this time will be a difficult "sell" to our employee base.

We are also concerned at Cytogen about the market's reaction to a potential setback in our path towards profitability as a result of the proposed stock option accounting rules. Cytogen's access to capital on terms favorable to the company is a critical factor to the future success of our business. My CEO and I spent much of the first quarter of 2004 engaged in capital raising activities, leading up to a successful $26 million capital raise during April. This process involved many face-to-face meetings over several months with bankers and advisers developing our strategy and getting them comfortable with the Cytogen model. This process culminated in a condensed 2-day deal "road show" to interested investors. During this 48 hour period, we met with approximately 15 potential

institutional investors – most of which were less than an hour in length. I would argue that helping a potential investor become truly knowledgeable about your financial model and cash flow prospects in less than one hour, especially on a company as multifaceted as Cytogen, is going to be near impossible if we are soon asked to carve out substantial non-cash charges like stock-based compensation. The core cash flow models of companies like ours is a critical marker of their eventual success or failure. An investor's understanding here is critical to their decision whether or not to invest. I would rather be spending that hour discussing the future promise of our marketed products and the quality of our research and development programs than dissecting our true cash flows from our public financial statements.

I would like to sum up my comments with my reflections as to why I, and perhaps many other employees like me, choose to work for small, development-stage businesses, particularly in the life sciences arena. It is not for the stability of a big company around you with adequate capital to insure its existence. It is not for businesses that to some degree run themselves due to their market penetration or vast resources. Among many other reasons, small businesses offer:

- The speed of innovation;
- The responsiveness to change;
- The ability to work with leaders and co-workers filled with entrepreneurial spirit; and
- The chance to change the face of a dreaded disease like cancer and improve the quality of life of the patients and their families who it affects.

For the anxiety, the long hours, the working weekends, and last-minute travels – I hope that my company's leaders, my co-workers and my staff can share in the reward of their company's success, commensurate with the enormous risks they assume in working for a small business. An important and effective tool for sharing this success is through the broad-based grant of employee stock options.

I fear that bringing subjective, assumption-based accounting charges to bear on the current system of employee equity compensation puts undue pressure on small companies and their ability to attract, retain and motivate the very employees that are critical to their success. I believe delaying the current rulemaking on stock-based compensation until 1) we have addressed the accountants' and investors' concerns over valuation methodologies and comparability among companies and 2) we better understand its broad economic impact to small business is of vital importance.

On behalf of Cytogen, and other similar small businesses, I sincerely appreciate the opportunity to express our views on these important issues.