This Stock Just Keeps on Rolling

Description

The headline numbers were impressive. **Valeant Pharmaceuticals** (TSX:VRX)(NYSE:VRX) reported results for the fourth quarter of 2013, with both product sales and revenue numbers doubling year over year.

Cash earnings per share increased by over three quarters, while adjusted cash flow from operations was up 43%. For all of fiscal 2013, Valeant surpassed expectations on all of the measures above. The results were yet another positive surprise in a long string of successes for Valeant, whose stock has increased 10-fold over the past four years.

Last year the defining event was the U.S. $8.7 billion acquisition of eye-care company Bausch and Lomb in August, which so far has worked out very well. The division's sales grew by 10% organically, performing very strongly in both the United States and emerging markets.

Valeant has relied heavily on acquisitions to fuel its growth ever since new CEO Michael Pearson took over, and to the company's credit, the strategy has worked extremely well. Last year was no exception. The company has said it is looking for another transformative acquisition in 2014, and given Mr. Pearson's track record at Valeant, this is good news for shareholders.

On the other hand, Valeant's reliance on acquisitions does create concerns. Firstly, it is extremely difficult to predict where the company will be long term, or even in the medium term. Analysts have complained that this is one of the most difficult companies to model. For investors that don't like surprises, this may be a stock to avoid.

Second, Valeant's strategy can lead to accounting distortions. For example, the company spent less than 3% of revenues on research and development in 2013, simply because Valeant buys new products instead of developing them internally. Meanwhile **Pfizer** (NYSE:PFE) spent 13% of revenues on R&D and **Merck & Co** (NYSE:MRK) spent 17%. So even though Valeant still had to pay for its targets' past R&D efforts (by paying up for its acquisitions), the company doesn't have to record that cash outlay as an expense, unlike its large American rivals.

Foolish bottom line

An investment in Valeant requires placing a big trust in management, more so than for almost any other company on the TSX. Investors who emphasize predictability of earnings should look elsewhere.

But those who have put their faith in Valeant's management have been handsomely rewarded so far. If management keeps delivering, then the good times will continue for shareholders.

CATEGORY

1. Investing

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2. NYSE:MRK (Merck)
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Date
2025/06/29
Date Created
2014/02/28
Author
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