CITY COUNCIL COMMUNICATION:

98-372

AGENDA:
AUGUST 24, 1998

SUBJECT:
DIAMOND ANIMAL HEALTH SUBORDINATION AGREEMENT WITH NORWEST BUSINESS CREDIT, INC.

TYPE:
RESOLUTION
ORDINANCE
RECEIVE/FILE

SUBMITTED BY:
RICHARD CLARK
DEPUTY CITY MANAGER

ITEM ____

OFFICE OF THE CITY MANAGER
CITY OF DES MOINES, IOWA

SYNOPSIS –

In February, 1994, the City Council approved a $200,000 loan for Diamond Animal Health, 2538 SE 43rd Street. This loan is secured by a lien on business assets and a Corporate Guaranty.

The Company and Norwest Business Credit have negotiated a $6,650,000 financing arrangement to fund facility improvements, equipment and working capital. This financing will help the company expand its contract manufacturing and its customer base. Norwest Business Credit wishes to secure its loans with a first lien on all business assets.

The City is being asked to subordinate its interest in business assets to this new financing. The State of Iowa, which has also provided funding to the Company, will also subordinate its lien position.

The Company has performed under the terms of the loan agreement. It has made its loan payments as agreed and is current on the outstanding City loan. The loan balance is presently approximately $124,000. In addition, it pledged to increase the plant workforce from 85 to at least 108 people, and present employment is approximately 140 employees.

Mike Ryan is the contact person.

FISCAL IMPACT –

No additional funding is requested. In addition to our lien on business assets, the City loan is also secured by a guarantee from Heska Corporation. Diamond Animal Health is a wholly-owned subsidiary of Heska Corporation.

RECOMMENDATION –

Authorize execution of the subordination agreement.

BACKGROUND –

Diamond Animal Health was created in December, 1993, when the management team of Diamond Scientific, a wholly-owned subsidiary of Miles, Inc. (now Bayer Animal Health), acquired the company from Miles in a management buy-out financed by $250,000 of equity investments from members of the management team; $2,350,000 of senior mortgage notes; $150,000 of subordinated notes; and $450,000 of State and municipal grants and low interest loans. In the buy-out, management negotiated a three-year contract to manufacture Miles' cattle and pig vaccines; acquired ownership to the cattle vaccine line; acquired or leased all physical assets of the business, including both a USDA and FDA licensed manufacturing facility and a 180-acre research farm.

In 1996, the company was purchased by Heska Corporation which is primarily a research and development company for companion animal products.

Diamond serves a manufacturing, warehousing and distribution role for its parent company.

Diamond management has followed a three-staged strategy:

1. Reorganize manufacturing operations to improve profitability;

2. Expand the contract manufacturing business to achieve a stable revenue and profit base; and

3. Differentiate the proprietary bovine biological product line to provide future growth and value.

Diamond negotiated a three-year "take or pay" contract to manufacture all of Miles (now Bayer) Animal Health's cattle and pig vaccines, initially representing 90 percent of Diamond's business. Since then, the Bayer contract has been renegotiated and extended by two and one-half years, through June, 1999. Additionally, new customers have been added, increasing Diamond's sales to customers other than Bayer. Goals for this business include further increase of the customer base to reduce dependence on a single customer, stabilization of revenues with steady future growth, and long-term reliance on this and the Heska contract business as a firm base of support for corporate growth.

As the company grows, its need for capital grows with it. In the 1997-1999 the company has made or projects capital expenditures for facility improvements and equipment of $10.6 million dollars. These expenditures have already provided a new tableting and powder facility as well as new customers and revenue. The company will also add an anti-bacterial handsoap to its contract manufacturing. Heska cat vaccines and other animal health care products are manufactured or distributed through the Diamond facility. These expansions are leading to revenue increases. As indicated, the company has grown from 85 employees to 140 employees since 1994.

This financing should be sufficient to fund this near-term expansion. The controller for Diamond does not foresee the company requesting public funding for this proposed expansion. The subordination by the City is necessary for this financing to occur and will continue the City support for the company.