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In search of a cure

Erez Vigodman, the new CEO of Teva, Israel's premier global company, has to work fast to pull the conglomerate out of crisis



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"WHAT CAN, and perhaps will, go wrong? What causes you to lose sleep at night? What is your worst nightmare? Suppose it has already come true; what action did you take?"

These are questions that Yoram Yahav, former CEO of the Technion Institute of Management, together with me and our TIM team, constantly fired at senior managers of startups and established global hi-tech firms with whom we worked. Yahav currently heads the Yoyah Group, a global strategic consulting group. TIM closed in 2009 after over a decade of activity.

One of TIM's objectives was to help Israel's global business leaders grapple with future uncertainties and face them head on. Our largest client was Teva Pharmaceuticals Ltd., Israel's flagship global firm. Yahav recalls presenting the late Teva CEO and chairman, Eli Hurvitz, years ago with this gloomy crisis scenario: "Sales of Copaxone, Teva's blockbuster multiple sclerosis [MS] drug, drop to a record low."

Yahav recounts that even the legendary-Hurvitz, who was "an inspiring leader," said he could not relate to a scary scenario of that magnitude. Hurvitz died in 2011.

Today, Teva finds itself in deep trouble. Copaxone, administered daily by injection, has a leading 28 percent share of the market for MS drugs. But its patents are expiring, and two low-cost, competing, generic equivalents may be marketed as soon as this May, one of them by arch-rival Novartis.

Teva does not yet have a viable replacement for Copaxone in its arsenal. And Teva's plan to launch six new drugs in 2014 was struck a blow when the European drug regulator denied Teva permission to market Nervenra, its new oral MS drug, developed in partnership with the Swedish firm, Active Biotech, because "the risk-benefit profile was not favorable" (translation: not enough impact on patients).

Meanwhile Teva's US competitor, Biogen, markets an MS drug called Tecfidera, administered orally, that is gaining ground.

As a result, Teva's stock, which is listed both in New York and in Tel Aviv, and which rose from \$5 in 1999 to a peak of \$65 in early 2010, has fallen sharply. In the past year, it has fluctuated between \$36.26 to \$45.98.

So, Teva is in crisis; and this is a matter of deep concern for Israel – because with its \$20 billion in revenues and 46,000 employees in 60 countries, Teva is Israel's eyes and ears on the world and its premier global company.

There are 519 companies that trade on the Tel Aviv Stock Exchange. Their shares' mar-



NORMAN ZAVALON / REUTERS

TEVA'S CORE PROBLEM IS THAT IT IS BASICALLY A GENERICS COMPANY; BUT 60 PERCENT OF ITS PROFITS ORIGINATE WITH ITS PATENTED DRUG, COPAXONE

ket value totals \$180 billion; but Teva shares alone make up nearly a quarter of that, with a market cap of \$42 billion. Teva stock comprises nearly 10 percent of the Tel Aviv Stock Exchange's 100 Index.

Part of the crisis concerns leadership. After 26 years of steady direction under Hurvitz, from 1976 to 2002, Teva has now appointed its third CEO in five years. The previous CEO, Jeremy Levin, a highly respected former Bristol-Myers executive, lasted only 17 months; he was asked to resign by the board of directors on October 30. Also last October, Teva announced it was laying off 5,000 workers, or about 10 percent of its workforce – the company's first major layoff since it was founded in 1901.

There are even rumors that Teva, which has acquired many drug firms, some of them huge, may itself be a target for acquisition by the Canadian firm, Valeant, which has swallowed 34 firms in the past four years.

This rumor is spurious; Valeant has one-fifth Teva's revenues and one-third its employees. But just three or four years ago, such a rumor was unthinkable. And spurious or not, it might be prudent for Teva to implement a "poison pill" (a defensive plan to forestall acquisition).

Why has the once stable Teva leadership become so turbulent?

Teva in some ways tried to emulate the global, Swiss-based food giant Nestlé. Nestlé seeks management talent worldwide and promotes it to senior positions. Long run by Israelis, Teva in recent years appointed a South African (Levin) and an American (Phillip Frost, who is board chairman) to its top jobs. But Israel is not Switzerland, and Petah Tikva is not Vevey.

A close look at Teva's financial data does not reveal a deep crisis. The company's revenues nearly doubled between 2008 and 2012, from \$11.1 billion to \$20.3 billion. Net profits in 2012 were a hefty \$2 billion. But for 2013, revenues were unchanged, while net profits fell by a third. For the second straight year, the cost of legal settlements and restructuring (i.e. lost law suits for patent infringements and failed acquisitions) equaled or exceeded \$2 billion. Despite falling profits, Teva maintained its R&D spending at a respectable 7 percent of revenue.

The capital markets are bashing Teva's shares largely because nothing Teva has on the horizon can replace Copaxone. And lurking in the background is Teva's \$12.2 billion in total net debt, accumulated partly when Teva made some bad acquisitions, including the US biopharmaceutical firm Cephalon in 2011 for \$6.8 billion.

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Like many listed public companies, Teva suffers from the myopic tyranny of the capital markets. I recently spoke with a senior Israeli manager who heads a division of a big global firm, and she recounted how the focus of Wall St. analysts on short-term quarterly financial reports distorts investment and decision-making, and discourages innovation and long-run strategic planning. "What have you done for me lately [this moment]?" was the analysts' theme, she said.

Teva's largest stakeholders are the Capital Group, an American investment and mutual fund giant, Wellington Management (one of the world's largest private investment firms, with nearly \$800 billion in assets), and Vanguard (the world's largest mutual fund company). They demand strong returns for their investors and are impatient when Teva's stock stagnates.

TEVA'S RECENT troubles began when Israel Makov was replaced as Teva CEO in 2007, in a dispute with Hurvitz. During Makov's five-year tenure, Teva became truly global. We at TIM worked with Makov during this period. He identified Teva's real weakness – not a lack of money, or products, but a shortage of senior management capacity, the ability to manage a sprawling global enterprise in a fiercely competitive industry. Under Makov, Teva became expert at acquiring smaller firms and integrating them speedily into Teva's operations.

His successor was Shlomo Yanai, who was replaced by Levin in May 2012. Levin, in turn, has been replaced by Erez Vigodman, formerly CEO of Strauss and Makhteshim Agan (acquired by ChemChina in 2011), and

an expert in healing troubled companies.

Teva's core problem lies in the fact that its historical DNA is that of a generics company, making low-priced drugs whose patents have expired. Though half of Teva's revenues come from generic drugs, 60 percent of its profits originate with its patented drug, Copaxone. Hurvitz, who died in 2011, spotted an opportunity in 1984, when the US Congress passed the Hatch-Waxman Act that encouraged the sale of generic drugs. From then on, Hurvitz focused Teva with laser sharpness on quickly developing low-cost generic versions of drugs whose patents were about to run out.

Copaxone was almost an accident. Weizmann Institute scientist Prof. Ruth Arnon, together with colleagues Michael Sela and Dvora Teitelbaum, synthesized molecules, known as copolymers, that they thought might initiate multiple sclerosis in animals, for research purposes. Instead, surprisingly, the molecules blocked MS in mice. Teva decided to take a risk and bring the drug to market. But it seemed an impossible task.

To gain US Food & Drug Administration approval for the drug, it had to pass three stages of clinical trials. Just to reach these trials, a formulation has to have a precise chemical composition, identical in every batch. How could this be done for a drug that is a complex mixture?

The task was given to Dr. Irit Pinchasi, a young neuro-biochemist, and she and her team managed to win FDA approval for Copaxone in 1996, against all odds. Pinchasi has since retired from Teva. She told me and my Technion students how she brought her children to New York for the FDA announce-

(Above) Former Teva CEO Eli Hurvitz at the company's distribution center in Shoham; (center) New Teva CEO Erez Vigodman; (left) A conveyor belt at the company's Jerusalem plant; (preceding pages) A technician at work in a Teva lab in Jerusalem

ment, after they had supported her hard work and long hours for a dozen years, working on developing Copaxone and piloting it through complex clinical trials.

And what does the future hold? Well, I am optimistic about Teva's long-term prospects – for several reasons.

While Teva lacks a new blockbuster drug like Copaxone, it has a broad range of innovative drugs, which it developed, that treat many illnesses, especially those that afflict the elderly, including Azilect, a Parkinson's drug. It has new leadership, under Vigodman, who has twice performed near magical turnarounds for companies in trouble. And most of all, Teva has outstanding human capital.

Some years ago, I had the privilege of working with Teva's South American businesses. I was impressed to see how Teva acquired companies in Peru, Chile, Argentina, Mexico and Brazil, and welded them into profitable, creative, motivated business units. Teva's global cadre of middle managers is a valuable strategic asset, one that will drive Teva's strategic rebound.

Teva must change. Its Chairman, Phillip Frost, announced last month Teva's plan to slim its board of directors down, from 15 to

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Entrance to Teva's Har Hotzvim plant in Jerusalem

12, and appoint new directors with global capabilities. It should appoint Benny Landa to the board; he now holds a significant block of Teva stock. A successful entrepreneur, Landa, 66, founded Indigo Digital Printing in 1977 and sold it to HP for \$830 million in 2002. Last year, he led a shareholder rebellion that sought to revamp Teva's board.

New CEO Vigodman must work fast. He must help Teva do better at managing its split personality, which wavers between low-cost generic drugs and high-margin innovative drugs. Vigodman knows Teva well; he has been a Teva board member for years. And he faces several urgent challenges.

First, he needs to slash Teva's costs; its Kfar Saba plant, once the most cost-efficient, paid some workers a 27 percent wage hike last summer and is now less competitive. "One of Teva's major challenges is to cut its cost base," consultant Yahav notes.

Second, he needs to restore morale among Teva managers and restore stability and a sense of direction.

Third, he needs to link Teva more closely with Israel's world-class academic biochemists. In his new book, "The Antidote: Inside the World of New Pharma," author Barry Werth explains how Big Pharma, including Teva, is switching from trial-and-error drug discovery (test thousands of compounds and hope for one that does good) to biotech (find a bad protein turned on by a gene, then build a good protein that shuts it down)—and why the

transition is proving very difficult.

Fourth, Vigodman needs to manage Teva's split personality and make the wolf of cost-cutting generics lie down with the lamb of innovative drugs, within one company. It takes more than a billion dollars today to develop a successful drug; even for Teva such investments are almost bet-the-company risks.

AND FINALLY, he needs to redesign Teva's board, bring in far more business expertise, and restore Teva's Israeli roots, while preserving its global energy and vision.

"No one is better suited to be head of Teva than Erez Vigodman," Yahav says. "I have worked with Erez in several of his previous companies and have watched his management style, his wisdom and his courage. The man is a visionary, a good listener, and if anyone can do it [turn around Teva], he can."

And in a letter to Teva shareholders, Landa wrote, "Erez Vigodman is made of the right stuff to succeed. He is a strategic thinker with excellent managerial skills. He is a straight shooter who [Wall] Street will learn to trust."

Teva's profit-and-loss statement reveals that while it earns large profits, it pays virtually no corporate tax to Israel. According to The Marker, Teva received around NIS 2.2 billion in tax breaks in 2010 (the latest year for which data exist), double that of Intel Israel. The justification for this is Teva's investment in plants and employment in Israel. Teva has

large plants in Kfar Saba, Jerusalem Ashdod and Kiryat Shmona. All over the world, global companies win tax breaks from governments, threatening to relocate facilities if they are turned down. Apple, like Teva, pays little corporate tax to its home country.

Teva is like a tough Klondike gold miner who struck a vein of gold (Copaxone), then saw it peter out and couldn't find a new one. Without its gold mine, Teva will try to prosper by refocusing on the equivalent of iron ore (generics), a much tougher task. This was Hurvitz's original vision. Other companies hate low-margin generics, he once observed; we at Teva love it, and that's the difference.

Vigodman will also have to renew Teva's romance with the capital market analysts. He will walk a fine line, boosting R&D spending to foster innovation but without destroying profitability, cutting costs without impairing innovation, and attaining short-term goals while maintaining long-run strategic focus.

"Like many Israelis, I have much pride in what Teva was able to achieve," Yahav says. "Like many, I am intrigued by its future."

I am, too. Teva is not just another Israeli company. It is the frontline of Israel's global competitiveness effort. Teva will bounce back, simply because like Israel, its workers and managers are resilient, tough, creative and stubbornly persistent. ■

The writer is Senior Research Fellow, at the S. Neeman Institute, Technion