Gopher Drugs

In this lesson, I will use Excel to model future cash flows and make decisions based on net present value (NPV).

Scenario

A large drug company, Gopher Drugs, is deciding whether one of its new drugs, Iguazu, is worth pursuing. Iguazu is in the final stages of development and will be ready to enter the market one year from now. The final cost of development, to be incurred at the beginning of year 1, is $9.3M. The company estimates that the demand for Iguazu will gradually grow and then decline over its useful lifetime of 20 years. Specifically the company expects its gross margins (revenue minus cost) to be $1.2M in year 1, then to increase at an annual rate of 10% through year 8, and finally to decrease at an annual rate of 5% through year 20. Gopher Drugs wants to develop a spreadsheet model of its 20-year cash flows, assuming its cash flows, other than the initial development cost, are incurred at the *end* of the respective years. Using an annual discount rate of 12% for purposes of calculating net present value (NPV), the drug company wants to answer the following questions:

1. Is the drug worth pursuing, or should Gopher Drugs abandon it now and not incur the $9.3M development cost?

Key Insights

1. Yes, It is advisable to pursue the opportunity, given the potential financial gain of $2.55 million.