



Can Valeant Pharmaceuticals Intl Inc. Continue its Meteoric Rise?

Description

Raising money via “junk bonds”

Valeant Pharmaceuticals Intl Inc.’s (TSX: VRX)(NYSE: VRX) debt-to-capital ratio is already over 70%. In order to fund the recent \$10 billion Salix Pharmaceuticals acquisition, the company has had to issue bonds that carry an interest rate of 6.125%. The company’s debt-to-EBITDA ratio is over six times, which is high, even though cash flows in the coming years are expected to be strong, as there is always risk in expected cash flow numbers.

Moody’s Investor’s Services rates Valeant a Ba3, which is three levels below investment grade or speculative, and S&P rates the company at BB. So, the rating agencies are seeing the risk in Valeant’s aggressive acquisition strategy, while equity holders are focusing more on the potential upside, seemingly without paying too much attention to the risk associated with it. This is a strategy that has obviously been great in the good times, but if and when things get rough, it can get ugly.

Execution risk

While the company no doubt has a stellar track record in integrating acquisitions, the bigger the company gets and the more acquisitions it makes, the more difficult it gets. Simply put, execution risk is rising. Valeant has made roughly 30 acquisitions in the last five years and the most recent acquisition, Salix, is the biggest one in the company’s history.

With the Salix acquisition, Valeant is counting on FDA approval of Xifaxan, which is expected in May. More problematic is the fact that recent revenue growth numbers have been disappointing at Salix and inventory at Salix has been mismanaged.

Cost savings targets are optimistic, with the company expecting \$500 million in cost savings from the Salix deal. And the market is counting on this, as reflected in the stock price. But given the disappointing sales performance at Salix this year and inventory issues, this target will be difficult to achieve without sacrificing growth.

In summary

The question that comes to my mind is one of sustainability: How long can the company keep growing at this pace given that its balance sheet is stretched already?

Furthermore, along with the company-specific risks outlined in this article, this stock is one that would be more vulnerable to overall market weakness, and a change in investor sentiment and downside would be big. And even if I'm wrong, I am still happy to stay on the sidelines given what I see is a company that has too much downside risk.

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1. Investing

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1. Editor's Choice

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Date

2025/09/10

Date Created

2015/04/03

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