



A Government-Induced Hullabaloo and One Stock Worth Keeping an Eye On

Description

Dear Fellow Fools,

The biggest headline-grabber in the financial world of late has been the partial shutdown of the U.S. government.

I'm no political maven — not even close — and therefore have no insight into how this ordeal will wash out. What I *do* know is that this has happened before, many times in fact, and the worst-case scenario has never played out — even though this is the scenario to which the media naturally gravitates.

As this helpful [graphic](#) from the *National Post* illustrates, from a financial markets perspective, past U.S. government shutdowns have hardly had any impact at all.

During past shutdowns, the longest of which was 21 days back in 1995, the U.S. stock market checked in with an average return of -0.8%. Two weeks and a month after these shutdowns ended, the market was up an average of 1.0% and 1.1%, respectively. These are hardly the disastrous numbers that the media might have you believe may occur this time around.

Business as usual

With that historical perspective in mind, it has been more or less business as usual here at Fool Canada HQ. We're long-term, business-focused investors and therefore don't tend to get rattled by whatever the media storm du jour might be. We tend to stick to what we do best, and that's bottom-up, fundamental research. We'll let Mr. Market worry about all of that other stuff.

And this is exactly what we did in the first issue of our new [Stock Advisor Canada](#) service, where I introduced two specific recommendations for subscribers — one Canadian and one U.S. We plan to follow this formula — one Canadian and one U.S. idea, month in and month out — forevermore.

In this week's Take Stock, I'd like to peel back the curtain on our process. You see, one of the keys to investing is selectivity. There are many (like, MANY!) more bad investments out there than there are good ones, and therefore, it's critical to remain on high alert at all times to ensure these bad apples don't somehow slip through the cracks.

Today, we'll profile one of the companies that was up for consideration to make it into the first issue of *Stock Advisor Canada*, but didn't quite measure up in the final analysis.

4 reasons Paladin Labs will remain on our watch list for now

The stock that didn't quite make the grade was **Paladin Labs** (TSX:PLB), a Montreal-based company that is involved in many aspects of the world of pharmaceuticals.

Paladin has been one of the leading stock performers in the Canadian market over the past decade or so. The stock's 10-year return is in excess of 1,000% — truly an investor's dream! Past performance was not the issue here; the company's underlying growth fundamentals have coincided nicely with the dramatic rise that the stock has had.

Paladin has benefitted from a model that does not involve the long and risky process of developing its own pharmaceuticals, which may or may not ever see the light of day. Instead, the company is focused on the marketing and sales of products that larger firms aren't really interested in any longer. Its ability to stick to these marketing- and sales-related strengths has served investors well.

Though this model has served it well and eliminates some of the significant risks tied to the pharmaceutical industry, it doesn't eliminate them all. Paladin ultimately didn't make the cut because of the concerns we had with how these remaining risks could impact the company's future. Let's dig deeper into those risks.

1. Competitive threats.

The biggest issue is the competitive risk the company faces. Competition from generics is fierce across Paladin's product portfolio because its products are largely free of the patent protection that the developer of these products enjoys. I wasn't able to gain a level of comfort with the fact that investors might wake up one morning to find that another company had introduced a superior product to one or more of Paladin's products.

2. Digesting acquisitions.

In addition to the competitive risk, the strategy that Paladin has employed is one of growth-by-acquisition. It has cobbled together a portfolio of products by acquiring them, and it seemingly expects that it'll be able to continue to execute on this strategy indefinitely.

This has worked very well for Paladin in the Canadian market, where it has a high degree of expertise in marketing and selling its lineup of products. To continue growing, however, the company has begun to employ this strategy in other parts of the world. Unfortunately, in the pharmaceutical world, where every product and every jurisdiction is different, an intimate level of knowledge of the market in which you're operating is required.

The same level of expertise that has been so good to the company in Canada is not necessarily present in these international markets. There is a not-insignificant risk that somewhere along the line,

this growth-by-acquisition strategy leads to a mistake.

3. Management turmoil.

A savvy management team is required to lead this kind of growth strategy, and there has been some rather unfortunate turmoil at the top of Paladin.

As a bit of background, Paladin came public back in 1996, when it was listed on the Vancouver Stock Exchange. Prior to this, the company had been known as Pharmascience and operated under a similar in-licensing business model to the one that Paladin has utilized over the years. At the helm of this newly public company were three individuals that were also part of Pharmascience. Seemingly, these three people have largely been responsible for Paladin's success.

The elder statesmen of the trio, Mr. Ted Wise, who spent time as chairman of Paladin's board, has since passed away. And the primary driver and Paladin's CEO for most of its life, Mr. Jonathan Goodman, incurred a rather significant injury while riding his bike back in August 2011. This forced Goodman to relinquish the CEO role to the third member of the trio, Mark Beudet, as he was not physically able to keep up with the demands of this position. However, in May 2012, Goodman did return to the company in the chairman's role.

Now, Goodman's family still controls 34% of Paladin's stock, and given that he's back in the mix, there may well be nothing to this. But because of the perceived importance of sound management in the build-out of the company's international business, there was enough sandpaper here to at least give us pause.

4. And finally, the valuation.

On their own, or even combined, these issues weren't necessarily deal-breakers *if* they appeared priced in to Paladin's stock. But with a trailing price-to-earnings multiple north of 20 and with the stock trading near the top of its historical price-to-book value range, I couldn't convince myself that there was much room for error baked into the Paladin story.

The company is priced as though its future will resemble the past, and given that I couldn't get a firm handle on what that future might look like because of the issues mentioned, I decided to move on.

The Foolish bottom line

That's not to say Paladin will never be recommended in our *Stock Advisor Canada* service. It has earned a spot on our watch list and we'll be looking (hoping?) for one of the concerns mentioned to come to fruition at some point down the line, thus causing the stock to become less perfectly priced.

This is an important angle, and perhaps the most important takeaway from this week's letter. Most viable businesses become an attractive investment opportunity at some point. You just need to determine what that point is, and then wait for it to occur. Which is why having a well-developed watch list full of names that you've spent time on and followed is a great tool that will help you ensure opportunities aren't missed when they arise.

'Til next time ... happy investing and Fool on!

Sincerely,

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1. Investing

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