Valeant Pharmaceuticals Intl Inc.: Why Analysts Still Have a +$90 Price Target

Description

In a survey of 24 sell-side analysts by *Bloomberg*, the average price target for **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) sits at an eye-popping $92 (U.S). In fact, only four of the analysts rate Valeant a sell, despite the company's countless problems.

Then again, analysts have always been bullish on Valeant. At the end of September, when Valeant was trading for $178 per share, the average price target on the company was $280. And only one analyst had a sell rating at the time: Dimitry Khmelnitsky of Veritas Investment Research.

So how exactly did analysts get this one so wrong? And why do so many analysts remain optimistic?

Overwhelming pressure

Anyone who thinks that sell-side analysts always offer independent opinions is truly kidding themselves. In reality, there are a number of strong incentives for analysts to give positive reviews.

First of all, whenever stocks are doing well, skeptics tend to get ridiculed. For example, Nouriel Roubini earned the nickname "Dr. Doom" and was called "the current archetypical Eeyore," after (correctly) predicting a housing crisis in 2006. Warren Buffett was thought to have lost his touch during the tech bubble. And if you go back even further, Paul Warburg received a harsh anti-Semitic reaction when he expressed pessimism about the markets in early 1929.

Secondly, analysts can face serious backlash when they are negative on a stock. The company itself may get upset. Fund managers who own the name don't like negative ratings either. And, most importantly, the analyst's employer risks losing out on banking business. Put simply, a negative rating is a career-threatening move.

Analyst David Maris is a perfect example. Back in 2003 he put out a sell report on one of Valeant's predecessor companies, Biovail. He even accused CEO Eugene Melnyk of lying. He eventually turned out to be right, but in the meantime he was sued by Biovail, fired from his job, and even stripped of rightfully earned compensation. He later told *The New York Times* that on Wall Street, "everyoneknows you play ball or live with the consequences."

Valeant is even tougher

Analysts still write negative reports from time to time, but they tend not to be for companies like Valeant for a couple of reasons.

First of all, Valeant is a large company. This means that any negative report comes with extra scrutiny. Secondly, Valeant has long been a serial acquirer, which makes for very high banking fees. And no bank wants to risk losing out on that money.

This brings me back to Mr. Khmelnitsky. The company he works for, Veritas, doesn't have an investment banking business. And that allows Mr. Khmelnitsky to perform truly independent research. It's no coincidence that he was the only analyst rating Valeant a sell until March. And this is something investors must consider before blindly following analysts' recommendations.

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