



# The war on drugs

Activist investors, long interested in biotech, are starting to renew their interest in pharmaceuticals after a couple of quiet years. M&A remains the primary, but not the only, way to monetize portfolios.

**B**etween probable healthcare reforms, global interest in pricing practices and scrutiny of their tax and compensation policies, the companies in charge of keeping us healthy have had little excuse to let themselves go over the past three years. Yet another source of pressure has come from the investment world, and early signs suggest 2017 could be the busiest yet for activist investors.



“Not all activists are so reliant on deals, however. Balance sheet demands became more popular in 2015 and 2016, especially with biotech firms.”

### A lit squib

Already this year, two of the biggest names in the space have shown interest. On February 21, **Jana Partners** inked a settlement agreement with **Bristol-Myers Squibb**, adding three directors to the board of the \$94 billion drugmaker. The same day, **Carl Icahn** was reported to have taken a stake as a prelude to pushing for the company to sell itself.

Icahn is no stranger to the sector, having previously targeted the likes of **Biogen** and **Forest Laboratories**. *Activist Insight Online* shows him as having agitated at seven pharmaceutical or biotech companies since 2010, second only to **Sarissa Capital Management** – a Connecticut-based hedge fund started by his former portfolio manager, Alex Denner. In 2016, Icahn invested in an eighth, **Allergan**, then as now run by the man helped up the corporate ladder by the convulsions at Forest Laboratories, Brent Saunders. Yet within months Icahn had lost interest and sold his shares, probably at a modest profit.

2017 so far sees Icahn paying the sector greater attention. Last month he hired Richard Mulligan, a co-founder of Sarissa, to be his new portfolio manager. “We are very pleased to have Richard join Icahn Capital given the depth and level of experience he brings as we look to enhance our focus on the biotechnology sector,” Icahn said in a statement.

### Alchemy and its opposite

With plenty of board experience, an advisory role at the Food and Drug Administration and a Harvard lectureship in his past, Mulligan is likely to offer an informed link to the sector at a delicate point in time. Icahn will certainly be hoping he can combine scientific and business expertise in ways activists have not always seen in the sector. At **Ariad Pharmaceuticals**, Sarissa waged a lengthy battle to defenestrate CEO Harvey Berger. “[We] are especially disturbed by the decision to renew Harvey Berger’s employment contract in October 2013

and, given the egregious terms of that employment agreement, urge the issuer to immediately disclose to shareholders any discussions of the board and the compensation committee regarding the decision to renew this agreement,” Sarissa wrote in a February 2015 filing.

Sarissa won that bout, though Mulligan was not appointed to the board in the settlement. The activist eventually sold the company to Takeda Pharmaceuticals for more than \$5 billion, despite pressure over pricing from presidential candidate Bernie Sanders. From an initial investment of \$45 million, Sarissa pocketed close to \$308 million through the takeover.

### The drugs don’t work

Recently, the performance of pharmaceutical and biotech firms has diverged. An S&P index of the former has produced a 0.4% gain in the last three years, despite a rally in the last 12 months. Optimism over the inauguration of a new administration in

## Cold turkey

When **Pershing Square Capital Management** first invested in **Valeant Pharmaceuticals International**, it knew the serial acquirer was in the crosshairs of short sellers like **Jim Chanos**. After reviewing a presentation by Chanos’ Kynikos Associates, however, Pershing Square jumped in, trusting then-CEO Mike Pearson to exercise discipline at the helm of the Canadian company.

Last month, the hedge fund bailed on its two-year investment, accepting a

loss of around \$4 billion. Other short sellers, including **Citron Research** and **Bronte Capital**, piled in behind Chanos, and even helped to uncover the business practices that laid Valeant low.

As it happens, Valeant is one of 16 biotech or pharmaceutical companies to have been targeted by both long and short activists since the beginning of 2013 – over 13% of the total companies facing long and short campaigns in that

period. Others include Bristol-Myers Squibb and **Immunomedics**.

Short sellers have mostly focused on biotech in their reports, targeting 106 companies in that sector to 39 pharmaceutical companies. Bearish calls spiked to 51 individual companies in 2015, falling to 31 last year even as the sector faced increased political scrutiny. Six have been targeted this year by activist short sellers, falling behind the nine targets of long activists.

*“Activist Insight Online shows Icahn as having agitated at seven pharmaceutical or biotech companies since 2010, second only to Sarissa Capital Management - a fund started by his former portfolio manager, Alex Denner.”*

the U.S., given Hillary Clinton’s sharp focus on drugmakers, has not been boundless. On March 7, President Donald Trump tweeted a promise of greater competition and lower prices for pharmaceuticals. Other countries are equally interested in keeping health costs down. The S&P’s biotech index, meanwhile, has risen 40% in the last 12 months, contributing to a 13.7% gain on an annual basis over the last three years.

Activists have followed the money. The number of biotech companies targeted leapt from 11 to 28 between 2014 and 2015, remaining at an elevated 23 in 2016. By comparison, pharmaceutical targets have fallen slightly each year, from 18 in 2014 to 15 last year – in spite of exceptions such as **Starboard Value** at **Perrigo**.

That disparity may also have something to do with the fallout from Valeant Pharmaceuticals International, a much criticized drugmaker that partnered with Pershing Square Capital Management for a controversial hostile takeover in 2014 and then saw its business implode the following year. Critics of the company’s business practices have called it “a creature of modern shareholder capitalism,” spreading ignominy from the industry to the asset class. Yet even before Pershing Square exited the stock this March, other activists were returning to the sectors.

**Fight club**

Just over two months into this year, the two industries are almost neck and neck in the number of companies that have been targeted. Sarissa initially nominated a majority slate at **Innoviva**, before cutting its size from four to three nominees. It criticized the

company for “pre-emptively” launching a contest by filing a preliminary proxy ahead of the activist.

**Richmond Brothers**, a first-time activist, has lost patience with **Rockwell Medical** and is seeking two board seats. In the biotech world, venture capital firm **venBio Select Advisor** won a major victory at **Immunomedics**; helped by a licensing deal, Immunomedics’ shares are up 70% in four months.

Much of the interest in the sector is spurred by recent M&A trends. In a letter to the CEO of **OptimizeRx**, **Wolverine Asset Management** Portfolio Manager John Ziegelman wrote, “We believe the company is an ideal acquisition target to strategic players in the healthcare services sector,” giving its products greater access to market and lessening OptimizeRx’s risk and cost burden.

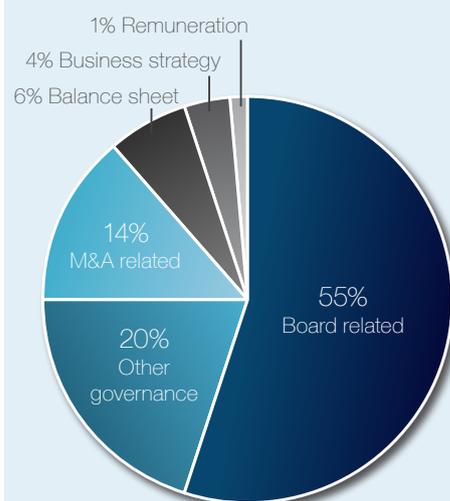
Tax-inversions between larger companies have largely given way to scouting for lucrative revenues, despite the interest in **Bristol-Myers Squibb**. Medical devices and pharmaceuticals also make up a significant part of the portfolio of **Hudson Executive Capital** – a deal-making activist run by former-JP Morgan banker Doug Braunstein.

Not all activists are so reliant on industry consolidation, however. Balance sheet demands became more popular in 2015 and 2016, especially with biotech firms. The suggestions are less share repurchases, as had been in vogue a few years previously, than asset monetization. At **Perrigo**, **Starboard** is understood to want management to sell royalties or even entire units, to correct a low valuation applied by the market. The hedge fund took its stake after a deal with **Mylan** had fallen through. ↴

**Companies publicly subjected to long activist demands by industry.**



**Breakdown of long activist demands at biotech and pharmaceutical companies in 2016.**



**16**

**Number of biotech and pharmaceutical companies subjected to both long and short activist campaigns since 2013.**