



Is Valeant Pharmaceuticals Intl Inc. the Next Enron?

Description

Shares of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) have been in an absolute free fall lately.

Since rising to almost \$320 per share in mid-September on the Toronto Stock Exchange, shares have fallen nearly \$200 per share each, or almost 60%. That's a huge drop for a company that was so big and popular that it temporarily replaced Royal Bank as Canada's largest company by market cap.

So, what happened? How does a stock that big fall by 60% in just over a month?

One word...fraud

A company called Citron Research published a scathing report on Valeant, alleging the company was a massive fraud.

Essentially, the story goes something like this. According to the report from Citron, Valeant used a specialty company called R&O Pharmacy to distribute some of its drugs. It sold the drugs to the pharmacy, which in turn sold them to customers and was reimbursed by the customers' insurance companies. R&O is owned by a company called Philidor, which Valeant owns an interest in; Valeant also has an option to acquire the whole company.

This isn't a real issue. It's an open secret in the pharmaceutical industry that many of the giants do this. The real issue is when Valeant billed R&O for \$69 million worth of drugs it claims to have never received or sold.

R&O has even gone as far as filing a lawsuit in a California court, alleging that either Valeant itself is attempting to defraud R&O, or both R&O and Valeant are the victims of fraud by a third party.

Valeant is still insisting it sold R&O the drugs. CEO Michael Pearson understandably isn't saying much, but he did say the product was sold to R&O. Valeant just hasn't booked the sales as revenue yet, only because R&O hasn't paid.

How is this similar to Enron?

During the late 1990s, when Enron was one of the largest companies in the world, it did some things that were similar to what Valeant is accused of.

Enron would create shell companies which were owned by some of its chief execs. The shell companies would transfer cash back to Enron, which it would book as earnings. Enron would then pay the money back (plus interest) to the shell company, allowing the parent to meet earnings targets and the execs who ran the shell companies to get rich at their employer's expense. This process repeated itself until the whole company collapsed.

Investors are concerned Valeant is doing the same thing, but through the use of specialty pharmacies. It's the whole cockroach theory; just like with cockroaches, there's never just one implication of fraud. If Valeant has messed up to the tune of \$69 million with R&O, there's likely bigger issues hidden among the books.

This isn't the first fraud allegation that's been leveled against Valeant. Several other short sellers have said the company intentionally consolidates sales of the companies it acquires, so investors don't have a complete picture of how the financials have changed from year to year. These short sellers allege that this allows Valeant's management to hide the poor performance of some of the companies it has acquired. Basically, if it wasn't for the acquisitions, growth would be muted.

There are several serious allegations against Valeant by a bunch of short sellers. There's also the threat of the U.S. Government starting investigations against the company and some of its peers over the use of specialty pharmacies and because of aggressive pricing practices.

At this point, I'm not certain the allegations are true, and frankly the depth of any potential accounting issues are tough for the average investor to understand. Still, investors should probably be safe and avoid any company that has serious fraud allegations levied against it, just in case they happen to be true and Valeant is the next Enron.

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Date

2025/09/12

Date Created

2015/10/23

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