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Bristol-Myers' imperiled megamerger may depend on Wall Street's loudest whisperers

By Damian Garde @damiangarde

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Bristol-Myers Squibb (BMY[1]), racing to convince shareholders to back its planned $74 billion acquisition of Celgene (CELG[2]), could have its plans derailed by a pair of hugely influential financial advisers.

ISS and Glass Lewis, two global firms that make recommendations to institutional investors, are yet to weigh in on the potential merger. Together they claim a roughly 97 percent share of market for shareholder advice, and their verdict on the deal could spoil the largest pharmaceutical acquisition in history.

"They're not almighty, but they wield enough power that management and the whoever's opposing management both will plead their case with these so-called shareholder advisory services," said Erik Gordon, a professor at the University of Michigan's Ross School of Business who studies M&A and the pharmaceutical industry.

Time is tight for Bristol-Myers. Shareholders will vote on whether to approve the Celgene merger at a meeting on April 12, and representatives for ISS and Glass Lewis said the firms will make their recommendations a few weeks before that date.

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"With a deal like this, they will be more influential than normal, because this is not a rubber stamp," said Ramon DeGennaro, a professor of banking and finance at the University of Tennessee.

Bristol-Myers has proposed buying Celgene at a price roughly 50 percent above its prior value, "and I can see Glass Lewis saying, 'We think this is a decent deal at a 10 or 20 percent premium, but we think 50 is too much," DeGennaro said. "That might swing a mutual fund."

It has happened before. Last year, a proposed $24 billion merger between Rite Aid and Albertsons fell apart after Glass Lewis and ISS came out against the deal. Conversely, last year, famed activist investor Carl Icahn dropped his attempts to block the $67 billion merger between Cigna and Express Scripts after the two advisory firms gave the deal their blessing.

Companies like ISS and Glass Lewis, little known outside financial circles, came to power in recent years as mutual funds grew to dominate the stock market. Major investors own shares in thousands of companies, making it impractical to keep tabs on every shareholder vote. That's where Glass Lewis and ISS, which make recommendations on thousands of proposals each year, command substantial influence.

Earlier this year, researchers at Stanford studied the voting records of more than 700 institutional investors and found that they were significantly more likely to vote in line[4] with Glass Lewis and ISS's recommendations than against them. Some funds even voted in near lock-step with the advisers. And, most pertinent to Bristol-Myers, a 2010 study[5] found that when ISS sides with dissident shareholders, their odds of victory go up by as much as 30 percent.

"The short answer is that they are influential," said David Larcker, an accounting professor who leads the Corporate Governance Research Initiative at the Stanford Graduate School of Business. "They can swing, easily, 15, 20, 25 percent of the vote, depending on who the shareholders are."

That's why "powerful CEOs come on bended knee" to the offices of ISS, as the chief justice of the Delaware Supreme Court once wrote, and it's why Bristol-Myers' best-laid plans could come undone in the coming weeks.

Things weren't always so. When Bristol-Myers announced its agreement to buy Celgene in January, the company said it was confident shareholders would back the idea. And Wall Street seemed to agree: SVB Leerink surveyed more than 200 investors and found that 91 percent expected the merger to close in the third quarter.

But that was before Wednesday, when Wellington, a $1 trillion fund with an 8 percent stake in Bristol-Myers, came out against the deal, arguing Celgene is too risky an investment to justify the price. Starboard Value, an activist investor with a small Bristol-Myers stake of its own, published a lengthy rebuke of the merger on Thursday, calling it "poorly conceived and ill-advised."

Representatives for Bristol-Myers' other major shareholders — Vanguard, Blackrock, State Street, and Dodge & Cox — declined to comment on the proposed merger.

Despite the documented influence of shareholder advisory firms, whether Wellington's fellow investors join the mutiny may depend less on the likes of ISS than it does on their balance sheets.

Egor Matveyev, a professor of finance at the MIT Sloan School of Management, ran the numbers and discovered that while Wellington is disproportionately invested in Bristol-Myers, the other top shareholders also have sizable stakes in Celgene. The proposed merger is "a huge value transfer from shareholders of Bristol-Myers to shareholders of Celgene," Matveyev said, which could explain Wellington's reticence. But it might not matter to a fund with bets on both horses.

"At the end of the day, for them, it's like moving money from one pocket to the other pocket," he said.

About the Author

Damian Garde[8]

National Biotech Reporter

Damian covers biotech and writes The Readout newsletter.

damian.garde@statnews.com[9]
@damiangarde[10]

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