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THE BIOPHARM-SELTEK NEGOTIATION

Formerly known as Synertech-Dosagen

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Role for BioPharm, CFO

You are the Chief Financial Officer of BioPharm, a U.S.-based pharmaceutical company that has annual sales of $700 million. You need to buy or build a plant in the U.S. to produce a genetically engineered ("biotech") antibiotic compound, Depox. You bought a license from the Belgian company that developed Depox. The Belgian company sold the license because they don't have the plant capacity or other resources to expand the business beyond the European market. The licensing agreement gives you exclusive rights to manufacture and sell Depox in North America.

It makes the most sense to manufacture Depox in the U.S. because this is your biggest market. Depox has great market potential, and it complements BioPharm's existing product line of conventional antibiotics. A special plant is needed because manufacturing genetically engineered compounds requires special water-processing facilities. You cannot modify an existing BioPharm plant because none of these is set up to handle "biotech" manufacturing with its special water processing requirements. You have two choices: you can build a new plant or buy a plant that is already set up to manufacture genetically engineered compounds.

It will cost $25 million to *build* a new plant. It will take 12 months from the time you break ground to the time when the first shipments of Depox will reach the U.S. market. Part of that time is taken up with getting the FDA (the U.S. Food and Drug Administration) to approve the *plant* for pharmaceutical manufacturing and to train a new work force in special biotech manufacturing techniques. The Depox compound has already been approved by the FDA.

Depox is ready for manufacture right now, and you would like to begin production as soon as possible, since time-to-market is a huge competitive advantage. In an ideal world, you would find a "turn-key" plant that you could move into immediately and start operating at the end of this month. Each month you wait for the plant to be ready for production costs BioPharm $1 million in lost profits. These profits cannot be recovered later: a sick patient can't wait for an antibiotic.

Anticipating that you will have to build—rather than buy—a plant, you have located a suitable site in a new industrial park 10 miles from your U.S. headquarters' operations. You need to commit to buying or not buying that site very soon, otherwise you might lose it. You took out a 90-day option to purchase that site for $500,000. Your option expires tomorrow. (It cost you $10,000 for that option and you will lose the $10,000 if you don't purchase the land tomorrow. If you do purchase the land, the $10,000 will be credited toward the purchase price.)

In the meantime, you discovered that Seltek, a smaller pharmaceutical company with annual sales of $150 million, has a suitable U.S. plant for sale. The location is not great—it is 70 miles away from your U.S. headquarters facilities where the research group is located—but Seltek's plant is running and already has FDA approval. It also has a high-quality, experienced work force which could save you the costs and time of hiring and training your own workers. If you were to buy the plant, you very much want to take over operating it as soon as Seltek ceases operations. You don't want them to shut down the

plant and leave it idle for a while, because the workers may take other jobs.

Thus, the Seltek plant seems like an ideal "turnkey" facility. Your plant engineers have assured you that BioPharm could start up Depox production and distribution immediately.

In addition to selling the plant, Seltek wants to sell the patent on Petrochek, the compound it has been manufacturing at the plant. Petrochek is of zero interest to you because it is not a pharmaceutical product and you have no way to distribute it. Petrochek is a genetically engineered bacterium that breaks down oil into water-soluble compounds (and is sold for use in treating oil spills). Your present sales force specializes in pharmaceuticals—selling to doctors, hospitals, HMOs, and drug store chains in the U.S.. The sales force would be useless for selling to the oil industry or to government agencies that deal with water pollution. You would need to set up a new sales force to market Petrochek, but it's not in your strategic interests to do so. You don't have any sales people to spare, and you have no one available who could recruit and manage a new sales force for this product. Thus, buying the patent would be inconsistent with BioPharm's corporate strategy. The Board and CEO have said *no* to buying the Petrochek patent.

You are about to meet with the Chief Financial Officer of Seltek. You have full authority from the Board and CEO to buy the plant at any price you deem acceptable. You have up to $40 million available for investment. To the right is the available information concerning the appraised value of the Seltek plant.

You have learned that Seltek apparently hasn't been paying real estate taxes and owes $200,000. This would have to be paid by one of the parties to remove the tax lien that would hold up transfer of title. The real estate taxes would be the same at either location you are considering.

Seltek Plant

The following information is in the public domain and was made available to BioPharm.

1. The plant (i.e., the building and land) was appraised by a real estate agent two years ago at $20 million. The local real estate market has declined 20 per cent in the last two years due to the state of the local economy.

2. Public accounting information shows that the plant is valued at $12 million on Seltek's accounting statements. The land value is recorded at its original purchase price of $1 million, and the building has been depreciated from an original $20 million down to $11 million, for tax advantages. (The IRS lets a corporation reduce the "book" value of a building every year as if it were "wearing out," like an automobile does with increasing mileage. The resulting theoretical "loss" in value can be deducted from the company's tax bill.)

3. The building is insured against total loss (fire, explosion, hurricane, etc.) for $8 million.

4. An identical plot of land across the street from the Seltek plant just sold for $500,000 after being on the market for three years.

5. There are no environmental liabilities pending, but there is a $200,000 tax lien on the property.