



Concordia Healthcare Corp.: Is This Stock as Bad as Valeant Pharmaceuticals Intl Inc.?

Description

The big story last week was the absolute pounding that **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) shares took.

You're likely familiar with the story. Short-selling firm Citron Research essentially said Valeant was a fraud. Allegations of fraud came to light when Citron discovered a filing from a pharmacy named R&O that claimed Valeant billed it for drugs it never received or sold. R&O Pharmacy is also owned by a company called Philidor, a company that Valeant admits to having a close-enough relationship with that it consolidates Philidor's results in its own financial reports.

Citron even went as far as comparing Valeant to Enron, since the latter used sales-stuffing techniques to inflate revenue.

This was just the latest piece of news to hurt Valeant. About a month ago the company first came under fire because of its strategy to acquire competitors and inflate the price of their drugs. Democratic presidential hopeful Hillary Clinton vowed that a White House led by her would crack down on this practice.

Valeant isn't the only drug company with this type of business; it's just the most famous. **Concordia Healthcare Corp.** (TSX:CRX)(NASDAQ:CXRX) has been crushed in sympathy, falling more than 60% since peaking at \$110 per share in the first part of September.

Should Concordia investors be concerned, or is this just a case of throwing out the baby with the bathwater? Let's take a closer look.

A big acquisition

Adding to this mess is Concordia's huge new acquisition of Amdipharm, a U.K.-based pharmaceutical company which has operations in more than 100 different countries. Like with Concordia and Valeant, Amdipharm follows a very familiar business model. It acquires the rights to drugs, slashes R&D expenses, increases prices, and uses other synergies to make these medicines more profitable.

These similarities between the two companies are the big reason why shares of Concordia have performed so poorly lately. When the market gets spooked, investors head for the exits and ask questions later. Besides, many long-term holders have still made money on the stock. It's done that well, even after falling more than 60%.

Management is bullish on the big acquisition. The company predicts adjusted EBITDA will soar in 2016, jumping up to between US\$510 and US\$540 million, which, on the surface, looks like a very reasonable multiple for a company with a market cap of just \$1.82 billion.

The big issue is with the debt needed to make the big purchase. In today's market, anything above a 5% interest rate is considered high risk. Concordia was forced to pay an average of 7.5% for the US\$2.8 billion it needed to finance the deal. In total, Concordia will owe more than US\$4.1 billion when it officially closes.

The bull case

It isn't all bad news for Concordia. The big acquisition does look to be a pretty good deal, provided it doesn't drown under the debt load.

The acquisition further diversifies its product base, with no one drug accounting for more than 10% of its sales. It also gives the company access to new markets for some of its existing drugs. As well, Amnipharm has outsourced much of its business to India, a low-cost area. The company plans further cost cuts by outsourcing more things to the country.

Concordia has a track record of successfully integrating these types of acquisitions, too. Since May 2013, it has made six separate transactions much like this one. These have all gone relatively smoothly.

Should you buy Concordia?

The reason why Concordia shares are down so much is because the market has overreacted to the Valeant rumours. It's that simple.

That said, there are plenty of other reasons to avoid Concordia right now. The debt load is very high. It could see pressure from U.S. lawmakers that limit price increases. And if Valeant continues to be targeted by short-sellers—either rightfully or wrongfully—it will react in sympathy. For those reasons, I'd avoid the stock as well as Valeant.

CATEGORY

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