



SAVING TEVA

Why the pharmaceutical giant
needs to be bailed out



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ISRAEL'S FLAGSHIP global giant, Teva Pharmaceuticals, is in deep trouble.

From January 2016 to June 2017, Teva's share price was cut in half. Then, in a few disastrous days in August, it was halved again.

The latest collapse was in part the result of a misguided \$40 billion acquisition that left Teva with massive debt and the patent expiration of Copaxone, a drug for treating multiple sclerosis that, at its peak, brought Teva \$4 billion in annual revenue and half of the company's total profit.

On October 3 Mylan, a global American pharma company, announced it had received US Food & Drug Administration ap-

proval for the generic version of Copaxone, giving Mylan sweet revenge on Teva, which earlier had tried and failed to acquire it.

The August stock-price collapse came in the wake of Teva's earnings report, which included a goodwill impairment charge (a euphemism for "We bought a Cadillac but it turned out to be an Edsel") of \$6.1b.

Should the government step in to bail out Teva? I spoke with a number of experts to learn why Teva is important for Israel and whether it merits a bailout. Among them: Gilead Fortuna, former senior vice president of Teva; Yuval Neev, a former Teva chief economist who co-authored (with Fortuna) a **Neaman Institute** study of Teva's importance to Israel's economy; Giora Shalgi, former CEO of Rafael Advanced Defense Systems; and Eitan Adres, a former steel industry CEO and now a **Neaman Institute** research fellow.

As academic director of TIM (Technion Institute of Management), I worked off and on with Teva managers on leadership development for nearly a decade from 2000 to 2009. I came to know and admire the company, its talented leaders and workers, and its vision.

How did Teva get into such deep trouble? The reasons are rooted in its long and storied history, its Israeli culture and the deplorable managerial decisions taken by senior management and the board of directors since 2007.

History: Teva is much older than Israel, dating back to 1901 and a drug distributor named Salomon, Levin and Elstein, which delivered medicine by camel. In the 1930s, European immigrants founded three new pharmaceutical companies – Teva, Assia and Zori, which merged to become Teva in 1976. Its CEO was the late Eli Hurvitz, who served as CEO and chairman for 26 years, and remained chairman until his death in 2011.

Hurvitz had a clear vision for Teva: We are an Israeli company that loves low profit margin generic drugs while most other pharma firms hate them, and we excel in making and selling them globally. Teva became expert at the alacritous production and sale of generic versions of drugs the moment their patents expired, a skill driven

by Israeli creativity and ambition.

Neev told me that "in fact, it was Eli Hurvitz's vision to make Teva a leading global generic pharmaceutical company and he was the one who was responsible for the big acquisitions during the 1990s in North America and Europe. In those days, these acquisitions, worth hundreds of millions of dollars, were considered as fantastic amounts in the Israeli culture of this period. Therefore, he should be considered the one who led Teva's globalization."

Hurvitz hired Israel Makov as CEO, who served from 2002 to 2007. Makov initiated clever strategic acquisitions along with a world-class system for quickly integrating acquired companies into Teva's ecosystem. He left in a dispute with Hurvitz, and that was when the trouble began.

There followed a series of three CEOs – Gen. (ret.) Shlomo Yanai, Jeremy Levin and Erez Vigodman – each of whom made major mistakes. Teva's efforts to extend its Copaxone patent for three years failed in the courts. And after failing to acquire generics giant Mylan (see "Teva vs. Mylan," July 27, 2015), Teva bought a consolation prize – Actavis Generics – for an inflated \$40.5b., 85% in cash, taking on huge debt as a result. Soon after, US President Donald Trump's August 14 tweet about "rip-off drug prices" led to a flight of capital out of generic drug companies.

Why Israel needs Teva: A 2014 **Neaman Institute** study by Fortuna, Neev and Dr. Daniel Friman noted that "on top of employing nearly 7,000 people in Israel, Teva does business with a network of smaller Israeli companies, funds much of the nation's academic research and serves as a spawning place for managers, who go on to run other successful businesses."

They note that Teva's "employment multiplier" is more than five (i.e. one Teva job generates five others). Teva accounts for about 10% of all Israeli industry's contribution to the economy, and, in Israel, where manufacturing is rarely world-class, Teva's Kfar Saba and Har Hotzvim plants are among the best in the world. Teva shares impact the Tel Aviv Stock Exchange heavily and are an important part of pension funds' portfolios.

The Jerusalem headquarters of Teva Pharmaceutical Industries, one of the largest generic drug companies in the world



Bailout debate – Yes vs. No: Neev raises tough questions. He asks, “Is the [political] leadership and civil service in Israel more talented than Teva’s current management? I doubt it!”

He asserts that “the solution is, first of all, to make Teva smaller and more focused on activities that generate a reasonable return on capital over time – activities that stress Teva’s Israeli culture. I do think that Teva’s comparative advantage is in its Israeli spirit, and mainly its built-in relationship with the wonderful basic research in Israel’s academic institutes.” Six Israelis have won Nobel Prizes in chemistry.

Neev notes a key Teva mistake. “By acquiring Cephalon for \$6.5b. [in 2011], not only did Teva fail to find a successor drug for Copaxone, but it led to destroying Teva’s own R&D and Teva’s links with Israel’s academic research.” Copaxone, a cash cow for two decades, arose from a discovery of a co-polymer at the Weizmann Institute by Ruth Arnon, Michael Sela and Dvora Teitelbaum. Teva’s anti-Parkinson’s drug Azilect (rasagiline) emerged from research by Technion Prof. Moussa Youdim.

On the other hand, Fortuna observes that “Teva needs to give up some of its current businesses in order to service its newly bloated debt related to the recent acquisitions. Management must do this diversification with caution in order to keep future growth opportunities in house.”

Adres believes Teva has already received enormous tax benefits from Israel’s treasury. “Management of Teva, the ‘pearl in the crown’ of the Israeli economy, irresponsibly took advantage of generous governmental incentives and tax benefits by maintaining short-sighted, lucrative risky strategies that served the inner circle, lacking accountability to stakeholders and their interests.”

The Israel Tax Authority says Teva got 11.8b. shekels in tax savings from 2006 to 2011 under a government program to encourage capital investment – more than any other company.

“Nonetheless,” Adres adds, “the effect on the Israeli society and economy of the unfortunate collapse of Teva deserves cautious governmental behavior. Any bailout act should take careful measures to ensure future taxpayer investment.”

Shalgi asserts that “Teva is really the only

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large global company Israel has created. If it fails, it will be clear Israel is good at start-ups but lacks the maturity to grow sustainable industry.

“I believe the government must help Teva, just as all normal nations do when a key industry faces existential threats, for example the US auto industry under Obama,” he adds.

General Motors bailout: What can we learn from other bailouts, like that of the American auto industry after the 2008 financial crisis? GM and Chrysler faced bankruptcy after the 2008 financial collapse and ensuing crash in car sales, as vehicle sales fell by nearly half. Ford, too, was in trouble.

The Big Three auto firms asked Congress for a bailout loan in November 2008, and the US Treasury invested \$80.7b. in GM and Chrysler as both loans and stock purchases. Essentially, the government nationalized the two ailing firms and ran them.

The bailout was highly successful. GM emerged from Chapter 11 bankruptcy and Chrysler was wholly acquired by Fiat. US vehicle sales, at \$18 million yearly, are now at record levels. The US Treasury sold the last of its shares in GM in December 2014 at a profit. Overall, the government recouped all but \$10b. of its \$80b. investment. Many thousands of jobs – arguably, the entire American auto industry – were saved.

Clearly, it is up to Teva to strategize and implement a strong recovery plan well before any bailout is implemented. Teva needs a revitalized board of directors and a senior management team that avoids unreasonable risks of the kind that have sunk it in the past. Teva’s new CEO is a good start.

A new CEO: Teva has hired a talented new Danish CEO named Kare Schultz. Unlike several previous CEOs, such as Yanai and

Vigodman, he has deep pharma experience and knowledge. Schultz, 56, was CEO of Lundbeck, a Danish pharma company, and led a successful turnaround there, slashing jobs and cutting costs. Teva knows Lundbeck well; Teva partnered with it to market its Azilect drug.

Teva has deep fundamental strengths, underlying its short-term crisis. It has more than 300 new products awaiting regulatory approval in its developed-country markets and over 600 awaiting approval in emerging markets. Teva has announced plans to close 15 plants globally and slash its workforce, now more than 40,000, by nearly 20% to reduce costs by \$1.5b.

Hebrew University precedent: There is an Israeli precedent for a Teva bailout. On October 15, the Finance Ministry announced it would pay some 700m. shekels (\$200m.) in the coming decade to the Hebrew University of Jerusalem to help cover part of its huge pension debts. From 1982 to 2000, the university paid its pensioners generous defined benefit pensions based on the employee’s earnings history, tenure of service and age. As a result, pension payments ballooned to 22% of the university’s budget, or 635m. shekels, in 2015. The actuarial liability of those pensions exceeds 13b. shekels. In 2000, the Hebrew University switched to a defined contribution system in which pensioners draw only what they have saved and earned in pension funds.

Many believe that this heavy financial drain was one reason the Hebrew University has dropped out of the world’s top 100 universities rankings from 53rd just five years ago. Budget deficits led to cutbacks in equipment, labs, research and new faculty.

I believe the use of public funds to bail out the Hebrew University is justified. Israel makes much of its living from the brainpower its universities generate.

If so, bailing out Teva is even more justified. The Hebrew University produces the brains; Teva uses them to create jobs, income, exports and wealth for investors and pension funds.

Let’s help Teva save itself. The alternative is nearly unthinkable. ■

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