15.997 Practice of Finance: Advanced Corporate Risk Management
Spring 2009

Case Assignment #5: Cephalon

1. As the date of the FDA meeting approaches and the possible need for cash looms, Cephalon faces a number of choices, not just whether or not to buy the options. Look at the decision tree on page 6. How should Cephalon make its choices along this tree? Sketch out the tradeoffs between costs and benefits at each decision point. Identify how to quantify the costs and benefits at each decision point.

2. Does Cephalon have enough cash to the rights from the partnership? What about debt capacity? Equity capacity?

3. How would you quantify Cephalon's cost of raising external funds?

4. Give a concise statement for why the options are useful. What is the problem they resolve? How do they resolve it?

5. Is there a cost of issuing the options? How would you try to estimate it? What would be the difficulties?

6. Why would you expect the cost of issuing the options to be less than the costs of any of the other means for accessing external financing sources?

7. Discuss key dangers in the design of these options. Can you think of alternatives that serve the same purpose, but avoid these dangers?

8. Is the need for "backwards insurance" a common financing problem, or is it unique to Cephalon?

9. Is it true that Cephalon doesn't need any money in the event that the FDA does not approve Myotrophin?

10. Purchasing the options gives Cephalon money in some states and takes money away in other states. Can you explain how this works to Cephalon's benefit? Can you explain why the value of a dollar of cash is greater in the states when Cephalon gets money and less when it pays out money?