

## **Potential of Wart-Reducing Drug Presents 3M with Challenges, Opportunities**

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In 3M's vast portfolio of 50,000 products, no single one holds more potential -- or poses more perplexing dilemmas -- than a cream that reduces warts.

Analysts estimate that sales from Aldara last year were only around \$80 million, accounting for less than one-half a percent of 3M's \$16.7 billion in net sales. Yet in his first conference call with analysts, 3M's new CEO, James McNerney, singled out the product as a potential home run.

Analysts say Aldara and its chemical cousins could generate about \$1.5 billion in sales by the end of the decade.

Along the way, the drugs may force 3M to decide exactly what kind of company it wants to be. "The answer comes down what this new CEO and his management want to make of this new business called 3M," said Chuck Blitzer, president and CEO of MGI Pharma, a Bloomington-based pharmaceutical firm that is developing an anti-cancer drug.

Aldara's main chemical ingredient, imiquimod, causes the body's immune system to attack viruses and tumors. In 1997, some 16 years after a 3M scientist stumbled on the compound, the company got approval from the Food and Drug Administration to market the drug to treat genital warts, caused by the human papilloma virus.

About 10 percent of sexually active adults have the virus. In a small percentage of cases, HPV can lead to cervical dysplasia, which in turn can lead to cervical cancer.

Treating genital warts alone, the company has told analysts, could turn Aldara into a \$200 million-a-year drug. But 3M is also testing similar compounds for other indications, including genital herpes and cervical dysplasia.

In a report last summer, Morgan Stanley Dean Witter analyst Robert Ottenstein estimates that drugs treating just those conditions could someday put more than \$1 billion in 3M's coffers.

But the terrific opportunity comes with a price tag. One is that it demands huge investment dollars. Ottenstein estimates 3M spends about 10 percent of its \$1 billion research and development budget on pharmaceuticals, with the majority of that going to this group.

Another challenge is more philosophical: 3M has built its multibillion-dollar business by advancing a technology -- say, adhesives -- and figuring out ways to sell it to customers in many different industries. That's the corporate glue that connects Post-it Notes, sandpaper and surgical tapes. Drug discovery is a different animal,

with high stakes, big payoffs and, often, big disappointments.

Chemical companies, even if they already market to health care professionals, often underestimate the differences between selling medical products and drugs, according to Blitzer, who held executive positions with Marion Laboratories and Marion Merrell Dow Pharmaceuticals.

Observers doubt that McNerney, a former General Electric executive who formally took the reins of the company Jan. 1, will reach a decision in the near future.

But at some point, he may want to take more deliberate action. One option would be spinning the drug group off through an initial public offering. A spinoff carries risks, however, and 3M would probably prefer to keep the division -- and its earnings growth -- on its own income statement. Blitzer said a joint venture with a large pharmaceutical firm might be a solution. 3M could also sell the group at some point.

Whatever McNerney does, Aldara and other fast-growing products will likely be at the forefront of 3M's campaign to get Wall Street to put a higher value on its stock. That's been a perennial challenge for 3M, whose stock has been a laggard in part because its diverse mix of business makes it hard for Wall Street analysts to value all its pieces.

Once abandoned The story of how 3M discovered Aldara has become a part of company lore.

In the early 1980s, Richard Miller was in charge of an anti-viral program for 3M's Riker Laboratories. With the help of a well-regarded 3M chemist, John Gerster, Miller tested a compound for treating herpes that at first showed only marginal results. But Miller persevered, and he later found the compound to be highly effective.

Despite the encouraging results, Miller's funding was cut for budget reasons, according to a 3M biography, and the anti-viral program was shut down. But Miller began championing the project to higher-ups. 3M scientists are allotted time for self-directed research, and Miller continued his work. Later, his funding was reinstated.

3M officials declined to discuss the so-called immune response modifier (IRM) products, citing the ongoing FDA trials. According to company literature, 3M is in clinical trials testing Aldara's effectiveness on two skin diseases and is testing another compound, resiquimod, for genital herpes. A compound for cervical dysplasia is in early development after delays in trials on a cream "shortened the time available for market commercialization," 3M said.

But the potential could be big. "Because the IRMs assist the immune system -- rather than target specific viruses or tumors -- they have potential uses in a wide variety of diseases," 3M wrote in materials for investors interested in the program.

Aldara has found loyal advocates.

"It's expanded our repertoire. It's very effective," said Karen Smith-McCune. Smith-McCune, a medical doctor who also holds a Ph.D., practices at a clinic specializing

in dysplasia at the University of California San Francisco and conducts research. One of the advantages of Aldara is that a patient can apply it herself, rather than coming into the doctor's office.

Smith-McCune also prescribes the drug for indications other than its FDA-approved use. That's an accepted practice when the drug appears effective for other problems. Assuming further studies confirm the results, her use suggests the drug may find wider acceptance. Smith-McCune, for example, combines the drug with laser surgery in some women with dysplasia.

Reaching doctors effectively will be one of 3M's biggest challenges, if the new drugs and uses are ultimately approved. John Roberts, an analyst at Merrill Lynch, notes that 3M doesn't have strong ties to oncologists, who may be important in selling the benefits of the drug for dysplasia. Some dermatologists may resist the drug for skin indications if it means fewer outpatient surgeries, a lucrative business.

Watching the stock As McNerney considers how he'll proceed with the IRM group, he'll be closely watching 3M's stock to decide if the potential of the business is reflected in the share price.

"You can create a great business and not get recognized for it," said Roberts. A partial IPO might look more attractive, he added, "if 3M's stock doesn't reflect the business."

As a stand-alone company, the IRM group might attract coverage from analysts who specialize in pharmaceutical firms; right now, 3M really isn't on their radar, he said.

Some of those firms carry lofty valuations on Wall Street.

MGI Pharma, for example, lost \$19.5 million on sales of \$21.3 million in 2000 but carries a market value of nearly \$275 million. That means MGI Pharma's stock trades at about 12.9 times sales. Shares of 3M, a highly profitable company, trade at only about 2.6 times sales. McNerney and analysts will ask if the fast-growing IRM group would be worth more alone than as part of 3M.

"The issue really comes down this: What do they see for their pharmaceutical business, how much appetite do they have for more risk and more investment, and how does the return compare to the return if they keep the business the way it is?" said Blitzer. "In 3M, every division is asking for money. They're all fighting for it. Somewhere down the line you have to figure out how much is going to go to pharmaceuticals."