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TEVA.TA - Teva Pharmaceutical Industries Ltd to Discuss Restructuring Plan and Additional Measures to Improve Its Business and Financial Performance Conference Call

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Co. provided an update on its restructuring plan.

DECEMBER 14, 2017 / 1:00PM, TEVA.TA - Teva Pharmaceutical Industries Ltd to Discuss Restructuring Plan and Additional Measures to Improve Its Business and Financial Performance Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, welcome to the Teva conference call to discuss restructuring plan. I must advise you today's session is being recorded. I would now like to hand the floor to Mr. Kevin Mannix, Senior Vice President Investor Relations.

Kevin C. Mannix - *Teva Pharmaceutical Industries Limited - Head of Global IR*

Thank you, operator. And thank you, everyone, for joining us today to discuss Teva's earlier announcement regarding its restructuring. On the call with us, today are Kåre Schultz, Teva's President and CEO; and Mike McClellan, our Chief Financial Officer.

We're going to begin the call with Kåre taking you through a short presentation before opening up for questions and answers. A copy of the slides can be found on our website at www.tevapharm.com as well as on our Investor Relations app, under Teva Investor Relations. During this call, we will be making forward-looking statements, which are predictions, projections or other statements about future events. These estimates reflect management's current expectations for Teva's performance. Actual results may vary, whether as a result of exchange rate differences, market conditions or other factors. In addition, the non-GAAP figures exclude the amortization of purchased intangible assets, costs related to certain regulatory actions, inventory step up, legal settlements and reserves, impairments and related tax effects. The non-GAAP data presented by Teva are used by Teva's management and Board of Directors to evaluate the operational performance of the company to compare against the company's work plans and budgets, and ultimately to evaluate the performance of management. Teva provides such non-GAAP data to investors as a supplement of data and not in substitution or in replacement for GAAP results because management believes such data provides useful information to investors.

And with that, I'll now turn the call over to our CEO, Kåre Schultz. Kåre, please.

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you, and welcome everybody to this call. I'll start by addressing our current situation.

In broad terms, you can say that we have 4 main challenges in our current situation. We have a significant depth that we want to service over the coming years and where we have some clear commitments. We have generic competition to our largest branded product COPAXONE that started just recently. So we are anticipating to see reduced sales of COPAXONE over the coming quarters.

We have had a challenging environment as has the whole market in our largest generic marketplace, the U.S., where we have seen significant price erosion recently. And we have also seen that we have had less generics launched, less first launches in the U.S. compared to what we've seen in future or in the years past.

So all these 4 challenges have led us to review our business and to develop a restructuring plan, which will significantly reduce our cost base. I'm confident that with the reduction in the cost base and with us protecting our revenue line, we will be able to manage in the short and medium term in a way where we can both address our financial obligations and ensure a solid sustainable base for our business going forward.

So supplement to the ongoing operations of the business, we will continue to divest noncore assets to the extent that we find this advantageous.

Now let me highlight the restructuring plan. We are planning to reduce our current cost base, which in 2017 will be just above USD 16 billion by USD 3 billion. One-half of these reductions will be achieved by the end of 2018, and they will be fully achieved by the end of 2019. The reductions will come from all elements of our cost base, so from the entire P&L so to speak. And they will, of course, be linked to reductions in the overall manning and overall estimated reduction of 14,000. This is more than 25% of our workforce. And this will be geographically split over all the markets where we operate and all the functions in the company.

The majority of these reductions will happen in 2018 and the majority of the changes in 2018 will happen within the next 3 months.

As inevitable in a reconstruction programs, there will be onetime cost, onetime restructuring charges, and we expect there will be a cash outlay of around USD 700 million in 2018 for this.

These savings will allow us to be more efficient, to be more operationally effective and to meet our financial commitments.

Now let me talk about the key areas that we are focusing on. How are we doing the restructuring? First of all, there's a link to the organizational structure that we revealed at the end of November. We are basically moving from a situation where we had 2, you could say, divisions and a lot of staff areas that were globalized to a much more unified and simplified organizational structure. Where we basically have 1 P&L. We have 1 situation, market by market, where we sell different products. It could be OTC. It could be generics, branded generics, specialty products. And we optimized the markets one by one. We optimized the products one by one, all leading to higher-end margins for the products that stay in the market, stay in the portfolio and at more profitable organization going forward.

We can see that our generics portfolio due to price pressure in several markets has a very mixed profitability and that there's a need for optimization, and I'll address that further in a minute. As a consequence of portfolio optimization and of optimizing the general footprint of our manufacturing, we will see the closure of a significant number of manufacturing facilities worldwide.

We will also see closures by the way of office sites and also of R&D sites. We are doing a thorough review of our R&D programs across the entire company. As you know, we have merged our 2 R&D organizations, so that all the things that are shared between the R&D process for generics and for Specialty Products can be done in a synergistic way. We do, of course, keep something separate, and we will ensure that we have a sustainable portfolio throughout the different development phases for both our generic pipeline and our specialty pipeline.

We're expecting through this restructuring to optimize our cost base in a way where we are protecting our revenues, we'll be serving our core capabilities in generics and in the specialty area. And in doing so we are securing the long-term growth of Teva.

Now a few comments to the new organizational structure. As I've already said, we're moving from 2 separate global commercial groups into 1 integrated organization. This ensures that we can effectively execute on the cost reductions, and we can effectively execute on the portfolio optimization, without having any risk of siloed or suboptimal analysis. We will be looking at the business from a holistic point of view, ensuring strong profitability long term.

That's also why we make sure that each region and each market has the full P&L accountability, which means that we can measure the markets on a comparable basis, and we can ensure that the totality of our activities are sustainable and profitable in all markets.

I just alluded to the merger of the 2 R&D groups. The thinking here is, of course, that by utilizing the synergistic effect of all the many aspects that are similar, whether you develop a drug for a generic launch or for a branded specialty launch that we get the synergistic effect there while keeping, of course, a research focus in specialty and a separate from the generic activities.

We have had a need for strong and available capabilities in addressing our portfolio throughout the lifecycle of our generic products, but also in connection with the planning and launch of new specialty products.

To this end, we are establishing a marketing and portfolio function that will have the global responsibility of integrating the inputs from R&D, manufacturing, markets, in order to obtain the optimal portfolio for both our generics and our specialty products.

We will ensure that we have 1 lean organizational infrastructure to support our business, basically having a lean setup for all staff functions, ensuring the high level of compliance, but in an effective and simplified way.

Now let me talk a bit about the global generics portfolio. There's been a lot of pricing dynamics on generic products in United States and elsewhere in the last couple of years. If you have a very dynamic situation, sometimes you have the risk that some of your products will not really meet a sustainable profitability benchmark.

In order to secure that we have a long-term sustainable portfolio, we are reviewing each and every product worldwide, and we will make pricing adjustments to the extent that this is necessary.

When we do that, we will in some cases experience that we will improve the profitability of the individual product and it will remain in the marketplace. In other cases, we might have to conclude that the product is not one that we will keep on manufacturing, and we will, therefore, discontinue these loss-making products.

This, combined with our general synergistic way of merging our manufacturing sites, optimizing our manufacturing sites will lead to a reduced number of manufacturing sites with reduced overheads. And at the same time, we will also optimize our R&D network.

In the same way, we will look at different parts of our portfolio to better reflect the current cost structures and the current market condition, all in all optimizing the profitability of our portfolio.

Now, we're also taking some additional measures. In order to secure the best possible cash flow, in order to be able to service our commitments related to our depth in the best possible way, we are immediately spending dividends on ordinary shares and ADRs. We will continue, as I said in the beginning, to look for additional divestment opportunities of noncore assets. We will, however, only do so if the price we achieve is improving our overall financial situation, both from a liquidity and a earnings point of view also longer term.

We will as a consequence of the very negative development of our financial performance in 2017, not be paying out any annual bonuses for those people who are having an annual bonus system. I should say this will, of course, not affect the normal bonuses paid out to sales representatives around the world.

In terms of our financial profile, we will, of course, utilize the cash flow from both the improved operating performance and from divestments, to continue to pay down debt over the coming years. Initially, we'll be focusing on the remaining bank debt, which is subject to covenants, roughly 4 billion, and we will pay that down within a relative short number of years.

We will be targeting a significant reduction of our leverage of going below 4x the EBITDA to net debt by the end of 2020. And I would like to stress at this point in time that we do not plan to raise equity in any of the forms that you could imagine. We will safeguard the value if at all possible for the current shareholders.

Talking about the debts, let me just restate once more that we are and we'll remain focused on deleveraging paying down the debt.

We have done so already within the last months, and we will continue to do so in the coming years.

Here you have a picture of our debt maturities over the next 5 years. And, of course, we need a strong cash flow and strong liquidity in order to service this debt and that is our aim to ensure that.

So what should you look out for in 2018? What can you expect? You can expect a simpler, leaner and more agile organization, organized in a much more straightforward way. You can expect that more than half of the $3 billion in cost reductions will be executed and will be achieved. You can expect the continued debt reduction. You can expect a very strong focus on protecting our top line and also on supporting the continued successful launch of AUSTEDO and the planning for and successful execution on the launch of fremanezumab. And you can expect us to continue to ensure a spend in the R&D area that maximizes the return on equity or the return on investment and secures a long-term sustainable pipeline for both our generics and our specialty business.

So we will ensure that we continue to provide high-quality medicines to the many millions of patients we serve every day. And we will ensure that we remain strong in terms of our operating performance and on our financial performance.

So with this, I would like to hand over for the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Umer Raffat from ISI.

Umer Raffat - *Evercore ISI, Research Division - Senior MD and Fundamental Research Analyst*

My question is really just to make sure we understand the cost cut properly. The $3 billion in cost cut announced, is that net reduction out of the system? I just want to be very clear about that one. And then also if -- it will be really helpful to understand and frame for us, what parts of the organization are being cut deep into versus not, and what are the takeaways from similar programs? Kåre, you may have done that. Lundbeck, for example? And then finally, is CGRP launch a top focus for you because I know some of your competitors are putting in some very serious resources going into 2018 into that?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you very much for these 3 questions, Umer. First of all, the USD 3 billion is a net reduction. So if I should make it very simplistically, I would say in 2017, you should expect us to report just above $16 billion in cost. So 2 years from now, you should expect us to report $3 billion less, so that's $13 billion. If we were to sell off major parts of the business in the meantime then, of course, that cost reduction would come on top of this. So that's the way you should understand it. In terms of what parts of the business, it's everything that we are optimizing, basically. The only thing

that we are really protecting is the product flow. So making sure that the sales efforts are not hampered, that we can continue to move our products as much as possible. And then, of course, the manufacturing of the products that make a profit that they are not hampered. So of course, we're keeping a very close eye on that. And then your last question about fremanezumab, we are packing fremanezumab 100%. We think we have an excellent clinical profile. You have probably noticed that we are the only one which can have a dosing only every 3 months, which we think will be an advantage. So we're very much focused on that. And we have, of course, made sure that we have the resources to continue the successful launch of AUSTEDO and to make a really successful launch of fremanezumab.

Operator

Your next question comes from the line of Ken Cacciatore from Cowen and Company.

Kenneth Charles Cacciatore - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Wanted to drill down a little bit more nuance on the cost reductions, hoping that maybe you can give a little bit of thought between SG&A and R&D versus cost of goods. And kind of relative to that, trying to understand the reductions over the next couple of years and the impact, specifically, on revenues, excluding, obviously, any divestitures. If you can give any nuance as we try to work through the P&L implications from revenues, the cost of goods and the reductions in SG&A and R&D? And I guess, dovetailing on that, just some perspective on 2018, you're giving us a good sense of the spending side, maybe if you could, any nuance on top line as we try to work through the model?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you very much for that question. So first of all, I'll say that we won't -- as you probably realize, we won't give any financial guidance today. We'll be talking about the restructuring program. We will, of course, give you a clear set of guidance once we get to February, and we announce the full year results for '17. We will also give you clear-cut guidance on '18. But trying to give you a bit more nuances on where the cost cuts are coming from. And first of all, they are coming from the entire P&L, as you also correctly stated. They are partly related to the 14,000 people that are leaving the company, and they are leaving the company basically in all functions. So there's not any function where we don't have a reduction. I would say, there's a reduction between 10% and 75% in the individual functions. So it's all over the place. Geographically, it's everywhere. So it's a very broad set of actions we're taking. And you referred to previous -- I don't want -- also to previous restructurings that I've done. So it's very much following the same pattern, where you basically look at everything and you try to optimize everything in one go, involving the management of each part of the organization, making sure that the plans you make are highly executable. And you can trust that they will be executed and they are sort of borne out of specific targets for specific units at a relatively low level. So that's how we're doing it. The majority will be, you would say, not in the cost of goods area, but they'll still be a large chunk there, as you know. Out of our total cost base, COGS are a very large part. So you will see COGS there as well. And some of them will, of course, be coming from the closure of sites. That's a major part of it. And some of them will coming from the optimization of profitability on individual products. Now when it comes to sales, I can't give you any specific guidance today, but I can tell you that there are some elements that are mentioned already that are pushing a downward pressure on sales. And those are the generic erosion on COPAXONE. And it is the pricing in the U.S. generic space. In the rest of the world, you have minor elements that could give some swings up and down. And then, of course, you have the launch of AUSTEDO, which is still small. So it won't have a big impact. You have the launch of fremanezumab that will be sort of probably around the middle of the year. So that will not have a huge impact either. So those are sort of the key elements. And in totality, with the divestments that, of course, gives a downward pressure on the top line. But I don't know if you -- Mike, if you want to add something?

Michael McClellan - *Teva Pharmaceutical Industries Limited - Executive VP & CFO*

Just let me add a couple more comments. First, on the costs side. You'll see the majority impact in 2018 coming more out of the operating expenses, the cost of good impact will be much more weighted towards the second year because of the time it takes. And a few other things to think about when you're modeling 2018, we did have the divestments, which will total -- in total, about $900 million in revenue, specifically, almost $800 million in the women's health that comes out, plus the Hungarian distribution business that we're going to take out. And then we had $150 million in the

first half of 2017 related to the NINLARO royalty stream that will not repeat going forward. I also remind you that, that we could be facing a generic competition to our ProAir franchise in the U.S. as early as mid-2018. So we're not sure that will happen, but it is a risk that you need to be considerate of.

Operator

Your next question comes from the line of Ronny Gal from Bernstein.

Aaron Gal - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Research Analyst*

Two for me. First one around the Israeli tax rate. Based on discussion, the Israeli media about negotiations, you're currently undergoing with the Israeli authorities about tax rate. And understanding what the impacts of the Israeli statutory tax, which we believe is 16% and the -- at center in the country and 8% in the periphery will be -- if we assume that, that will be the net tax that you would have? And second, Kåre, coming from the outside, one of the things surprises in 2018 was the lack of significant generic launches despite the acceleration of FDA's general approvals. Any diagnosis from you so far about what might be the problem with Teva in that respect?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you, Ronny, for those 2 questions. First, on the Israeli tax rate then -- tax is always a complicated issue, as you know, with many moving parts. I think the short version I can give you is that, I don't expect to see any major political initiatives that would significantly change our tax rate on a global scale. That doesn't mean that we can't have some discussions here in Israel. But I don't see that as a risk to us that we will have a dramatic change there. And then when it comes to generic launches, I don't think that there's one simple explanation for why some years we have more launches than others. I think there's a dynamic at play here, which I've been discussing with my colleagues, which is that branded players, or you would say, also us with COPAXONE and other players with other products, they are getting more sophisticated in how to prolong, you could say the commercialization through different rebating schemes, authorized generics, different moves that happens in the marketplace where you blur the red line in a way between the original product and then the follow-on generics. And the originated companies are utilizing that in a way to maintain more turnover as we can see right now, where we are also seeing that we don't lose everything, you know, in our prediction in the first quarter that we have generic competition on COPAXONE. Now that works both ways for us because it also works the way that when we launch new generic products, we also have the risk that we will have a slower ramp up or get less market share than we would have gotten 10 years ago. So you could say that the dynamics are being slowed down for various reasons. And that's maybe one of the reasons that we see less income from the generic launches. Another reason is that there's a certain gamble in this because you know when you do a first-to-file you make a lot of assumptions and you need to do a lot of things very fast. So being first-to-file, then needs to be followed up by being first to launch in order to get the value out of it. And it is a clear focus of mine and of the whole organization going forward that we do not only manage to get first-to-file, which I think we are excellent at, probably the best in the industry, but we also manage to be first to launch.

Michael McClellan - *Teva Pharmaceutical Industries Limited - Executive VP & CFO*

Ronny, let me -- this is Mike. Let me add a little more flavor to the tax rate. I think, Kåre answered the Israeli impact. But just to be clear, as we go from this year, where we have in 2017 roughly a tax rate of 15.5%, we would expect that to go up a little bit to next year, mainly due to the reduction of COPAXONE revenues, which are enjoying those favorable rates in Israel. So overall, we would expect tax rate in 2018 to be a few points higher than the tax rate we see in 2017. But we'll give you a full analysis when we do the earnings and the guidance in February.

Operator

Your next question comes from the line of Jami Rubin from Goldman Sachs.

Jamilu E. Rubin - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Can you hear me, all right? Just was wondering, if you can walk through some math with me, Kåre. So you're talking about a $3 billion reduction all dropping to the bottom line, $16 billion in expenses dropping to $13 billion in expenses. If I look at consensus numbers for EBITDA in both 2019 and 2020, The Street, and we assume about $5 billion in EBITDA. You also said that you expected net leverage by 2020 to reach about 4x. That implies an EBITDA of $6 billion. So recognizing that there's going to be some hit to revenues because of the sharp cost reductions, I'm wondering if you can kind of square the difference between the additional $3 billion, which should boost EBITDA by maybe that much or maybe not quite that much and the $6 billion that you're sort of referring to or implying when you talk about 4x net leverage by 2020?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Yes, I can try, Jami, to give you a little bit of flavor to it, but I can't give you the real specifics because, we will, of course, give the guidance on the EBITDA for 2018 in February. So I can't really comment on that right now. But the way you should think about it is, of course, that we will be focused on using basically all our cash flow, both the operating cash flow and the divestment cash flow to reduce debt. That's #1 priority for us to do that. So that will hopefully, by the end of 2020 see us reducing debt significantly. And then, of course, we will use all our energy to also optimize the operating profit of the organization, thereby ensuring we can reach that situation that you're alluding to. And, of course, there's 2 factors: there's how much is the net debt at that point in time; and how much is our EBITDA at that point in time. But I'm confident that in the balance of those things we can make it, how it's going to look exactly, I can't say right now because imagine we do a lot of divestments of the noncore assets that will reduce the debt, but also the EBITDA, so that's one scenario. Or the other scenario, let's say, we don't divest anything, as an example, and we just improve the EBITDA to the maximum of what we can. That's another scenario. So I can't tell you exactly how it's going to look, but I can tell you that I'm convinced that it's very realistic that we will be able to achieve this. I hope this clarifies. And I know it's not completely precise, but it will be more precise in February.

Jamilu E. Rubin - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Can I follow-up with a quick question on revenues? What sort of -- if you look at consensus revenues by 2020, that's around $20 billion to $21 billion. To what extent would you anticipate this cost-cutting program to impact those revenues? I mean, how -- to what extent do you think you can preserve revenues in the context of this rather significant cost-cutting program?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Yes, that's a good question. What I expect is that revenues on profitable product lines will not be impacted. So I don't expect this to, in any way, impact all the good solid products we have. But there will be an impact from the optimization exercise because we will take nonprofitable product lines, try to increase the pricing to make them profitable. Some of them we will succeed, some we will not. And those where we will not, we will discontinue. That will take out both cost and revenue, but it will be sort of neutral on the EBITDA level. So it's a little difficult for me to say, but there will, of course, be a negative effect on revenues, that's for sure.

Jamilu E. Rubin - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

And I guess, one more follow-up. Go ahead. Go ahead. And also, if you could just touch on your conversations with the rating agencies. And go ahead, Mike.

Michael McClellan - *Teva Pharmaceutical Industries Limited - Executive VP & CFO*

No, I just -- when you're looking at the consensus revenue, we really need to restress that we do have these divestments that are coming out, and I've talked about those earlier. We also have variability on the COPAXONE. So we're being very conservative in our initial thoughts, and we'll follow that up in the February guidance because we will have more information about how well Mylan is doing. It's still early days on that. And then we

could face additional generic competition to the ProAir franchise in the U.S. And there is also a risk in 2019 around the Treanda franchise. So you got to take in to consider all of those when you're looking out into those years. In terms of the rating agencies, yes, we've had preliminary discussions with them. We're going to have a much more in-depth discussion with them and Kåre next week. They're still sifting through the information that we've given to them. And we will keep in a constant dialogue. So I can't really give you any indications right now, but we will be in a constant dialogue with them and lay out our plans, and show them that we're on a path to continuing our efforts of cost cutting, divestments. Moving to delever. We do have to deal, of course, with the slightly earlier-than-expected generic entry into the COPAXONE 40 milligram. And that will be a headwind as well as the U.S. generic environment. So it will take us some time to deleverage -- to the leverages that we want to get to. And I think being under 4x by 2020, hopefully, we'll be significantly under, but at this time, that's our target.

Operator

Your next question comes from the line of Greg Gilbert from Deutsche Bank.

Gregory B. Gilbert - *Deutsche Bank AG, Research Division - MD and Senior Analyst*

I was hoping you could provide the total cash cost of the restructuring. I think, you just talked about the cost for the 2018 portion. Secondly, on the product rationalization or optimization exercise, I'm very interested in that, in terms of its implications for you and the industry. Are you simply going to go through products that are unprofitable, try to raise price, and then discontinue if you can't? Or could you give us any more context around that? And lastly, Kåre, other than having fewer people and a lower cost base, a few years out, can you give us a preliminary glimpse of your vision for Teva? I think, most folks know you to be someone with a branded background, someone with a cost optimization and efficiency background, but maybe you could provide a preliminary glimpse of what you think is core to Teva longer term?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Yes. Mike, will you comment on the cash cost?

Michael McClellan - *Teva Pharmaceutical Industries Limited - Executive VP & CFO*

Yes. So we've put a number of $700 million in for 2018. We've also, you may have seen in the press release, said this could go a little bit higher as we get into 2019 and have a more definite list of which sites administrative and manufacturing to close. So the rest of it, we don't have an accurate enough estimate to give to you, but the $700 million will be the majority of the program. There could be some extra as we get into 2019 that we'll disclose as soon as we have a reliable estimate.

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

And on the product optimization, very good question. I would put it a simplistic way first, and then try to explain a little bit more. Basically, I'm a big believer in margins more than just volume. So rather than just try to get the world's biggest volume, I would like to get a good margin and a real good profitability on our portfolio. Now when you do that, of course, there's a lot of technicalities in how you do it, but in principal, you take it product by product, market by market, and you ensure that in totality, you have a good margin on your business in a geography. But also, that individual products are sustainable and profitable. And I'm not a believer in that you can have a couple of lost leaders and then you make it up somewhere else. That's not a good way to do business. So we will be looking at specific products where we will conclude that these products are being sold at a nonsustainable, noneconomical price level. And then we will, of course, in a polite and well-organized way discuss with our customers, how we can rectify this. Whether they prefer us to phase out of that product and discontinue it. Or whether we can adjust the pricing to a sustainable level. With regard to the vision, it's a little too early for me to bring forward a sort of clear-cut vision for the company. I'll be working with my executive management on it, and with the Board of Directors on it. And a comprehensive strategy will be communicated sometime after the first half of this year when we had good times to discuss it with the Board of Directors. But I can give you a hint that I think Teva has unique capabilities from a overall point of view in terms of being able to develop and manufacture medicines in many -- in different shapes and forms. And that is still

a very valuable thing, which can be used both to bring branded specialty products to the market because you have the whole value chain, but also to bring complex generics, biologics, biosimilars, standard old-fashioned generics, and even OTC products to the marketplace. So I see us as being able to utilize that broad capability base in a way which will secure a strong financial performance, strong operational performance, but also strong benefits for millions of patients every day.

Operator

Your next question comes from the line of Liav Abraham from Citi.

Liav Abraham - *Citigroup Inc, Research Division - Director*

I understand that you're not giving 2018 guidance and you have provided some color on dynamics in 2018. But as it relates to the restructuring plan and your -- the cost cuts that you've outlined. How conservative are the revenue assumptions behind this cost plan? And how comfortable are you that -- this is not something that you'll have to redo again, you'll have to reassess and cut more costs, a year from now, for example? And then secondly, Kåre, you did talk about the impact on longer-term revenues from product discontinuations. I'm curious as to your thoughts and your philosophy on R&D and balancing cuts in R&D with optionality -- preserving optionality for longer-term growth?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you. So if we talk about the top line and how to assist that and maybe also the execution of the restructuring, then, I think, it's fair to say that I'm traditionally conservative on that. So you would not find that I would be basing this analysis on a very optimistic outlook for revenues. And I think you will also find that I'm pretty conservative and strict on implementation of restructuring. So it would be very surprising if we did not meet the exact targets in terms of cost reductions. So I think on that, I can tell you, it's conservative on both accounts. In terms of the R&D and the philosophy there, then the philosophy is to have a sustainable balance pipeline, which is balanced both in terms of risk, but also in terms of timing. So that you have throughout the pipeline, you have early projects, you have mid-stage and you have late-stage projects. That's what we have right now. So -- but on the other hand, I'm also a big believer in that, in specialty, in branded research, you can't be good in everything, so you need to focus in and specialize in the areas where you have core competencies. And that's what we are going to do and what we are doing in the research and development of specialty. And in the space of generics, it's very much, of course, about being focused on the right products on the first-to-files, but then also following through and being the first to launch.

Operator

Your next question comes from David Maris from Wells Fargo.

David William Maris - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

I have 2 questions. The first is just a simple yes or no question. Based on what you know now, do you think Teva retains its investment-grade rating? In response to a previous question, you said, well, we've had some initial talks, we've had this feedback, we've laid out our plan. We get all that. Just based on what you know now, do you think Teva retains its investment-grade rating? And then secondly, the idea of raising price to increase profitability on commodity products that are seeing massive price pressure from buying groups and others in the U.S., seems like that would be a strategy that someone would have thought of before. So maybe can you answer how you'd address an investor that says, well, why wasn't that done before? And doesn't that sound like that's going to be futile?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

So on the first question, I'm going to disappoint you. And I have to answer that, "I don't know," because I don't do that decision. So all I can say is, I -- I'm laying out the facts. And then, of course, I leave it for the rating agencies to take that decision. On the second one, I think it's a good point. Why the race to the bottom? That's not sustainable, not for the patients either. So if you want to have a society where you have sustainable supplies of high-quality medicines, which is what we all want. Then, of course, it's good to have price competition. But you also need to be responsible as a company and make sure that you're supplying the products in a way that is sustainable. And rather than supplying something at a loss, it's better not to supply it. So I think it's because of the dynamics that the dynamics have been unleashed, you could say, in a very extraordinary way in the U.S. marketplace, the consolidation on the payer side, the actions from FDA to approve a lot of products from manufacturers in India and China and so on. The total dynamics have just led to that -- my guess is that not only Teva, but other manufacturers have ended up competing to the bottom where it's not really sustainable or profitable. This is not a new phenomenon. If you look into economics here in history, then, of course, it's a classic. And then there comes a period where less producers, less manufactures are active in certain areas and then prices normalize and stabilize at some point in time at a sustainable level. So I just think it's a normal economic cycle of rapidly changing competitive environment. And hopefully, we will end up seeing us having some product lines that will then be sustainable and profitable and all our product lines where we are no longer manufacturing these products.

Operator

Your next question comes from the line of Chris Schott from JPMorgan.

Christopher Thomas Schott - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Just had 2 questions here. Coming back to optimization process, you're going to go through in the generic portfolio. I appreciate it's very hard to quantify a sales impact at this point. But is there any more color you can provide in times of either how many products or what percent of your current sales fit into that bucket of either you need to raise price or you need to exit the business? Just anything about -- just how big a piece of the portfolio does this encompass? And then second question was on asset divestitures and how that fits into the picture at Teva at this point? I know you alluded to this in your commentary. Are there specific assets you have in mind for divestiture? Or is this kind of a wait-and-see process where you have to see how the restructuring plays out? And really evaluate how well assets fit into the mix versus what doesn't fit in anymore?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you very much, Chris. Good questions. With regard to the optimization, I can't get into the very specific details, but being an old consultant, I can tell you the 80-20 rule probably applies here as anywhere else. So that basically means that 20% of your products will make up 80% of your profits, that's quite normal for all pharmaceutical companies. And I'm sure it's also the case here. And that is, of course, not where you're looking. You're looking at the tail end where I'm sure that probably, the last 20% of your products might make up 80% of your losing products. And that's why you're going to be looking. So you take it from the tail so to speak, you look at the least profitable products and that's where you're going to start. And I think it happens in all industries, if you have a very broad portfolio. And if nobody is really focused on it, then it's not the most popular thing to do to be looking at the loss-making products and making sure that they get optimized. It's more fun to launch a new product at a high price and make a big splash out of that. So I'm a believer in that you should optimize everything, and that's why I'm also focusing in that end. And hopefully, that is something that can lead to better total profitability of the portfolio. In terms of the assets, then I'm also a believer in keeping all the good products we have. All the good assets we have in terms of actual products we're supplying. So you will not see us doing big asset sales that are linked to pharmaceutical product sales, so to speak, the generic or specialty pharmaceuticals. But you will see us look at sort of side things like, it could be distribution or could be other, sort of, side businesses that are not directly linked into product sales.

Operator

Your next question comes from the line of Jason Gerberry from Bank of America.

Jason Matthew Gerberry - *BofA Merrill Lynch, Research Division - MD in US Equity Research*

Kåre, first question is for you is, can you talk a little bit about your observations regarding Teva's manufacturing network? You've got a global business, brands and generics. And my recollection from the last downsizing of the facility footprint was that you'd be pretty close to Mylan, but Mylan's reducing their spend as well. So just as you think about a business of your size, where do we net out following the cost reductions, just from a manufacturing footprint? And if I can squeeze another one in, your fasinumab partnership with Regeneron I think you guys are on the hook for about $0.5 billion of R&D with that program. Are you still committed to that program?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thank you very much. So on the manufacturing footprint, it is, of course, no secret that Teva's manufacturing network is the result of numerous acquisition and mergers of the company over a long period of time. And roughly, today we have around 80 manufacturing sites. Now with my sort of insight into the volumes we do and how we do them and my insight into manufacturing over many years, pharmaceutical manufacturing, if you took it the other way around and said if you start it from scratch, how much would you have? You'll probably have 2 to 4 API sites, and you'll probably have 6 to 8 finished manufacturing sites with different technologies to cover broadly. So there would be sort of -- around sort of 8 to 12 sites all together. Now that's not realistic where we're coming from historically. But it's just to give you a feel for that there's a big difference between the setup we have and what would be the ideal setup. Then, of course, it's also well known that it takes time. It's costly to establish pharmaceutical manufacturing. And therefore, in that total optimization, we will most likely not go from 80 to 12 in the next 5 years, right? But we will move in that direction. So directional, you should expect us probably over the next 10 years to keep on moving in the direction of consolidation, optimization, improvement of our manufacturing network. With regard to fasinumab then we are, of course, totally committed to that program. and very excited about the fact that we potentially can develop a product that is a very effective painkiller without having misuse issues that we see with certain opioid-based products.

Operator

Your next question comes from the line of Marc Goodman from UBS.

Marc Harold Goodman - *UBS Investment Bank, Research Division - MD and United States Healthcare Analyst*

So just on the comment about cutting the plants. I just want to make sure I understand, what -- we should expect a pretty significant cut even in 2 years? Because previously, when companies have tried to take plants out, it usually takes even longer than 2 years. So maybe just you can come back to what's a realistic expectation for within this $3 billion cost cutting? And then second, when you talk about areas that you are committed to, do you think about the business and franchises, like the old Teva did, like we're going to stay in respiratory, we're going to stay in women's health, we're going to stay in oncology? And if so, can you just talk about what franchises you're committed to?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

So first on the number of plants, then we, of course, in an ongoing process of optimizing this. And this will continue and it will be accelerated as a consequence of the restructuring program. It's a huge parcel as you can imagine because there's a lot of moving parts. But you will see a significant double-digit number of plant closures within the next 2 years. So that's on the plant side. On the sort of, you could say the -- whether we have a therapeutic focus, whether we have some specific areas where we are very strong. It's a little different whether you talk about the generic strategy or whether you talk about the specialty strategy. In specialties, I would say that, our key areas, as you all know, are in the sort of CNS/neurology area, and that's where, I think, we have the biggest chances of bringing new innovation to the marketplace. On the other hand, in the, sort of, all the territory between generics and complex generics within respiratory and oncology, I also think that we will be able to bring very, very valuable products into the marketplace. Women's healthcare, we have divested and it's not an area where we will be focusing neither strongly on the generic side, nor on the specialty side. So I hope that gives you some idea about it.

Operator

Your next question comes from David Risinger from Morgan Stanley.

David Reed Risinger - *Morgan Stanley, Research Division - MD in Equity Research and United States Pharmaceuticals Analyst*

I have a couple questions. First, with respect to the U.S. generic price adjustment initiative, could you just sort of put that in perspective relative to the fact that, I think, there are over 3,000 ANDAs pending at the FDA. And it would seem that it might be a little bit different to try to raise price in a generics market that the FDA intends to further commoditize then, let's say, in other industries where there isn't so much incremental new supply coming on when a company decides to raise prices. So maybe you could just contextualize that for us, so that we understand it? And then, I guess, the second question is, you mentioned good solid generic products that you plan to continue to sell those. How do you think about the clearing of the backlog implications for those products? And whether what's a good, solid generic product today will be a good, solid generic product in 2 years? And then third, with respect to generic and brand R&D, they've typically been separate at Teva and most other companies. And so how will you be able to employ and retain people that want to focus on innovation, if they're also working on generics?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Thanks for those 3 questions, David. If we talk about the first thing, so the U.S. generics and the number of competitors and how that might play into the whole pricing. Then if you go down and analyze in detail, then of course, for each specific product, there's a difference in how many suppliers there are, and there's a difference in the manufacturing cost and the challenges of manufacturing the products. And the more complex the products get, typically the lower the number of manufacturers that provide the product, the bigger the quality and technical challenges in manufacturing the products become. So that means that you could say that for the more complex products, there's a high likelihood that you will be able to command a price that is equal to the value, and that makes sense from an overall profitability point of view. There will certainly be products where there's a high number of suppliers, and where it's relatively easy to manufacture. And in those cases, of course, if you have a margin loss on a product, it doesn't make any sense to manufacture it. And that means, you can actually improve your EBIT, your EBITDA, by simply not manufacturing the product anymore. So that's one element. The backlog, I think, a lot of the backlog that you will see will be on the simple products that will come to the market from -- as I said before, from manufacturers in places such as China and India. And I don't think that will have a sort of major impact to the areas where we see that we have a strong situation. And then, of course, we have to remember that a big part of the annual revenue generation in generics is from the first-to-file, first to launch. And that's, of course, where we have a lead. And we need to just make sure we execute to the maximum of our ability, so that we get a lot of the first-to-files also resulting in a first to launch. With regard to the research and development, maybe I didn't explain it well enough. We are not going to mix up the research groups in specialty with the research groups in generics. That's exactly where we are not going to mix it up completely. But we are going to have people working on CMC, people executing clinical trials, people doing PK/PD, all these kind of practical things that you do. We are going to have synergies in those areas. And I believe that that's a rational way to do it, which will sort of safeguard the creativity and the intellectual dynamics, both in the generic space and the specialty space with, of course, different groups of people.

Operator

Your next question comes from the line of Tim Chiang from BTIG.

Timothy Chiang - *BTIG, LLC, Research Division - MD and Specialty Pharmaceutical Research Analyst*

Kåre, I just had 2 questions, really big picture. First and foremost, how long do you think it will take? I know, you've just joined the company. How long do you think it will take to sort of find the inflection point for Teva's generic and specialty businesses, certainly like the market's highly skeptical of the company's current growth trajectory? And obviously, you're sort of an outsider to the Teva organization. You're announcing some disruptive cost cuts right off the bat. And I sort of wanted to get your thoughts, just looking at your experience in the business. Is this a 2- to 3-year turnaround plan? Or is this a 5-year turnaround plan for you?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Yes. Is that your question? That's great, Tim. So I'll give you my completely subjective take on it, right. I think, it's a 2-year turnaround restructuring. So in 2 years from now, it's going to look good. If we do well, then in 5 years, it's going to look great. But I can guarantee you in 2 years, it's going to look good because we will be handling the debt. We will be handling the operational challenge of declining revenues on COPAXONE and generics. But in the meantime, we will be sort of doing everything to regenerate growth from AUSTEDO, from fremanezumab, from a beta and more-focused generic strategy and execution. And that's why I'm saying that 2 years from now, we will have the cost down, we'll have optimized the operational performance. But the real sort of the big development in a positive sense then -- will then be 2 to 5 years out. So good in 2 years, and hopefully, great in 5 years.

Timothy Chiang - *BTIG, LLC, Research Division - MD and Specialty Pharmaceutical Research Analyst*

And Kåre, just one follow-up question, if I may. On fremanezumab, you certainly come from a background on the CNS side, how do you think you can optimize this product, assuming it's approved and launched next year?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

Well, I think it's a great product. You know that it's a great product class with 4 products in the class. And we have the most flexibility in terms of dosing. And we've seen, in the CNS area, I don't know if you follow the LAIs, but we have seen this move from once monthly to once every 3 months. And there's a move in that direction in several areas. And I believe that, that flexibility combined with best-in-class efficacy, that is a real edge that fremanezumab has.

Operator

We will take one further question. It comes from Rohit Vanjani from Guggenheim Securities.

Rohit Govind Vanjani - *Guggenheim Securities, LLC, Research Division - Senior Analyst*

Kåre, you mentioned $700 million of onetime payments. Just from a cash flow perspective, how do we think about the timing of those payments? Are the bulk happening at the beginning of 2018 because of severance? And then secondly, as a result of the cost cuts, do you feel like you can remain within the covenant even if another 1 to 2 additional COPAXONE generics come to market in 2018? Or what's the threshold there? And then, lastly, you mentioned taking price increases on products, some will win, some will lose, and maybe it'll be -- you'll have to discontinue and maybe it'll be a wash. But have you started those talks with the consortiums, or have any sense of what that's going to look like?

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

So, Rohit, thanks for those 3 questions. I think, the first 2 ones, Mike will handle and then I'll take the price at the end.

Michael McClellan - *Teva Pharmaceutical Industries Limited - Executive VP & CFO*

Thanks. Thanks, Rohit. So the severance cost of $700 million, I think, would be concentrated mainly in Qs 2 and 3, as we have salary continuation for the employees that leave. That will be the bulk of it. You will also see some in Q4, but I think the majority will be there. When it comes to covenants, we're in good shape for the end of this year. We're doing our evaluation as we look at the revenues of 2018 combined with the costs. We will may be, of course, in active dialogue with our banking partners. And if we see that we do not have enough cushion as we go into 2018 on those, we will be getting a little more active in a dialogue to see if we need to make adjustments. So we're looking at that very closely, but that will probably come together with the finalization of our 2018. And we will update the market in February on that one.

Kåre Schultz - *Teva Pharmaceutical Industries Limited - President, CEO & Director*

And with regard to the discussions with the consortium, with the customers, we are initiating those discussions as we speak. So we haven't been through that yet, so it's too early for us to say exactly what's going to happen. And I guess, it also depends on the dynamics in the marketplace. So we will just have to see how it plays out over the coming months. Thank you, everybody, for listening in.

Operator

Ladies and gentlemen, that concludes today's session. For those wishing to review this conference, the replay facility can be accessed by dialing from the United States, (631) 510-7499; from the United Kingdom, (0845) 245-5205; or from elsewhere, country code (0044) 1452-55-0000. The on-call access code is 3888788. Thank you for your participation. You may disconnect.