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ZONAGEN INC
Form DEF 14A
May 16, 2002

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES EXCHANGE ACT OF 1934
(AMENDMENT NO.)

Filed by the Registrant [X]

Filed by a Party other than the Registrant []

Check the appropriate box:

- [] Preliminary Proxy Statement
- [] Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- [X] Definitive Proxy Statement
- [] Definitive Additional Materials
- [] Soliciting Material Pursuant to Section 240.14a-11(c) or Section 240.14a-12

ZONAGEN, INC.
(NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

(NAME OF PERSON(S) FILING PROXY STATEMENT IF OTHER THAN THE REGISTRANT)

Payment of Filing Fee (Check the appropriate box):

- [X] No fee required.
- [] Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1) Title of each class of securities to which transaction applies:

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- 1) Amount Previously Paid:
- 2) Form, Schedule or Registration Statement No.:
- 3) Filing Party:
- 4) Date Filed:

ZONAGEN, INC.
2408 TIMBERLOCH PLACE, SUITE B-4
THE WOODLANDS, TEXAS 77380

May 16, 2002

TO OUR STOCKHOLDERS:

You are cordially invited to attend the 2002 Annual Meeting of Stockholders of Zonagen, Inc. to be held on Thursday, June 20, 2002, at 1:00 p.m., Central Daylight Time, at the Wyndham Greenspoint Hotel, 12400 Greenspoint Drive, Houston, Texas. A Notice of the Annual Meeting, Proxy Statement and form of proxy are enclosed with this letter.

We encourage you to read the Notice of the Annual Meeting and Proxy Statement so that you may be informed about the business to come before the meeting. Your participation in the Company's business is important, regardless of the number of shares that you hold. To ensure your representation at the meeting, please promptly sign and return the accompanying proxy card in the postage-paid envelope.

We look forward to seeing you on June 20, 2002.

Sincerely,

Joseph S. Podolski
President and Chief Executive Officer

NOTICE OF ANNUAL MEETING OF

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STOCKHOLDERS
TO BE HELD JUNE 20, 2002

To the Stockholders of Zonagen, Inc.:

The Annual Meeting of Stockholders (the "Annual Meeting") of Zonagen, Inc. (the "Company") will be held on Thursday, June 20, 2002, at 1:00 p.m., Central Daylight Time, at the Wyndham Greenspoint Hotel, 12400 Greenspoint Drive, Houston, Texas, for the following purposes:

1. To elect a board of five directors of the Company, each to serve until the Company's next Annual Meeting of Stockholders or until their respective successors have been duly elected and qualified; and
2. To act on such other business as may properly come before the Annual Meeting or any adjournments thereof.

Only stockholders of record at the close of business on May 10, 2002 will be entitled to notice of and to vote at the Annual Meeting.

It is important that your shares be represented at the Annual Meeting regardless of whether you plan to attend. THEREFORE, PLEASE MARK, SIGN AND DATE THE ENCLOSED PROXY AND RETURN IT IN THE ACCOMPANYING POSTPAID ENVELOPE AS PROMPTLY AS POSSIBLE. If you are present at the Annual Meeting, and wish to do so, you may revoke the proxy and vote in person.

By Order of the Board of Directors,

Louis Ploth
Secretary

The Woodlands, Texas
May 16, 2002

ZONAGEN, INC.
2408 TIMBERLOCH PLACE, SUITE B-4
THE WOODLANDS, TEXAS 77380

PROXY STATEMENT
FOR
ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD JUNE 20, 2002

SOLICITATION AND REVOCABILITY OF PROXIES

The accompanying Proxy is solicited by the Board of Directors of Zonagen, Inc. (the "Company"), to be voted at the Annual Meeting of Stockholders of the Company to be held on Thursday, June 20, 2002 (the "Annual Meeting"), at 1:00 p.m., Central Daylight Time, at the Wyndham Greenspoint Hotel, 12400

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Greenspoint Drive, Houston, Texas, for the purposes set forth in the accompanying Notice of Annual Meeting of Stockholders, and at any adjournment(s) of the Annual Meeting. If the accompanying Proxy is properly executed and returned, the shares it represents will be voted at the Annual Meeting in accordance with the directions noted thereon or, if no direction is indicated, it will be voted in favor of the proposals described in this Proxy Statement. In addition, the Proxy confers discretionary authority to the persons named in the Proxy authorizing those persons to vote, in their discretion, on any other matters properly presented at the Annual Meeting. The Board of Directors is not currently aware of any such other matters.

Each stockholder of the Company has the unconditional right to revoke his Proxy at any time prior to its exercise, either in person at the Annual Meeting or by written notice to the Company addressed to Secretary, Zonagen, Inc., 2408 Timberloch Place, Suite B-4, The Woodlands, Texas 77380. No revocation by written notice will be effective unless such notice has been received by the Secretary of the Company prior to the day of the Annual Meeting or by the inspector of election at the Annual Meeting.

The principal executive offices of the Company are located at 2408 Timberloch Place, Suite B-4, The Woodlands, Texas 77380. This Proxy Statement and the accompanying Notice of Annual Meeting of Stockholders and Proxy are being mailed to the Company's stockholders on or about May 16, 2002.

In addition to the solicitation of proxies by use of this Proxy Statement, directors, officers and employees of the Company may solicit the return of proxies by mail, personal interview, telephone or the Internet. Officers and employees of the Company will not receive additional compensation for their solicitation efforts, but they will be reimbursed for any out-of-pocket expenses incurred. Brokerage houses and other custodians, nominees and fiduciaries will be requested, in connection with the stock registered in their names, to forward solicitation materials to the beneficial owners of such stock.

ALL COSTS OF PREPARING, PRINTING, ASSEMBLING AND MAILING THE NOTICE OF ANNUAL MEETING OF STOCKHOLDERS, THIS PROXY STATEMENT, THE ENCLOSED FORM OF PROXY AND ANY ADDITIONAL MATERIALS, AS WELL AS THE COST OF FORWARDING SOLICITATION MATERIALS TO THE BENEFICIAL OWNERS OF STOCK AND ALL OTHER COSTS OF SOLICITATION, WILL BE BORNE BY THE COMPANY.

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PURPOSES OF THE MEETING

At the Annual Meeting, the Company's stockholders will be asked to consider and act on the following matters:

1. The election of a board of five directors of the Company, each to serve until the Company's next Annual Meeting of Stockholders or until their respective successors have been duly elected and qualified; and
2. Such other business as may properly come before the Annual Meeting or any adjournments thereof.

QUORUM AND VOTING

The close of business on May 10, 2002 has been fixed as the record date

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(the "Record Date") for the determination of stockholders entitled to vote at the Annual Meeting and any adjournment(s) thereof. As of the Record Date, the Company had issued and outstanding 11,381,925 shares of the Company's common stock, par value \$.001 share (the "Common Stock").

Each stockholder of record of Common Stock will be entitled to one vote per share on each matter that is called to vote at the Annual Meeting. Shares of Common Stock may not be voted cumulatively.

The presence, either in person or by proxy, of holders of shares representing a majority of the Common Stock entitled to be cast at the Annual Meeting is necessary to constitute a quorum at the Annual Meeting. Abstentions and broker non-votes are counted for purposes of determining whether a quorum is present. A plurality vote is required for the election of directors. Accordingly, if a quorum is present at the Annual Meeting, the five persons receiving the greatest number of votes will be elected to serve as directors. Withholding authority to vote for a director nominee and broker non-votes in the election of directors will not affect the outcome of the election of directors. All other matters to be voted on will be decided by the vote of the holders of shares representing a majority of the votes present or represented at the Annual Meeting and entitled to vote on such matter. On any such matter, an abstention will have the same effect as a negative vote but, because shares held by brokers will not be considered entitled to vote on matters as to which the brokers withhold authority, a broker non-vote will have no effect on such vote.

All Proxies that are properly completed, signed and returned prior to the Annual Meeting will be voted. Any Proxy given by a stockholder may be revoked at any time before it is exercised by the stockholder (i) filing with the Secretary of the Company an instrument revoking it, (ii) executing and returning a Proxy bearing a later date or (iii) attending the Annual Meeting and expressing a desire to vote his shares of Common Stock in person. Votes will be counted by Computershare Investor Services, LLC, the Company's transfer agent and registrar.

PROPOSAL NUMBER 1: ELECTION OF DIRECTORS

The Board of Directors has nominated and urges you to vote for the election of the five nominees identified below, who have been nominated to serve as directors until the next Annual Meeting of Stockholders or until their successors are duly elected and qualified. Each of the nominees listed below is a member of the Company's present Board of Directors. Proxies solicited hereby will be voted for all nominees unless stockholders specify otherwise in their Proxies.

If, at the time of or prior to the Annual Meeting, any of the nominees should be unable or decline to serve, the discretionary authority provided in the Proxy may be used to vote for a substitute or substitutes designated by the Board of Directors. The Board of Directors has no reason to believe that any substitute nominee or nominees will be required.

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NOMINEES FOR ELECTION AS DIRECTORS

The names of the nominees for election as directors, and certain additional information with respect to each of them, are set forth below.

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| NAME | AGE | POSITION WITH THE COMPANY | YEAR FIRST BECAME DIRECTOR |
|----------------------------|-----|---|----------------------------|
| Martin P. Sutter..... | 46 | Chairman of the Board | 1987 |
| Joseph S. Podolski..... | 54 | President and Chief Executive Officer and Director | 1992 |
| Lloyd M. Bentsen, III..... | 57 | Director | 2000 |
| Steven Blasnik..... | 44 | Director | 1990 |
| Timothy McInerney..... | 41 | Director | 1996 |

Martin P. Sutter. Mr. Sutter, a co-founder of the Company, has served as Chairman of the Board of Directors since December 1987. Since July 1988, Mr. Sutter has been the Managing General Partner of The Woodlands Venture Partners, L.P., a venture capital firm based in The Woodlands, Texas, and the General Partner of The Woodlands Venture Fund, L.P. Since June 1998, Mr. Sutter has been managing director of Essex Woodlands Health Ventures, L.L.C. He has a B.S. degree from Louisiana State University and an M.B.A. from the University of Houston.

Joseph S. Podolski. Mr. Podolski joined the Company in 1989 as Vice President of Operations and has served as President and Chief Executive Officer of the Company and as a director since 1992. Prior to joining the Company, Mr. Podolski spent twelve years in various engineering, product development and manufacturing positions at G.D. Searle, a subsidiary of Monsanto Company. Before joining Monsanto, Mr. Podolski held positions in manufacturing, engineering, quality control and development of fine chemicals, antibiotics, pharmaceuticals and hospital products with Abbott Laboratories, Dearborn Chemical Company and Baxter Pharmaceuticals. Mr. Podolski holds a M.S. in chemical engineering from the Illinois Institute of Technology.

Lloyd M. Bentsen, III. Mr. Bentsen has been a Director of the Company since June 2000. Mr. Bentsen is a general partner and co-founder of Triad Ventures and the AM Fund, a group of venture capital funds that invest in Texas-based emerging growth companies. Prior to founding his venture capital firm in 1979, Mr. Bentsen spent ten years with Rotan Mosle, Inc., a regional investment banking firm, as a member of the corporate finance department. Mr. Bentsen is also on the board of directors of Stewart Information Services Corporation, one of the largest title insurance companies in the United States and traded on the New York Stock Exchange. Mr. Bentsen is a graduate of Princeton University with an M.B.A. from Stanford University.

Steven Blasnik. Mr. Blasnik has served as a Director of the Company since April 1990. Since 1987, Mr. Blasnik has been employed by the Perot Group and is currently President of Perot Investments, Inc., an investment firm owned by Ross Perot. He is also a director of Perot Systems Corporation. From 1983 to 1987, Mr. Blasnik was an attorney at Hughes & Luce in Dallas, Texas. Mr. Blasnik has a B.S.E. from Princeton University and a J.D. from Harvard Law School.

Timothy McInerney. Mr. McInerney has served as a Director of the Company since December 1996. Since 1992, Mr. McInerney has been a Managing Director of Paramount Capital, Inc. where he oversees the overall distribution of Paramount's private equity product. Prior to 1992, Mr. McInerney was a research analyst focusing on the biotechnology industry at Ladenburg, Thalman & Co. Prior to that, Mr. McInerney held equity sales positions at Bear, Stearns & Co. and Shearson Lehman Brothers, Inc. Mr. McInerney also has worked in sales and marketing for Bristol-Myers Squibb. He received his B.S. in pharmacy from St. John's University at New York. He also completed a post-graduate residency

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at the New York University Medical Center in drug information systems.

THE BOARD OF DIRECTORS RECOMMENDS THAT STOCKHOLDERS VOTE "FOR" THE ELECTION OF EACH OF THE ABOVE-NAMED NOMINEES.

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DIRECTORS' MEETINGS AND COMPENSATION

The Company's operations are managed under the broad supervision of the Board of Directors, that has ultimate responsibility for the establishment and implementation of the Company's general operating philosophy, objectives, goals and policies. During 2001, the Board of Directors convened on six regularly scheduled occasions and took certain additional actions by unanimous written consent in lieu of meetings. All directors attended at least 75% of the meetings held by the Board and any committee of the Board on which he served during his tenure in 2001.

Employee directors do not receive additional compensation for service on the Board of Directors or its committees. The Company reimburses each non-employee director for travel expenses incurred in connection with attendance at Board meetings. For board meetings attended in person non-employee directors receive \$1,000.00 per meeting in cash, stock awards, or options. Employee directors are eligible to participate in the Company's 1994 Employee and Consultant Stock Option Plan and the Amended and Restated 1993 Employee and Consultant Stock Option Plan (the "Incentive Plans"). Non-employee directors are entitled to participate in the Company's 2000 Non-employee Directors' Stock Option Plan (the "2000 Director Plan").

The Board terminated the 1996 Non-employee Directors' Stock Option Plan (although all options previously granted will remain outstanding pursuant to their original terms) in connection with the approval of the 2000 Director Plan.

Under the 2000 Director Plan, (i) each non-employee director who is first elected to the Board is entitled to receive an option to purchase 40,000 shares of Common Stock on the date on which he first becomes a non-employee director, and (ii) each non-employee director in office on the date of the Company's annual meeting of stockholders will receive an option to purchase 5,000 shares of Common Stock effective on such date. Additionally under the 2000 Director Plan, the chairman of the board who is first elected to the Board is entitled to receive an option to purchase 10,000 shares of Common Stock on the date on which he first becomes chairman, and the chairman in office on the date of each of the Company's annual meeting of stockholders will receive an option to purchase 10,000 shares of Common Stock effective on such date. In 2001, the Company granted options to acquire an aggregate of 30,000 shares of Common Stock to non-employee directors under the 2000 Director Plan. During 2001, the Company paid \$5,000 to one director, issued stock awards totaling 2,690 shares of Common Stock to two directors, and granted options to purchase an aggregate of 1,852 shares of Common Stock to one director, for the attendance of board meetings in person.

BOARD COMMITTEES

Pursuant to delegated authority, various Board functions are discharged by the standing committees of the Board. The Board of Directors has appointed four principal standing committees: the Executive Committee, the Compensation and Option Committee, the Nominating Committee and the Audit Committee.

The Executive Committee, currently comprised of Messrs. Sutter and Podolski, is authorized to exercise, to the extent permitted by law, the power

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of the full Board of Directors when a meeting of the full Board is not practicable or necessary. The Executive Committee convened once in 2001.

The Compensation and Option Committee, currently comprised of Messrs. Blasnik and McInerney, selects the employees to whom stock options are to be granted, determines the terms and conditions provided for in each option grant and reviews and recommends to the Board of Directors the amount of compensation to be paid to officers of the Company. The Compensation and Option Committee convened once in 2001 and took certain additional actions by unanimous written consent in lieu of meetings.

The Nominating Committee is currently comprised of Messrs. Sutter and Podolski, and did not meet in 2001.

The Audit Committee, currently comprised of Messrs. Bentsen, Blasnik and McInerney, provides assistance to the Board of Directors in fulfilling its responsibilities relating to corporate accounting and reporting practices, recommends to the Board of Directors the engagement by the Company of its independent public accountants, approves services performed by the Company's independent public accountants, including fee arrangements and the range of audit and non-audit services, maintains a direct line of communication between the Board of Directors and the Company's

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independent public accountants and performs such other functions as may be prescribed with respect to audit committees under applicable rules, regulations and policies of The Nasdaq Stock Market, Inc. The Audit Committee meets quarterly and convened four times in 2001 and two times during the quarter ended March 31, 2002.

As required by Nasdaq Stock Market and Securities and Exchange Commission (the "Commission") rules regarding audit committees, the Board of Directors has reviewed the qualifications of its Audit Committee and has determined that none of the current members of the Audit Committee have a relationship with the Company that might interfere with the exercise of their independence from the Company or its management.

RELATIONSHIP WITH INDEPENDENT PUBLIC ACCOUNTANTS

In past years, the Audit Committee has recommended the appointment of independent auditors for the current year to the board of directors, which in turn has recommended ratification of such appointment by our stockholders. Arthur Andersen LLP ("Andersen") had served in that capacity for us, but this year, in light of the events surrounding Andersen, the Audit Committee and management have decided to change independent auditors and are currently performing due diligence to make an informed decision. Accordingly, the stockholders are not being asked to ratify the appointment of independent auditors to audit the Company's financial statements for the year ending December 31, 2002. The Audit Committee intends to make a decision with respect to the appointment of our independent auditors for the year ending December 31, 2002 that we believe to be in the best interest of the Company and its stockholders.

REPORT OF THE AUDIT COMMITTEE

The Audit Committee includes three directors who are independent, as defined by the standards of the Nasdaq Stock Market. The Audit Committee assists the Board in overseeing matters relating to the Company's accounting and

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financial reporting practices, the adequacy of its internal controls and the quality and integrity of its financial statements.

The Audit Committee met four times during the year ended December 31, 2001. Also, the Audit Committee reviewed with management and the independent auditors the interim financial information included in the Company's quarterly reports on Form 10-Q for the fiscal quarters ended March 31, June 30 and September 30, 2001 prior to their being filed with the Commission as well as for the fiscal quarter ended December 31, 2001, as filed with the Company's Form 10-K for the year ended December 31, 2001.

The independent auditors provided the Audit Committee with a written statement describing all the relationships between the Company and its auditors that might bear on the auditors' independence consistent with Independence Standards Board Standard No. 1, "Independence Discussions with Audit Committees." The Audit Committee also discussed with the auditors any relationships that may impact their objectivity and independence and satisfied itself as to the auditors' independence.

The Audit Committee discussed and reviewed with the independent auditors all communications required by generally accepted auditing standards, including those described in Statement of Auditing Standards No. 61, as amended, "Communication with Audit Committees."

With and without management present, the Audit Committee discussed and reviewed the results of the independent auditors' examination of the Company's December 31, 2001 financial statements. The discussion included matters related to the conduct of the audit, such as the selection of and changes in significant accounting policies, the methods used to account for significant or unusual transactions, the effect of significant accounting policies in controversial or emerging areas, the process used by management in formulating particularly sensitive accounting estimates and the basis for the auditors' conclusions regarding the reasonableness of those estimates, significant adjustments arising from the audit and disagreements, if any, with management over the application of accounting principles, the basis for management's accounting estimates and the disclosures in the financial statements.

The Audit Committee reviewed the Company's audited financial statements as of and for the year ended December 31, 2001, and discussed them with management and the independent auditors. Based on such review and discussions, the Audit Committee recommended to the Board that the Company's audited financial statements be included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2001 for filing with the Commission.

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FEEES PAID TO PRINCIPAL ACCOUNTING FIRM

The following table sets forth the aggregate fees billed to the Company by its principal accounting firm for the 2001 audit of its financial statements, Andersen, for the fiscal year ended December 31, 2001:

| | |
|--------------------------------|-----------|
| Audit Fees | \$ 77,000 |
| Financial Information Systems | |
| Design and Implementation Fees | 0 |
| All Other Fees | \$ 20,834 |
| | ----- |
| Total Fees | \$ 97,834 |

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The Audit Committee considered whether the provision of the services reflected under "All Other Fees" above might have affected Andersen's independence with respect to their audit of the Company's financial statements, and the Audit Committee believes that such services did not affect, and were compatible with, Andersen's independence.

This report of the Audit Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933, as amended (the "Securities Act"), or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

Steven Blasnik
Lloyd M. Bentsen, III
Timothy McInerney, Chairman

REPORT OF THE COMPENSATION AND OPTION COMMITTEE OF THE BOARD OF DIRECTORS

The Compensation and Option Committee (the "Committee") of the Board of Directors of the Company currently consists of Steven Blasnik and Timothy McInerney, neither of whom is an officer or employee of the Company. The Committee is responsible for evaluating the performance of management and determining the compensation for executive officers of the Company and for administering the Company's Incentive Plans under which grants may be made to employees of the Company. The Committee has furnished the following report on executive compensation for 2001:

Under the supervision of the Committee, the Company has developed a compensation policy which is designated to attract and retain key executives responsible for the success of the Company and motivate management to enhance long-term stockholder value. The annual compensation package for executive officers primarily consists of (i) a cash salary which reflects the responsibilities relating to the position and individual performance, (ii) variable performance awards payable in cash or stock and tied to the achievement of certain personal and corporate goals or milestones and (iii) long-term stock-based incentive awards which strengthen the mutuality of interests between the executive officers and the Company's stockholders.

In determining the level and composition of compensation of each of the Company's executive officers, the Committee takes into account various qualitative and quantitative indicators of corporate and individual performance. Although no specific target has been established, the Committee generally seeks to set salaries comparable to those of peer group companies. In setting such salaries, the Committee considers its peer group to be certain companies in the biotechnology industries with market capitalizations similar to that of the Company. Such competitive group does not necessarily include the companies comprising the indexes reflected in the performance graph in this Proxy Statement. Because the Company is still in the development stage, the use of certain traditional performance standards (e.g., profitability and return on equity) is not currently appropriate in evaluating the performance of the Company's executive officers. Consequently, in evaluating the performance of management, the Committee takes into consideration such factors as the Company's achieving specified milestones or goals in its clinical development programs and the general progress of the Company's clinical trials. In addition, the Committee recognizes performance and achievements that are more difficult to quantify, such as the successful supervision of major corporate projects and demonstrated leadership ability.

Base compensation is established through negotiation between the Company and the executive officer at the time the executive is hired, and then subsequently adjusted when such officer's base compensation is subject to review or reconsideration. While the Company has entered into employment agreements with certain of its executive officers, such agreements provide that base salaries after the initial year will be determined by the Committee after review. When establishing or reviewing base compensation levels for each executive officer, the Committee, in accordance with its general compensation policy, considers numerous factors, including the responsibilities relating to the position, the qualifications of the executive and the relevant experience the individual brings to the Company, strategic goals for which the executive has responsibility, and compensation levels of companies at a comparable stage of development who compete with the Company for business, scientific and executive talents. As stated above, such comparable companies are generally those with similar market capitalizations and are not necessarily among the companies comprising the industry or broad market indexes reflected in the performance graph in this Proxy Statement. No pre-determined weights are given to any one of such factors. The base salaries for the executive officers generally, and the Chief Executive Officer specifically, for fiscal 2001 were comparable to the Company's peer group companies.

In addition to each executive officer's base compensation, the Committee may award cash bonuses and the Committee may grant awards under the Company's Incentive Plans to chosen executive officers depending on the extent to which certain defined personal and corporate performance goals are achieved. Such corporate performance goals are the same as discussed above.

All employees of the Company, including its executive officers, are eligible to receive long-term stock-based incentive awards under the Company's Incentive Plans as a means of providing such individuals with a continuing proprietary interest in the Company. Such grants further the mutuality of interest between the Company's employees and its stockholders by providing significant incentives for such employees to achieve and maintain high levels of performance. The Company's Incentive Plans enhance the Company's ability to attract and retain the services of qualified individuals. Factors considered in determining whether such awards are granted to an executive officer of the Company include the executive's position in the Company, his or her performance and responsibilities, the amount of stock options, if any, currently held by the officer, the vesting schedules of any such options and the executive officer's other compensation. While the Committee does not adhere to any firmly established formulas or schedules for the issuance of awards such as options or restricted stock, the Committee will generally tailor the terms of any such grant to achieve its goal as a long-term incentive award by providing for a vesting schedule encompassing several years or tying the vesting dates to particular corporate or personal milestones.

Section 162(m) of the Internal Revenue Code of 1986, as amended (the "Code"), added by the Revenue Reconciliation Act of 1993, places a \$1.0 million cap on the deductible compensation that can be paid to certain executives of publicly-traded corporations. Amounts that qualify as "performance based" compensation under Section 162(m)(4)(c) of the Code are exempt from the cap and do not count toward the \$1.0 million limit. Generally, stock options will qualify as performance based compensation. The Committee has discussed and considered and will continue to evaluate the potential impact of Section 162(m) on the Company in making compensation determinations, but has not established a set policy with respect to future compensation determinations.

COMPENSATION OF CHIEF EXECUTIVE OFFICER

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The annual base salary of Joseph S. Podolski, the Company's President and Chief Executive Officer, was increased to \$280,000 for 2002. In increasing Mr. Podolski's annual base salary for 2002, the Committee evaluated a number of factors, including Mr. Podolski's responsibilities, his general background and qualifications, his achievement of various corporate and personal milestones set by the Committee from time to time, and compensation levels for executives in Mr. Podolski's position and with his background at peer group companies. The Committee has not attached any particular relative weighting to the foregoing factors (or any other factors which the Committee may also consider in reaching compensation decisions for the Company's executive officers).

The Committee did not grant a bonus to Mr. Podolski for 2001. In March 2002, the Committee approved a bonus plan for Mr. Podolski under which he will receive year end bonuses that will equal two percent (2%) of the amount of milestone payments received by the Company during such year. Such plan terminates after December 31, 2003, unless prior thereto there is either a change of control or a termination of Mr. Podolski's employment. If either such event occurs prior to such date, the bonus plan will terminate upon the occurrence of such event. The Committee retains

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discretion to determine the amount of any future incentive bonus awards to be paid to Mr. Podolski under its general plan of incentive bonus awards for the Company's executive officers. The Committee expects that it will evaluate a number of factors in reaching this decision, including the Company's strategic goals for which Mr. Podolski has responsibility, his other responsibilities, his initiatives and contributions to the Company's achievement of various corporate and strategic goals and his own achievement of certain personal milestones as determined by the Committee from time to time.

Mr. Podolski was granted options to purchase an aggregate of 25,000 shares under the Company's Incentive Plans during 2001. In March 2002, the Committee approved the grant of an option to Mr. Podolski to purchase 50,000 shares of Common Stock with an exercise price equal to the fair market value of the Common Stock on the date of grant and usual time-based vesting provisions and an additional performance option to purchase 225,000 shares of Common Stock with an identical exercise price, all of which vest on the tenth anniversary of the date of grant but with accelerated vesting of certain portions of such option on certain milestone events related to the approval of Vasomax(TM) in Europe and the United States. Mr. Podolski participates in the Company's Incentive Plans on the same general terms as other participants in the Plan, although the amount of shares underlying option grants to Mr. Podolski has historically been larger than for other employees as a result of his position.

The foregoing report is given by the following members of the Committee:

Timothy McInerney, Chairman
Steven Blasnik

The report of the Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933, as amended, or under the Exchange Act, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such Acts.

EXECUTIVE COMPENSATION

EXECUTIVE OFFICERS

Set forth below is certain information concerning the executive officers of the Company, including the business experience of each during the past five years.

| NAME ---- | AGE --- | POSITION ----- |
|-------------------------|------------|---|
| Joseph S. Podolski..... | 54 | President, Chief Executive Officer, and Director |
| Louis Ploth, Jr..... | 47 | Chief Financial Officer, Vice President, Business Development and Secretary |

Information pertaining to Mr. Podolski, who is both a director and an executive officer of the Company, may be found in the section entitled "Directors".

Louis Ploth, Jr. Mr. Ploth has over sixteen years experience in the biotechnology industry. Since January 2001, Mr. Ploth has served as Chief Financial Officer, Vice President, Business Development and Secretary. He served as Vice President, Finance from March 1999 to January 2001. He had previously served as Chief Financial Officer and Vice President, Business Development from 1993 to 1998 and as Chief Financial Officer from 1998 to March 1999. Previously Mr. Ploth was employed by Unisyn Technologies where he served concurrently as Chief Financial Officer and as Vice President of Finance and Administration. Mr. Ploth was also Corporate Controller of Synbiotics Corporation. Mr. Ploth has a B.S. degree from Montclair State College.

COMPENSATION OF EXECUTIVE OFFICERS

Summary Compensation Table

The following table provides certain summary information concerning compensation paid or accrued during the last three years to the Company's President and Chief Executive Officer and to the Company's only officer who had compensation in excess of \$100,000 during the last fiscal year (the "Named Executive Officers"):

| NAME AND PRINCIPAL POSITION ----- | ANNUAL COMPENSATION ----- | | | LONG-TERM COMPENSATION ----- | |
|--------------------------------------|------------------------------|------------|---------------|---------------------------------|-------------------------------|
| | YEAR | SALARY | BONUS | RESTRICTED STOCK AWARDS (\$) | SECURITIES UNDERLYING OPTIONS |
| Joseph S. Podolski..... | 2001 | \$ 235,000 | -- | -- | 25,000 |
| President and Chief Executive | 2000 | \$ 232,500 | \$ 75,000 (2) | -- | - |
| Officer | 1999 | \$ 225,000 | \$ 13,680 (3) | -- | 35,000 |

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| | | | | | |
|--|------|------------|---------------|----|-------|
| Louis Ploth, Jr..... | 2001 | \$ 139,133 | -- | -- | 30,00 |
| Chief Financial Officer, Vice | 2000 | \$ 129,600 | \$ 57,500 (2) | -- | 20,00 |
| President, Business Development and Secretary | 1999 | \$ 121,500 | \$ 28,500 | -- | 30,00 |

- (1) During the periods indicated, perquisites for each individual named in the Summary Compensation Table aggregated less than 10% of the total annual salary and bonus reported for such individual in the Summary Compensation Table. Accordingly, no such amounts are included in the Summary Compensation Table.
- (2) Stay bonus granted on October 18, 1999 and paid during 2000.
- (3) Performance bonus paid in 2000 but earned in 1999.
- (4) Represents car allowance.

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Option Grants in 2001

The following table provides certain information with respect to options granted to the President and Chief Executive Officer and to each of the Named Executive Officers during the fiscal year ended December 31, 2001 under the Company's Incentive Plans:

| NAME | INDIVIDUAL GRANTS | | | | | POTENTIAL ASSUMED PRICE APPRECIATION |
|----------------------|---|--|----------------|-------------------------------|-----------------|--------------------------------------|
| | NUMBER OF SECURITIES UNDERLYING OPTIONS GRANTED (#) | PERCENT OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR | EXERCISE PRICE | MARKET PRICE ON DATE OF GRANT | EXPIRATION DATE | 0% |
| Joseph S. Podolski.. | 25,000 | 18.1% | \$3.15 | \$3.15 | 9/20/2011 | -- |
| Louis Ploth, Jr..... | 20,000 | 14.4% | \$2.72 | \$2.72 | 5/23/2011 | -- |
| Louis Ploth, Jr..... | 10,000 | 7.2% | \$3.15 | \$3.15 | 9/20/2011 | -- |

- (1) The Securities and Exchange Commission (the "SEC") requires disclosure of the potential realizable value or present value of each grant. The disclosure assumes the options will be held for the full ten-year term prior to exercise. Such options may be exercised prior to the end of such ten-year term. The actual value, if any, an executive officer may realize will depend on the excess of the stock price over the exercise price on the date the option is exercised. There can be no assurance that the stock price will appreciate at the rates shown in the table.

Option Exercises and Holdings

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The following table sets forth information concerning option exercises and the value of unexercised options held by the President and Chief Executive Officer and each of the Named Executive Officers of the Company named in the Summary Compensation Table as of the end of the last fiscal year:

AGGREGATED OPTION EXERCISES IN 2001
AND OPTION VALUES AT DECEMBER 31, 2001

| NAME | SHARES ACQUIRED ON EXERCISE (#) | VALUE REALIZED (\$) | NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS HELD AT DECEMBER 31, 2001 | | EX |
|--------------------------|---------------------------------------|------------------------|--|---------------|----|
| | | | EXERCISABLE | UNEXERCISABLE | |
| Joseph S. Podolski | -- | -- | 251,360 | 46,000 | \$ |
| Louis Ploth, Jr. | -- | -- | 97,700 | 54,000 | \$ |

(1) Computed based on the difference between aggregate fair market value and aggregate exercise price. The fair market value of the Company's Common Stock on December 31, 2001 was \$7.00, based on the closing sales price on the Nasdaq Stock Market on December 31, 2001.

EMPLOYMENT AGREEMENTS

The Company has employment agreements with Messrs. Podolski and Ploth which provide for current annual salaries of \$280,000 and \$150,000, respectively. The agreements provide that the Company will pay Messrs. Podolski and Ploth an annual incentive bonus as may be approved by the Board of Directors and that they are entitled to participate in all employee benefit plans sponsored by the Company. Mr. Podolski's employment agreement provides for a renewal term expiring in January 2003, with automatic annual renewals unless terminated by either party. If terminated for reasons other than cause, Mr. Podolski is entitled to receive his annual base salary and certain employment benefits for one year following termination. Mr. Podolski's employment agreement provides that in the event that he terminates

his employment for Good Reason (defined as a change in duties or pay or the like) or is terminated by the Company without Cause, within 12 months of a Change of Control, that he will receive, in lieu of any other severance payments payable to him under such agreement, a lump sum bonus payment of \$666,045, as consideration for past services and services rendered in connection with the change of control. Such payment will be deposited in the Joe Podolski Rabbi Trust, and paid to him in installments over the six years following the event. Mr. Ploth's employment agreement expires in October 2002 with automatic annual renewals unless otherwise terminated by either party. If terminated for reasons other than cause, Mr. Ploth is entitled to salary and certain employment benefits for six months following termination.

Mr. Ploth's agreement provides for the following additional benefits

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for Mr. Ploth if he remains employed by the Company at the date of a change of control:

- o a lump sum cash bonus payable upon the earlier of (i) a change in control (as defined therein) or (ii) the Board's termination of further action to facilitate a change in control;
- o upon a change in control, all outstanding options he holds shall accelerate in full and shall remain exercisable for two years following the change in control;
- o upon a change in control, the Company shall pay him a lump sum cash payment equal to one-half of his then current annual salary; and
- o for a period of six months following a change in control, the Company shall continue to provide his fringe benefits, such as health and dental insurance.

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PERFORMANCE GRAPH

The following performance graph compares the performance of the Company's Common Stock to the Nasdaq Combined Composite Index and to the Nasdaq Index of Pharmaceutical Companies. The graph covers the fiscal years ending December 31, 1996 to December 31, 2001. The graph assumes that the value of the investment in the Company's Common Stock and each index was \$100 at December 31, 1996 and that all dividends were reinvested.

MARKET COMPARISON OF CUMULATIVE RETURN
AMONG ZONAGEN, INC.,
NASDAQ COMBINED MARKET INDEX AND
NASDAQ PHARMACEUTICAL COMPANIES INDEX

| | 12/31/96 | 12/31/97 | 12/31/98 | 12/31/99 | 12/31/00 |
|---------------------------------------|----------|----------|----------|----------|----------|
| Zonagen, Inc. | 100 | 194 | 204 | 47 | 1 |
| Nasdaq Combined Market Index | 100 | 122 | 169 | 315 | 3 |
| Nasdaq Pharmaceutical Companies Index | 100 | 103 | 130 | 247 | 3 |

The foregoing stock price performance comparisons shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act or Exchange Act, except to the extent that the Company specifically incorporates this graph by reference, and shall not otherwise be deemed filed under such Acts.

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SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

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The following table presents certain information regarding the beneficial ownership of the Company's Common Stock as of March 31, 2002 by (i) each person who is known by the Company to own beneficially more than five percent of the outstanding shares of Common Stock, (ii) each director of the Company, (iii) the Company's chief executive officer and each of the other Named Executive Officers and (iv) all directors and executive officers as a group. Except as described below, each of the persons listed in the table has sole voting and investment power with respect to the shares listed.

| NAME OF BENEFICIAL OWNER ----- | AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP OF COMMON STOCK (1) | PERCENT OF CLAS |
|---|---|--------------------|
| Joseph Edelman c/o First New York Securities L.L.C. 850 Third Avenue, 17th Floor New York, New York 10022..... | 905,300 (3) | 8.0% |
| Petrus Fund, L.P. 12377 Merit Dr., Suite 1700 Dallas, Texas 75251..... | 755,793 (4) | 6.6% |
| Lloyd M. Bentsen, III..... | 13,000 (5) | * |
| Steven Blasnik..... | 825,508 (6) | 7.2% |
| Joseph S. Podolski..... | 291,481 (7) | 2.5% |
| Martin P. Sutter | 247,899 (8) | 2.2% |
| Timothy McInerney..... | 213,698 (9) | 1.9% |
| Louis Ploth..... | 108,497 (10) | * |
| All directors and executive officers as a group (6 persons)..... | 1,700,083 (5)-(10) | 14.3 |

* Does not exceed one percent.

- (1) Unless otherwise noted, the Company believes that all persons named in the table have sole voting and investment power with respect to all shares of Common Stock beneficially owned by such persons.
- (2) In accordance with the rules of the Securities and Exchange Commission, each beneficial owner's percentage ownership assumes the exercise or conversion of all options, warrants and other convertible securities held by such person and that are exercisable or convertible within 60 days after March 31, 2002.
- (3) Based on information contained in a Schedule 13G filed on behalf of Mr. Edelman on January 23, 2002 and a Schedule 13G filed on behalf of First New York Securities L.L.C. on April 5, 2002. Pursuant to information contained in both filings, 788,900 of such shares are held by Perceptive Life Sciences Master Fund Ltd., the investment manager of which is Perceptive Advisors LLC, of which Mr. Edelman is managing member.
- (4) Based on information provided to the Company by Petrus Fund, L.P.
- (5) Includes 13,000 shares issuable upon exercise of options.
- (6) Includes (i) 755,793 shares of Common Stock which may be deemed to be beneficially owned by Mr. Blasnik by virtue of his affiliation with Petrus

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Fund, L.P. and (ii) 69,715 shares of Common Stock issuable upon the exercise of options. Mr. Blasnik disclaims beneficial ownership of the shares owned by Petrus Fund, L.P.

- (7) Includes (i) 300 shares of Common Stock which are held by certain of Mr. Podolski's family members and (ii) 224,000 shares of Common Stock issuable upon the exercise of options. Mr. Podolski disclaims beneficial ownership of the shares owned by his family members.
- (8) Includes (i) 115,029 shares of Common Stock which may be deemed to be beneficially owned by Mr. Sutter by virtue of his affiliation with Essex/Woodlands Health Ventures, L.P., (ii) 80,000 shares of Common Stock issuable upon the exercise of options and (iii) 524 shares of Common Stock which are held by certain of Mr. Sutter's family members. Mr. Sutter disclaims beneficial ownership of the shares owned by Essex/Woodlands Health Ventures, L.P. and by his family members.
- (9) Includes (i) 51,194 shares of Common Stock issuable upon the exercise of warrants, (ii) 53,500 shares of Common Stock issuable upon the exercise of options, and (iii) 3,131 shares of Common Stock which are held by certain of Mr. McInerney's family members. Mr. McInerney disclaims beneficial ownership of the shares owned by his family members.
- (10) Includes 103,700 shares of Common Stock issuable upon the exercise of options.

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COMPENSATION AND OPTION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The Compensation and Option Committee currently consists of Messrs. Blasnik and McInerney. During fiscal 2001, no executive officer of the Company served as (i) a member of the compensation committee (or other board committee performing equivalent functions) of another entity, one of whose executive officers served on the Compensation Committee of the Board of Directors, (ii) a director of another entity, one of whose executive officers served on the Compensation Committee of the Board of Directors of the Company or (iii) a member of the compensation committee (or other board committee performing equivalent functions) of another entity, one of whose executive officers served as a director of the Company.

COMPLIANCE WITH SECTION 16(a)

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires the Company's directors and officers, and persons who own more than 10% of the Common Stock, to file initial reports of ownership and reports of changes in ownership (Forms 3, 4, and 5) of Common Stock with the Securities and Exchange Commission (the "SEC"). Officers, directors and greater than 10% stockholders are required by SEC regulation to furnish the Company with copies of all such forms that they file.

To the Company's knowledge, based solely on the Company's review of the copies of such reports received by the Company and on written representations by certain reporting persons that no reports on Form 5 were required, the Company believes that during the fiscal year ended December 31, 2001, all Section 16(a) filing requirements applicable to its officers, directors and 10% stockholders were complied with in a timely manner.

PROPOSALS OF STOCKHOLDERS

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Any proposal of a stockholder intended to be presented at the next annual meeting must be received at the Company's principal executive offices no later than January 17, 2003 if the proposal is to be considered for inclusion in the Company's Proxy Statement relating to such meeting.

FINANCIAL INFORMATION

A COPY OF THE COMPANY'S ANNUAL REPORT ON FORM 10-K, INCLUDING ANY FINANCIAL STATEMENTS AND SCHEDULES AND EXHIBITS THERETO, MAY BE OBTAINED WITHOUT CHARGE BY WRITTEN REQUEST TO SECRETARY, ZONAGEN, INC., 2408 TIMBERLOCH PLACE, SUITE B-4, THE WOODLANDS, TEXAS 77380.

By Order of the Board of Directors

Louis Ploth
Secretary

May 16, 2002
The Woodlands, Texas

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PROXY

ZONAGEN, INC.

PROXY

THE ANNUAL MEETING OF STOCKHOLDERS
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints Joseph S. Podolski and Louis Ploth, Jr. or their designees as proxies to represent the undersigned at the Annual Meeting of Stockholders to be held at the Wyndham Greenspoint Hotel, 12400 Greenspoint Drive, Houston, Texas, June 20, 2002, at 1:00 p.m., Central Daylight Savings Time, and any adjournments thereof, and to vote the shares of stock the undersigned would be entitled to vote if personally present, as indicated below.

The shares of stock represented by this proxy will be voted as directed. If no contrary instruction is given, the shares will be voted FOR the election of the nominees for director.

PLEASE VOTE, SIGN, DATE AND RETURN THIS PROXY CARD PROMPTLY
USING THE ENCLOSED ENVELOPE.

(Continued and to be signed on reverse side.)

1. Election of Directors -
Nominee(s):

For All

01 Martin P. Sutter 02 Joseph S. Podolski 03 Lloyd M. Bentsen III
04 Steven Blasnik 05 Timothy McInerney, R. Ph.

[]

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* INSTRUCTION: To withhold authority to vote for any individual nominee, print that nominee's name.
At their discretion, the proxies are authorized to vote on such other business as may properly come before the meeting.

Dated: _____

Signature, _____

Signature, _____

Please date, sign as name and return promptly. If the Signer is a corporation, please print the names of two or more persons signing as Corporate Officers, Secretary, Treasurer, Administrator, Trustee or other authorized officer and their titles. Please note any change in the address as it appears on the proxy card.