Is Valeant Pharmaceuticals Inc. a Soaring Rocket or a Hot Air Balloon?

Description

Needless to say, there are a lot of struggling companies in Canada, and this has left investors very frustrated.

But one company in particular has been roaring along in recent years. **Valeant Pharmaceuticals Inc.'s** (TSX:VRX)(NYSE:VRX) stock price has skyrocketed past $250 from less than $16 this time in 2009. So it's only natural for investors to gravitate towards this stock.

That said, before you go buy a big chunk of Valeant, there are some major concerns about the company. In fact, it could be the most polarizing company on the TSX. On that note, we take a look below at what's made the company so successful, and we also look at why there are so many detractors.

A very simple strategy

The essence of Valeant's strategy is centred on acquisitions. To be more specific, the company doesn't like to spend money developing its own drugs. Instead, it would rather buy product lines that have already been established. Once a company is acquired, Valeant slashes the target's costs.

To illustrate how this affects Valeant's numbers, just take a look at its (lack of) research and development (R&D) expense. According to its most recent annual report, R&D totals just 2.7% of revenue. By comparison, this ratio was 12.9% and 17.0% at **Pfizer Inc.** and **Merck & Co., Inc.** respectively.

There's a very strong case to be made for Valeant's strategy. Research and development costs are typically very steep, and can get out of control quite easily. This is why there are so many mergers in the pharmaceuticals industry; when two companies combine, R&D costs can be more easily absorbed.

Valeant's strategy has certainly worked thus far. Just this past quarter, revenue increased by 11% year-over-year, and net income was up by a lot more. Valeant has also announced plans to buy gastrointestinal drugmaker **Salix Pharmaceuticals Ltd.** for US$10.1 billion, something investors have reacted to very enthusiastically. For the Valeant believers, the future looks as bright as ever, and there's no reason to doubt the company now.

There's more to the story

Valeant has a lot of detractors, and these aren't just your average investors. One is Jim Chanos, who gained fame by betting against Enron. Another is Jim Grant, who writes the much-respected newsletter *Grant's Interest Rate Observer*.

The two investors label Valeant as a "roll-up," meaning the company thrives only by using its inflated stock price to make acquisitions. By doing this, Valeant is able to mask its lack of profitability.

According to Mr. Chanos, once Valeant stops making acquisitions, its lack of true revenue growth will show. That could come before long—once the Salix merger is complete, Valeant's net debt will nearly double to US$30 billion, or 5.6 times earnings before interest, taxes, depreciation, and amortization. With this kind of debt load, further big deals will be tougher for Valeant to pull off.

It's true that Mr. Grant's and Mr. Chanos's bets have not worked out so far. In fact, Valeant shares are up by 68% since early March 2014, when Mr. Grant first presented his idea. But their ideas are still worth considering, to say the least.

So, if you're thinking of owning Valeant, you may get some diversification from Canada's struggling companies. But you shouldn't own very many shares—the risk is just too great.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:BHC (Bausch Health Companies Inc.)
2. TSX:BHC (Bausch Health Companies Inc.)

Category

1. Investing

Date
2025/07/22
Date Created
2015/02/25
Author
bensinclair