CASE STUDY

# Going for growth: Teva's global strategy

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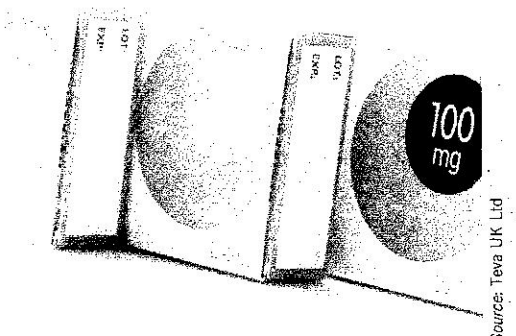
*This case explores the growth strategies of Teva, an Israel-based pharmaceutical company and the world's largest 'generic' producer. Under the direction of Shlomo Yanai, Teva followed an aggressive growth programme. The company became a more diversified pharmaceutical company with markets all over the world using acquisitions and strategic partnerships. Investors, however, became uneasy about the lack of improvement in profitability, and at the end of 2011, Shlomo Yanai retired. In 2012 Teva appointed Jeremy Levin in the hope that he would be able to increase profitability by moving Teva towards mainstream pharmaceuticals.*

In December 2011 Teva Pharmaceutical Industries ('Teva') announced the resignation of Shlomo Yanai, the 59-year-old President and CEO. He was to be replaced in June 2012 by the first non-Israeli in the role, the 58-year-old Jeremy Levin. Phillip Frost, Chairman of Teva, said: 'Jeremy is a highly regarded manager, but we are sad that Shlomo is leaving us, after doing great work. [Teva] has expanded and achieved growth in all financial parameters.' He added that if Mr Yanai 'chooses public service, the Israeli people will benefit'.[1]

At an investor call following publication of the annual results in February 2012, Shlomo Yanai declared: 'Our strategy is focused on growth and creating a highly diversified business, and on reducing our dependence on any one particular market or product. During the year, we took major steps towards reaching our strategic goals.'[2]

Investors may, however, have taken a different view, after Teva failed to achieve its planned EPS for 2011, and declared that it was unlikely to meet its target of $35 billion (£23bn; €27.3bn)[3] turnover by 2015. After peaking in 2010, the share price had plummeted (see Figure 1).

Teva built its success on manufacturing 'generic' drugs. These are identical copies of branded medicines that can be launched when the patent on the branded drug expires, typically at far lower prices. Ironically, despite being the world's largest generic drug manufacturer, the two most important contributors to Teva's turnover and profit were Copaxone, a widely used patented treatment for multiple sclerosis, and Provigil, a proprietary treatment for sleep disorders. These brands were themselves threatened with generic competition in 2013 and 2012 respectively.

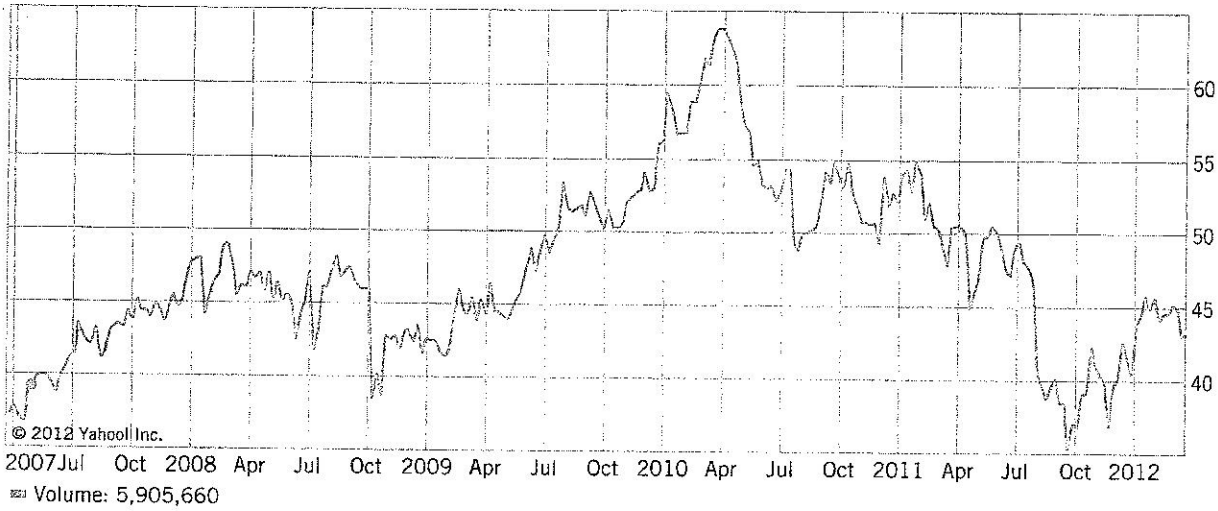



*Source:* Teva UK Ltd

## Teva in a nutshell

- World's number one generic company
- World's 15th-largest pharmaceutical company
- Sales of $18 billion in 2011
- Product portfolio of over 1400 molecules
- Active in 120 countries
- Over 40,000 employees.

Figure 1 **Teva's share price**




*Source*: Yahoo Finance

## Strategy

For the previous five years, under the leadership of Teva's President and CEO Shlomo Yanai, a former Israeli Army general with no previous pharmaceutical experience, the company had followed an aggressive policy of expansion and diversification. The company grew from an $8.4 billion business mainly focused on generics in 2006, to a more diversified pharmaceutical company reporting revenues of approximately $18 billion in 2011, with an expanded footprint in Europe, Asia and Latin America.

At the start of Mr Yanai's tenure, Teva's strategy was to acquire competitors in key markets to become, or to consolidate, a position as the dominant generic drug producer. However, by 2011, Teva was pursuing a diversification strategy, signalled by the purchase of Cephalon, a US-based research pharmaceutical company, and the announcement of a joint venture with the consumer health conglomerate Procter & Gamble to produce and promote over-the-counter (OTC) medicines.

## Acquiring generic competitors in the USA, Europe and Japan

Generics win market share on price. Given the small margins, companies need to focus on economies of scale and ensure that they have a robust and cost-effective manufacturing capacity. The purchases of Barr in the USA, Ratiopharm in Europe, and Taisho and Taiyo in Japan, were all driven by these goals.

Teva purchased US-based Barr in 2008, at the time the fourth-largest generics company globally. On completion of the takeover Yanai commented:

> 'Acquisition of Barr will elevate Teva's market leadership to a new level . . . it will enhance our market share and leadership position in the U.S. and key global markets, further strengthen our portfolio and pipeline, and provide upside to our strategic plan, by allowing us to exceed our 20/20 goals for 2012.'[4]

Barr was acquired for a total consideration of $7.46 billion, plus the assumption of net debt of approximately $1.5 billion. Teva anticipated the transaction would generate at least $300 million in annual cost savings within three years and would continue to provide additional cost savings well beyond 2011. By April 2012 Denise Bradley, Vice President, Corporate Communications, Teva Pharmaceuticals-Americas, was able to tell JointMedia-News that: 'Today, one in seven prescriptions filled in the US are filled with a Teva drug.'

In 2010 Teva purchased ratiopharm, a German-based generic manufacturer with extensive reach in the EU and Eastern Europe. The price was approximately $4.95 billion and Yanai said:

> 'This is an exciting day for Teva and ratiopharm, with the acquisition of ratiopharm we will become the leader in key European markets and we are well-positioned to become the leader in many other European markets in the near future.'[5]

Following this acquisition, Teva became the number one generic company in Europe, holding the leading market position in 10 countries, as well as ranking in the top three in another seven. In addition, the transaction substantially increased Teva's sales in Canada.

Table 1 **The generic pharmaceutical market, 2010**

| | Market size, 2010 ($bn) | Percentage volume penetration by generics of drugs no longer under patent protection |
|---|---|---|
| USA | 312 | 75% |
| Japan | 96 | 23% |
| Germany | 45 | 68% |
| UK | 22 | 63% |

*Source*: IMS Market Progress

With the purchase of ratiopharm, Teva also gained significant 'bio-similar' manufacturing capacity and technical knowhow in Europe. 'Bio-similars' are copies of complex biological products such as monoclonal antibodies. A number of important blockbuster biological drugs were due to lose patent protection over the coming years. Bio-similars were expected to command substantially higher prices than traditional generics and represented an exciting prospect.

In the summer of 2008, when Teva acquired Barr Pharmaceuticals, Yanai commented that he was keen to forge a joint venture in Japan, arguing that the country was an important but difficult market to break into, and adding that it was ripe for generic development. For historical and cultural reasons, Japan had one of the lowest uptakes of generic drugs globally (see Table 1). In order to reduce the burden of prescription medicine costs on their healthcare system, the Japanese government introduced various measures aimed at increasing generic use from around 20% of prescriptions to a target of 40%. Words became actions a few months later, when Teva and the Japanese company KOWA Pharmaceuticals signed a definitive agreement to establish a 50:50 joint venture, Teva-KOWA Pharmaceuticals.

In December 2009, Teva-KOWA Pharmaceuticals acquired a majority interest in Taisho Pharmaceutical Industries Ltd, a Japanese generics company with over 200 products and annual sales exceeding $130 million. As a result, Teva-KOWA Pharmaceuticals became the fifth-largest generics company in Japan.

Teva-KOWA followed this with another acquisition in May 2011, of Taiyo Pharmaceutical Industry, in a deal worth $460 million in cash. Teva claimed that Taiyo, a privately owned company, was the third-largest generics company in Japan, with sales of $530 million in 2010, and brought with it significant manufacturing capacity in Asia. Teva now expected to reach its target of $1 billion in sales in Japan ahead of its 2015 schedule.

## The move away from generics into research-based pharmaceuticals and over-the-counter medicines

In May 2011 Teva successfully trumped a rival hostile bid from Valeant Pharmaceuticals to acquire Cephalon, a research-based pharmaceutical company with around 4,000 employees located in Pennsylvania, in a deal worth $6.8 billion.

Cephalon posted sales of $2.76 billion in 2010, up 28%, and adjusted net income of $657 million, an increase of 40%. Growth was driven by the sleep disorder drug Provigil and its follow-up long-acting drug Nuvigil, the cancer drug Treanda and the cancer painkiller Fentora. Cephalon also boasted a large research portfolio in several key areas – Central Nervous System ('CNS'), Oncology, Respiratory and Women's Health, the most promising but highest risk being its proprietary stem cell technology.

Valeant, an aggressively acquisitive Canadian pharmaceutical company, had seen in Cephalon's established products an opportunity for further revenue growth and increased profitability, and had bid $5.7 billion, but had discounted the value of the therapies in development. The takeover by Teva was welcomed by the board of Cephalon, who saw Teva as an organisation that valued their pipeline and would support their ambitious research and development plans. As Cephalon CEO Kevin Buchi said at the time: 'Teva shares our strong commitment to R&D, and we believe our pipeline will thrive under their leadership.'[6] Mr Yanai added:

> 'Our newly-expanded portfolio in CNS, Oncology, Respiratory and Women's Health along with our robust pipeline of more than 30 late-stage products truly cements our position as a leader in speciality pharma. . . . We are welcoming many of Cephalon's talented employees into the Teva family. The combination of our two winning teams will position Teva to create maximum value for our patients and customers.'[7]

Teva and Cephalon executives said they saw particular potential in a stem cell therapy for congestive heart failure under development with Mesoblast Ltd, in reslizumab for asthma, and in the lung-cancer treatment obatoclax. Ori Hershkovitz, a partner at Sphera Global Healthcare Fund in Tel Aviv, commented in an interview at the time: 'Teva's making four or five shots on goal with a very high-risk, high-reward kind of profile. If they pull off the stem-cell product, they're in the clear. But if they pull off two or three of the others, it would also be a very good deal.'[8]

In another diversification move in November 2011, Teva announced a joint venture with Procter & Gamble to create PGT Health headquartered in Geneva, Switzerland. Bob McDonald, Chairman of the Board, President and Chief Executive Officer of P&G, said: 'P&G's partnership with Teva creates a combined set of capabilities that is unmatched in the industry. Starting today our combined consumer health care business will now offer more branded OTC products to more consumers in more parts of the world.'[9]

The idea behind the joint venture was that P&G would bring best-in-class consumer understanding, branding, design and in-store merchandising, with brands such as Vicks, Metamucil and Pepto-Bismol, whereas Teva would bring deeper, broader pharmacy distribution, including a pharmacy sales force and strong pharmacy relationships, broader regulatory capabilities and new technologies and manufacturing capacity to P&G's leading brands. There was also the hope that the joint venture would be able to find synergies in the two research pipelines to bring novel approaches to areas such as allergy therapy. Teva became the manufacturer and supplier for the PGT Healthcare business and P&G's North American OTC business.

PGT Healthcare expected to accelerate growth for its parent companies and compete for leadership in the fast-growing, $200 billion consumer healthcare industry. The partnership started from a base of approximately $1.3 billion in annual sales, with the claimed potential to grow this to $4 billion towards the end of the decade.

## 2011 challenges for TEVA

Despite these bold acquisitions, 2011 proved to be a difficult year for Teva and for shareholders, with the share price nearly halving over the course of the year.

There were three major challenges. Firstly, problems following an FDA inspection at the former Barr plant led to a six-month closure of the main production line. As a consequence, Teva suffered a 48% reduction in US sales in the first three-quarters of 2011. Secondly, following a change of vial size for the anaesthetic propofol, some patients contracted hepatitis C due to alleged reuse of vials which were intended for single-patient use. In resulting litigation, it was argued that the increase in vial size led a number of centres to reuse the vials and so put patients at risk. Thirdly, the crucial profit generators Copaxone and Provigil were facing generic competitors earlier than expected.

## December 2012: new strategy announced

Following the appointment of Jeremy Levine as CEO and Michael Hayden as President of Global R&D, Teva spent much of 2012 formulating its new strategy, which was unveiled to investors on 11 December. Levin promised to reshape the company into 'the most indispensable medicines company in the world' and provide significant value to shareholders. Levin said Teva would sustain 'profitable growth' through 2017. Analysts and investors were not convinced, as the share price fell sharply.[10]

Key elements of the new strategy included:

- Tailoring the product offering to address regional needs. With its diversified portfolio, Teva was well placed to focus on high-value generics in the USA and Japan but on consumer OTC products in Latin America and Russia, for example.
- Rationalisation of the marketed generic product portfolio. Less profitable products were culled, while price increases were implemented for others.
- Globalising key functions to streamline operations and gain economies of scale, cutting costs by $1.5 to $2 billion per year.
- New R&D focus on high-value generics called NTEs (New Therapeutic Entities). Teva planned to leverage its huge portfolio of over 1,400 medicines, and its extensive formulation and drug delivery expertise, to create new combination products that would be harder to imitate than traditional generics. These would offer medical value through improved efficacy or compliance, or reduced side-effects, in order to justify higher prices. For the first time, Teva would incorporate formal medical input to its generics business.
- Refocusing the R&D pipeline, with a strong emphasis on CNS and respiratory products. The oncology product obatoclax was discontinued.
- Formation of a drug discovery network comprising all the academic centres in Israel.
- Business development focused on smaller transactions to add pipeline and expand capabilities in key growth geographies.