The Argument For and Against Valeant Pharmaceutical International Inc.'s Growth Strategy

Description

Canada's largest pharmaceutical company, **Valeant Pharmaceuticals International Inc.** (TSX:VRX)(NYSE:VRX) is controversial. One after the other, it acquires companies, which has many investors concerned that it can't grow organically. Other investors believe that Valeant is in a good business and is focused on finding profit-ready drugs now rather than waiting years. Both sides have merit and the next couple of years will be pivotal for Valeant's success.

The bull case

Many bulls say that Valeant is in the right business because it doesn't waste money on research and development. Specifically, the company spent only 2.7% of revenue on R&D last year. In comparison, merger target **Allergan, Inc.** (NYSE: AGN) spent 16.5%. The reason for that is because CEO Michael Pearson doesn't believe in investing in early drugs that might never come to fruition.

Creating drugs is incredibly costly and then the FDA can come along and say that the drug isn't approved. If the company had invested half a billion dollars, it's all for nothing. Valeant doesn't believe it should waste money on those early-stage drugs.

And that has quite a bit of merit. Valeant's business is finding those drugs that are in late-stage development, have shown a lot of promise, and have a good chance of being approved. It wants to get those products on the market and start generating revenue from the products as soon as possible.

To get those drugs, Valeant spends a lot of money on acquiring companies to increase the number of products the company offers. In September 2012, Valeant bought Medicis for $2.6 billion. In May 2013, Valeant bought Bausch & Lomb for $8.57 billion. In both cases, the company shut down dozens of products in the pipeline because they didn't offer any short-term potential.

The bear case

Many bears disagree with this approach. Their argument is that without strong R&D departments, Valeant can't find new products that could revolutionize a sector and generate significant revenue.

Further, the bears fear that all of these acquisitions make Valeant a house of cards, which is a valid point. By making all of these acquisitions, the company has racked up US$16.27 billion in debt. If Valeant succeeds in acquiring Allergan, that debt will only balloon.

Finally, the company doesn't have enough money to offer a dividend because it's not actually profitable. It won't be able to offer a dividend for a while because it will have to focus most of its money on paying down the crippling debt.

Who's right?

Both sides make valid points. Why invest in early-stage drugs when you can license late-stage ones? That saves money and allows Valeant to focus on selling drugs. On the other side, burdening the company with all that debt doesn't make investors any wealthier and could cause problems later on.

While I remain bullish on Valeant, it is a volatile company and might not be for the faint of heart. However, I've got a list of great stocks that I definitely think you should look at.

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1. Investing

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