M&A on the way to the top

Swooping on opportunities, making daring moves and working on vision. Israel Makov, president and CEO during critical years, explains how Teva grew into a world power

by Ayellet Globerman and Raz Darabi

The year 1995 marked a turning point in the history of Teva Pharmaceutical Industries, today the world's biggest producer of generic medicines. That year, the company, which was established in 1901, submitted to the United States Food and Drug Administration a file for marketing approval for its first innovative, home-made drug – Copaxone, which in fact was the first innovative drug to be developed in Israel. Based on research done at the Weizmann Institute of Science, the drug is used to treat the symptoms of a horrendous, incurable disease, multiple sclerosis.
The success of developing Copaxone and the comprehension of the future potential economic value once the drug was approved by the FDA brought the company to a strategic crossroads. It had to decide whether to focus on the generic market, broaden the development of innovative drugs, or do both. Despite the potential identified in innovative drugs in general, and Copaxone in particular, the management decided in favor of generics.

That was also the year that Israel Makov joined the company, later becoming its Chief Executive as the company gained a global foothold and became a world leader in its field. He came on board as vice president of business development, landing straight into the minefield of the company's decision-shaping and analysis.
No question about it, Teva's systems of analysis and implementation worked. In the 13 years since that critical turning point, the company has grown fourteen-fold. Today Teva, listed on the Tel Aviv Stock Exchange and dual-listed on Nasdaq, is worth about $38 billion. Makov explains how it all happened.

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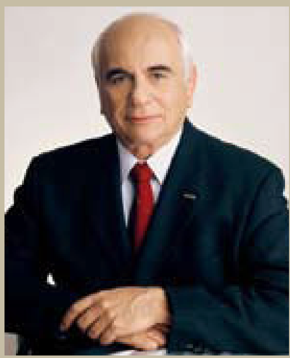
The interview took place in his offices, located in the Teva headquarters. Today Makov chairs another Israeli medical-technology company, Given Imaging, which pioneered a whole industry of noninvasive endoscopy with its breakthrough miniaturized camera-in-a-capsule. You swallow, it takes pictures as it travels through your digestive tract and transmits the images to an external receiver for diagnostic purposes. It then leaves your body much as you would imagine. But let us return to 1995, when Copaxone was submitted for approval.
"At that junction, we asked ourselves whether we should develop new additional innovative drugs, or to leverage Copaxone's sales income to support the emerging generic company", Makov relates. "At the end of the day, an interesting strategic analysis led us to conclude that we should become a world leader in generic drugs. Our vision was to become the world-leading provider of affordable drugs,

M&A on th

which became a value by its own right".
Also, in parallel, Makov says, the company aspired to use the scientific infrastructure in Israel in order to develop solutions to unmet medical needs such as Parkinson's Disease. The next stage was for the company to design its new strategy and business model.

The mathematical model

How was the analysis conducted? Teva built a mathematical model that compared alternatives based on shareholder value. "The analysis led us to realize that we couldn't compete with the giant drug companies. We then conducted an analysis of the generic market in the US", Makov shares. The analysis also led to the enlightenment that the industry was heading towards consolidation, both at the client and industry level. The consolidation process would significantly reduce the number of companies and clients, and create a number of gigantic networks. It would also create growing pressure on prices.
"It was clear that the consolidation trend was upcoming", he says, "The risk that such a process involved was clear: it threatened the very existence of the company. But we were looking for the opportunity that the situation offered. Then came the question that would later become a major milestone: what if Teva were to become a consolidator?"
"We put that into our model and saw something very intriguing indeed. It produced impressive results". The next question was how to become a consolidator, Makov says. So, based on analysis of the market and of the company, what strategy did Teva choose? The management started from what should be obvious, but tends not to be: to be the consolidator, a company has to be the leader in its field . "Consolidation isn't led by the tail, it's led by the head", Makov quips. "Until then at Teva we hadn't even thought about leadership, even though in practice, we acted like a leader".
The question then was what should be done in order to become the industry leader. As the man chosen to design and execute the vision and strategy, Makov is well positioned to describe it. "Our strategy was profitable growth that would generate value for shareholders, supported by strategies of leadership and globalization. All those strategies were interwoven", he says.
Teva really had been endowed with vision: the process of consolidation in pharmaceuticals had not yet begun in those years. "We asked ourselves when the process would



Makov's key success factors for acquisitions:

- Choose targets carefully
- Perform thorough due diligence
- Don't underestimate essentials and don't dramatize problems
- Integrate properly
- Involve a broad management echelon
- Define goals clearly
- Create transparency
- Maintain clear accountability
- Be aware of timing

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begin. The concept of consolidation didn't even exist in the generic drugs industry, which by nature is a very localized industry: producing different drugs in different countries with different regulations.
We decided to go global, not on front end but on back end – through the supply chain. Globalization would enable us to achieve economics of scale and help us to broaden our offering of products".
Asked if they had a time-frame in mind, he smiles: "You can't know when consolidation will begin, "he answers". An economist can predict a price or time, but never both. "Since we did not know if the process would start in a month, or in five years, we simply decided to start it".
Correct analysis including the ability to read the writing on the wall is crucial to any company's success. But that's just the first stage. The next stage is to decide on the strategy the company must adopt in order to implement its model, and the third stage and most critical one is the execution.
Regarding that stage of execution, Makov says: "Companies fail, primarily due to poor execution. At the end of the day the test is to create value for shareholders, workers and clients. That's the heart of the matter".

The Hungarian test-case

The first company chosen for application of Teva's new model was the Hungarian drug company Biogal, which was being sold in a wave of privatization in the region.
Makov recalls the transaction as a particularly tough, complex one, but by its end Teva received a company with a great deal of value to offer and was energized for future acquisitions.
In 1995 Hungary was a country plagued by unemployment, newly free of communism. With 1,800 workers, Biogal was the biggest manufacturing plant in Debrecen, the second-biggest city. At that time, the plant boasted turnover of $100 million a year. But its processes were out of date and had to be modernized and streamlined. Teva reached a unique agreement with the government that any accord would be subject to agreement with the labor union and the company's management. Once the agreement with the

The challenge of management

What was the biggest challenge that Israel Makov faced as a manager? Without hesitation, he answers: leadership capacity. Managers must not only be leaders but have global vision as well. "In Teva we invested in a special program to cultivate global leadership. I asked each manager to check whether he has sufficient management capacity in his unit and what needs to be done over the next three years in order to develop it". Once the road had been paved, the managers took their steps accordingly, Makov says. That is the route to growth. Any company with global ambitions must cultivate talent and encourage ambition. Top management must nurture the next generation. The empowerment of global and local management is a key challenge of a CEO, says Makov: the concept is to create a culture of leadership, a management chain from the top to the very bottom. When an executive thinks like a leader - it is reflected in all his actions and empowers managers at all levels.
These days Makov is implementing his vision at Given Imaging, which is another world. He finds the challenges at Given Imaging fascinating, he says. The company, based in Israel, is a global firm, publicly traded and boasting growth momentum as well. "It has its challenges and I'm enjoying myself very much". During his free time, Makov lectures to corporate managements. He feels that his talks have impact, giving the companies management tools that translate into actual change.

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state had been signed, Teva entered into negotiations with labor representatives. The union leaders were invited to Israel. "We made a presentation and showed them that they were in roughly the same situation as Teva ten years earlier. They had two choices. They could choose to be like Teva and grow similarly, or, they could continue to fade and, within a few years, remain without a livelihood. To save the company, there was no choice but to lay off a third of the workers" Makov says. The union chiefs promised to reach an agreement with the employees regarding the planned changes. Makov was skeptical, but they did it. Teva's model for conducting negotiations with the management involved setting up each manager with his counterpart from Teva, a model they continued to use in the future,

How do you find a company to buy?

Makov can share how Teva goes about locating companies to acquire. The first condition is that it only seeks strategic acquisitions within its field of occupation. "We wouldn't try to buy a bank, even if it might bring us profit," he smiles. The next stage is to find synergies. How the acquisition will benefit the company from the perspectives of costs, sales, "soft" synergies at the management level, industry, and so on. However, there may be other considerations, such as the desire to gain a foot-hold in a new market or territory, or to increase the general offering of products.

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Makov describes. "The Teva managers had been instructed not to talk about layoffs, but to try to work out together how many people were required to carry out the same activities. The Teva managers were sort of coaches who accompanied the process, but it was the local managers who made the decisions in each division". Once they had decided how many and which positions were needed, a plan was prepared to make the change in one step and assist the dismissed workers. "We created a fund with several million dollars, run by the management and workers. We rented a place, where teams were waiting to handle each one individually. Ones who wanted relocation received money for it. Ones who wanted to go into business on their own received loans on especially good terms. The same was true of others who wanted higher education". Consequently, Makov says, what could have been a very traumatic event was, in fact, carried out in a positive atmosphere. Once the process had been completed, Biogal's privatization became a model for emulation in Hungary.

Acquisition as a way of life

In the years since that first acquisition in 1995, Teva has become a master of M&A. In today's business world excellence in mergers and acquisitions is a superb way to distinguish a company. Even in complex transactions the guideline at Teva is to create added value for both companies and synergy. "You aren't just buying the company itself. What matters at the end of the day is integration. Also, synergy means that Teva's consolidated profit will increase. It isn't that each body's profit will increase separately". Biogal, for instance, is a chemicals plant, which became part of the chemicals production of the parent company, he explains. When Teva later acquired Ivax Corporation, it also received a great many companies that Ivax had owned, and the contribution to the company was different. "In general, we buy a company in order to improve Teva's results as a whole. That is what synergy means", Makov says. There is no one rule or method for shepherding an acquisition to safe harbor. "It's

M&A on th

very important to find a target that suits us, and then, the stage of negotiation is critical, and so is the due diligence", Makov advises. "Any process of acquisition is littered with bumps. You can't take fright at every threat, but on the other hand, it's also important to know when a threat is real".
The process of integration starts right at the first meeting of the negotiation phase, Makov emphasizes. Companies sometimes come to the preliminary meetings behaving like conquerors, which can be detrimental to future cooperation.
"In these meetings with the management of the acquired companies, we always present Teva first, in order to create a comfortable atmosphere and to convey a soothing message. This way we assure they became partners to the process. In most cases the managers stayed after the acquisition. By the way - in one case we called off an acquisition, because we saw the management was counting on getting big money and leaving the company afterwards", Makov relates.
Key to the process at Teva is broad involvement in the process of acquisition and integration. When a lot of people are involved, Makov explains, lower echelons gain experience and contribute to the process. "They have to know what the value and goals of the company are, and to understand what to do when they meet with their counterparts at the acquired company".
Can a company grow without acquisitions? Makov has a firm opinion: Organic growth is limited unless their sector is rapidly growing. In more saturated markets M&A becomes essential. "You can't survive without it", he declares, "especially in the era of globalization and consolidation". Excellence in the execution of the M&A processes becomes a differentiator in the competitive environment.

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The evolution of Teva: 107 years in three chapters

Teva was founded in 1901. Israel Makov sees its history in terms of three chapters, strategically speaking. The first lasted 85 years. From its establishment – well before that of the State of Israel - to 1985, Teva grew steadily, reaching turnover of $100 million a year and operating almost entirely in Israel. In 1985 the company began to seek growth drivers beyond the local market, and realized that opportunity lay in the growing U.S. market for generic drugs. Teva took advantage of the pertinent regulation in the U.S. at the time, and – together with a local company - acquired a small generic drug-maker based in Pennsylvania, Lemmon Co. That was the start of the second phase, which lasted through to 1995. Teva had become bi-national, more than 90% of its business turnover remained confined to Israel and the U.S. The two parts of its operations remained disconnected. In Israel, Teva focused on receiving licenses from big pharmaceutical companies.

In a perhaps ironic twist, Israel's pharmaceutical industry can thank the Arab embargo for its very creation. Global companies avoided doing business with Israel, and Big Pharma was no exception. But they circumvented the boycott by selling licenses to local companies, which made the drugs themselves. During those years, Teva sprouted. Income soared to $680 million in 1995. The turning point in the company's history, starting its third era, was the request for an FDA approval of the multiple-sclerosis therapy Copaxone, an innovative drug. At this point Teva had strategic choices and decided on a strategy to become a leader in the generic drugs market. Through a series of acquisitions and a globalization process the company became the world-leading generic drugs maker.

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