Valeant Pharmaceuticals Intl Inc. May Not Be an Enron, But Trouble Lies Ahead

Description

Last week, shares of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) plunged after short-seller Andrew Left suggested the company could be a "pharmaceutical Enron." He pointed to Valeant's relationship with a specialty pharmacy called Philidor, and then noted Philidor's relationship to a small Californian pharmacy called R&O.

Mr. Left then suggested that Valeant was "stuffing the channel" by selling product to R&O and similar pharmacies, then falsely booking the transaction as revenue.

Fortunately for the company, Mr. Left is an easy target. He is very brash during interviews. His report has a sensationalized tone, which includes the repeated use of red bold letters. He has an imperfect past, which includes sanctions from the National Futures Association. And while he has uncovered some very suspicious activity, the notion that Valeant is stuffing the channel remains very speculative.

As would be expected, Valeant has focused its defence on Mr. Left. The company has even asked the Securities and Exchange Commission to investigate him. Valeant has also strongly denied the channel-stuffing accusations.

But here's the problem: Mr. Left isn't the only one doing some digging on Valeant—others include the Southern Investigative Reporting Foundation, Bronte Capital, *The New York Times*, and *The Wall Street Journal*. And compared to these other outfits, Mr. Left has only scratched the surface.

Suspicious activity

This story is a very complicated one, but I will try to simplify it for you. Late last year, Valeant paid US$100 million to Philidor for an option to acquire the company for $0. This should already raise some red flags—after all, why purchase such an option when you can simply buy the company instead?

It also seems that Valeant has tight control over Philidor's operations. An article in *The Wall Street Journal* claims that Valeant went to great lengths to conceal this arrangement—some employees even used fake names.

Meanwhile, it seems that Philidor is essentially selling pharmaceuticals in California (and elsewhere) through R&O. This is significant because Philidor was denied a license to sell drugs in California back in May 2014.

What does this mean?

Here's the good news for Valeant shareholders: there is still no evidence of channel stuffing. So, for now it is still inappropriate to call Valeant the "pharmaceutical Enron."

But there's plenty of bad news. Philidor's actions appear fraudulent, and the problems concern sales all over the United States, not just in the state of California. The potential penalties against the company are massive.

Valeant maintains that since it technically doesn't own Philidor, it cannot be held liable for these issues. This is probably why Valeant purchased an option rather than purchase Philidor outright.

But if *The Wall Street Journal's* report is true, then Valeant could find itself in deep trouble with regulators, insurers, and pharmacy-benefit managers. This case is far from over, and you should certainly not own any Valeant stock in the meantime.

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