**Draft for discussion purposes**

**Viability study: moving to the main campus in Petah Tikvah**

**Examining the option of creating 1,140 workstations**

**Prepared for:**

**Teva Pharmaceutical Industries Ltd.**

|  |  |
| --- | --- |
| **Jerusalem, January 2018**  **Job No. 4027/18** |  |

Table of Contents

[1. Overview and Goals: Statement of Opinion 4](#_Toc504415567)

[2. Methodology and structure of the viability study 5](#_Toc504415568)

[3. Option A: The Current Situation 6](#_Toc504415569)

[4. Projected lease payments and handling fees 7](#_Toc504415570)

[5. Option B: the Teva campus – cost and benefit estimate 8](#_Toc504415571)

[6. Projected Cash Flow for Each Option 11](#_Toc504415572)

[*6.1 Option A: projected cash flow for the current situation 11*](#_Toc504415573)

*6.2*[*.* *Option B: projected cash flow for the move to the campus* 12](#_Toc504415574)

[*6.3 Differential Cash Flow 13*](#_Toc504415575)

[*6.4 Sensitivity Tests 13*](#_Toc504415576)

# Overview and Goals of this Opinion Paper

Teva Pharmaceutical Industries Ltd. (hereinafter referred to as: “**Teva”**) are currently leasing office space and stores in three areas in the city of Petah Tikvah, which it will vacate by December of 2018. The company intends to assess the option of leasing one main structure in Petah Tikvah, which would provide all of the company’s office space.

Three long-term lease options were chosen through a tender proceeding initiated by the company. This viability study used price quotes the company received, as presented to us by the company, though the deal has not been completed.

**The objective of this opinion paper is to assess the viability of moving its current offices, which are distributed throughout Petah Tikvah, to a single and central campus, from the company’s perspective.**

# Methodology and structure of the viability study

To assess the economic viability of moving to a single and central campus, as opposed to the current distribution, a projected cash-flow statement for both options was drawn up.

**Option A** – the current distribution, which entails leasing the two areas, planned for December 2018

**Option B** – moving to a single, central campus in Petah Tikvah, and leasing this space from one developer

In the case of Option B, the benefits of concentrating the office space were taken into consideration, such as the more efficient use of space, savings on management and maintenance fees and more, though drawbacks, such as the added cost of new equipment and furniture the move would entail, were taken into consideration as well.

Economic viability was assessed in terms of the net present value (NPV), or the absolute value of the move expressed in present values.

The basic assumptions employed in the assessment of these two options is the following:

* Date of the move: January 2022.
* Cost of capital: 6.8%
* Assessment period: 15 years.
* USD to ILS exchange rate: 3.4 ILS to 1 USD.

# Option A: The Current Situation

The company gave us their current expenses for leasing offices, warehouse and stores, as well as handling, maintenance and holding costs for the two areas that the company expects to continue leasing in December of 2018: the Bezeq and Kodak complexes, housing a total of 1,426 workstations.

Table 1, below, lists the leasing and handling fees that the company pays for these two complexes at present:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Site | Area (in square meters) | Stores | Annual lease payment (in ILS) | Annual handling fee (in ILS) |
| Basel 5 | 3,371 | 80 | 3,641,600 |  |
| Basel 12 + 16 | 14,201 | 300 | 8,445,277 | 2,286,722 |
| Basel 12 | 2,000 | 22 | 1,301,040 |  |
| Basel 14 |  | 313 | 1,840,644 |  |
| Kodak | 3.120 | 200 | 3,813,884 | 692.261 |
| **Total** | **22.692** | **915** | **19,042,445** | **2,978,986** |

To Orit - in the Excel file you sent me, handling fees are listed as 3,788,026, though the figure in the table is 2,978,986... To Avi Steinman - please ignore this comment

* Total office space leased by the company in the Basel and Kodak complexes: 22,692 square meters.
* Quantity of stores leased by the company: 915.
* Annual lease payment: ~ ILS 19 million. We were told following negotiations with the owners of these properties and the company’s assessment of lease costs, beginning in 2022, the company expects the lease payment to increase by an average of about 18%. Later, the cost will rise by 5% every five years.
* Annual management fees are approximately ILS 3 million.
* **City Tax (“Arnona”)**: at present the company pays city tax of approximately ILS 4 million.

# Projected lease payments and management fees

The following is a list of the lease payment amounts resulting from the tender proceedings that the company conducted:

* Monthly lease payments per square meter of office space, fully furnished: ILS 97.5
* Monthly management fees per square meter of office space: ILS 20
* Monthly lease payment per parking space: ILS 600

# Option B: the Teva campus – cost and benefit estimate

As specified above, there are benefits and savings associated with moving to a single and central campus, though the move also entails extra costs associated with moving from the current office space to this campus.

Moreover, the company estimates that following a transition to the non-assigned workstations model, the total number of workstations will be reduced by 20%. In accordance with the company’s directive, 1,140 workstations were used to calculate the data for Option B.

The following is a set of basic assumptions the company and its professional advisors presented to us, assuming the company would move to a single and central campus:

* **Office space rental**: the cost of leasing the office space, which was reached following the tender proceedings, is fixed for a lease period of 15 years, and includes construction, infrastructure, and finishing costs, which are completely adapted to the company’s needs, in terms of the dimensions of the structure, the infrastructure and the finishing materials.
* **Savings in office space**: the company estimates that moving to a dedicated office building, built to the company’s specifications, will lead to streamlined office planning and the optimal usage of space, resulting in a savings of 15% in terms of the leased space. This assumption addresses all the space the company will lease in the future, under the option of a single and central campus.
* **Rental fees for parking spots**: the company assumes that the monthly cost of leasing each parking spot will be about ILS 600.
* **Management fees for offices**: the company estimates that the monthly management fees per square meter of office space will be ILS 20.
* **City Tax** - the forecasted city tax costs for the new campus are based on an annual city tax rate for office space of ILS 180.73 per square meter, and ILS 27.74 per square meter of parking space.
* **Savings, remodeling and adjustments:** in light of the fact that the structures the company presently uses were not originally earmarked as office space, the company estimates that the cost of remodeling and adjustments is high compared to structures originally meant to be used as office space. Teva has a modular specification, according to which changes can be implemented viably and efficiently through a particular module, such that the future costs of remodeling and adjustments in the new structure when planned in accordance with this specification will be lower. The percentage of space allocated to workstations in the new building is planned to be 90%, versus 30% usage of space for workstations in the present structures. The company estimates that once it moves to a dedicated office building, it will save about 40% of the annual remodeling costs. The company also estimates that in the first 5 years of the lease period for the new buildings, it will not need to invest in any adjustments or remodeling, since they are optimally adapted to the company’s needs. Furthermore, the developer who will build these offices is responsible for making any repairs to the premises during this period.
* **A reduction in maintenance costs at Basel 5**: the company leases approximately 3,371 square meters at the property located at Basel 5. The company performs maintenance activities at this property, rather than paying management fees to another entity. Since we have taken into account the handling fees for all office space at the new complex, we must offset the expected cost of management fees included in the maintenance costs specified above. We estimated the costs of management fees included in maintenance costs as follows: the total office space at Basel 5 is 3,371 square meters, and if we assume monthly handling fees of ILS 20, the total annual cost is about ILS 809,000. This cost is deducted from the projected carrying costs.
* **Carrying costs**: The company estimates that it will save in carrying costs, due to the benefit of concentrating office space at one site, and in light of the fact that the structure is much newer. According to the company’s estimates, the resulting annual savings are about 30%.
* **Electricity**: The company estimates an annual savings of about 30% in annual electricity costs, because it will move to using new equipment, particularly air conditioning equipment. Today, most of its equipment is dated and wasteful.
* **Security**: The company estimates an annual savings of about 47%, since by concentrating its office space, it will require less security personnel, thanks to, inter alia, to the reduced quantity of entrances and exits.
* **Staff**: The company estimates an annual savings of about 30%, due to the concentration of its facilities, the concentration of manpower in one place, and the fact that the structure and its systems are newer.
* **Gardening**: The company estimates an annual savings of about 25%.
* **Shipping, taxi service, mail and package delivery**: Once the company’s operations are concentrated at one campus, these costs will be reduced.
* **Printers**: The company rents printers distributed throughout its offices. The company estimates that the streamlined planning of office space resulting from a move to a single campus will lead to savings of about 8% in these costs.
* **Water**: The company estimates an annual savings of about 10%, in light of the fact that the new systems will be more economical.
* **One-time costs associated with the move**: according to estimates given to us by the company, a capital budget of about ILS 20 million will be required for the move. This cost represents investments in furniture, computer equipment, the security system and more.

# Projected Cash Flow for Each Option

We created a cash flow for each option, based on the basic assumptions listed above. The following are the project cash flows for each option, as well as the annual differential cash flow when comparing these options, which will be used to deduce the economic viability of moving to a single and central campus.

## Option A: projected cash flow for the current situation

The following is the projected cash flow for the current situation (in thousands of ILS):

## Option B: projected cash flow for the move to the campus

The following is the projected cash flow for moving to the new campus (in thousands of ILS):

## Differential Cash Flow

We created a differential cash flow that assesses savings or additional costs when comparing the current situation to concentrating the offices at the campus.

The following is the differential cash flow:

This data demonstrates that, pursuant to the basic assumptions listed in this statement of opinion, after the first year of operations, in which investments will be made in the move to the new structure, the estimated average annual savings will be about ILS 12.3 million.

**When capitalizing the permanent differential cash flow at a capital cost of 6.8% (the capital cost provided to us by the company), we can see that the current amount is ILS 44.6 million. This means that by moving to the concentrated campus, the company will save a total of about ILS 44.6 million of the value.**

## Sensitivity Tests

The following are a number of sensitivity tests for main parameters: