Why Are Valeant Pharmaceuticals Intl Inc. Shares in Absolute Free Fall?

Description

The U.S.-listed shares of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) plunged by roughly 35% on Wednesday (as of this writing), as a new report by Citron Research called the company's business practices into question.

This could not come at a worse time for Valeant, which is facing increased scrutiny for its drug-pricing strategy. But this time the allegations have nothing to do with raising drug prices.

Some murky dealings

At the beginning of October, practically no one had heard of Philidor Rx Services. But Philidor is at the epicentre of Valeant's latest controversy.

The story began when Valeant sent R&O Pharmacy—a small outfit just outside of Los Angeles—a letter demanding US$69.8 million for "invoiced amounts." This was a strange request for R&O's owners, since the pharmacy didn't do any business with Valeant. So R&O filed suit against Valeant on October 6, claiming it didn't owe the drug giant any money.

This is where Philidor comes in. The company describes itself as a "pharmacy administrator" with Valeant as its only client. Philador's ownership structure is murky, but we found out on Monday that Valeant owns an option to acquire the company. We also found out Philador's financial statements are consolidated into Valeant's.

That provides an explanation for why R&O may owe Valeant money. In reality the pharmacy owes Philador money, and this debt is consolidated into Valeant's financials. But this does not explain why Valeant has been so secretive.

Then on Wednesday Citron claimed that Philador owns R&O Pharmacy! It pointed to some very interesting facts to back up this statement. For example, Philador and R&O have the same patient privacy disclosure (they are even formatted in the same way), and have the same toll-free contact number.

What does all of this mean?

The web of ownership may be confusing by now, but if true, such a structure could allow Valeant to record false sales, thus inflating revenue. The trick would also allow Valeant to boost its stock price, which makes it easier for the company to make acquisitions. It's a very tempting trick to use, but it can eventually lead to disastrous results.

Worst of all, it looks like Valeant has created several other companies that look a lot like Philador. So, this is certainly not a one-off issue.

At this point, nothing is proven. But Citron's findings raise some very strong suspicions against Valeant, which is what the share price is reacting to. There will surely be more updates to come.

Could this be an opportunity to buy the stock?

After surging for years, Valeant's stock has now reached a 52-week low, and the stock must look very cheap to a lot of people.

But Valeant has always been a risky bet to make, essentially because it there's little visibility on the company's true profitability. Now that these revelations have come about, the bet all of a sudden becomes reckless. You shouldn't touch the shares with a 50-foot pole.

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