Valeant Pharmaceuticals Intl Inc.: 3 Lessons From Bill Ackman's Painful Experience

Description

As **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) shares continue to plunge, activist investor Bill Ackman of Pershing Square Capital Management continues to stick by the company. He's even bought more shares along the way, costing Pershing's clients a ton of money.

To be fair to Mr. Ackman, he is still a widely respected investor, and for good reason. He has had a number of big successes, including the turnaround at **Canadian Pacific Railway Limited**, which has been a big win for shareholders of that company.

But much of his suffering with Valeant was avoidable, and there are some very valuable lessons we can all learn along the way.

1. Don't hesitate to put stocks in the "too hard" pile

Valeant has always been a difficult stock to analyze for a number of reasons. First of all, the company has been a serial acquirer for years, which makes it difficult to compare different time periods. On top of that, Valeant emphasizes non-GAAP measures in its financial reporting, such as "cash earnings per share," which exclude some very legitimate costs. And if that wasn't enough, sales data for individual drugs isn't always provided.

Then when skeptics such as Andrew Left, Robby Boyd, and John Hempton started exposing Valeant's seedy underbelly, the story got even more complicated. At this point, knowing what was going on at Valeant became impossible to figure out. And the company's future became even more unclear.

At this point, Valeant deserved a place on the "too hard" pile, meaning the stock was too complicated to figure out, and thus too complicated to own. There's nothing wrong with thinking this way, and anyone who did would have saved a lot of money on this stock, including Mr. Ackman.

2. Don't be too concentrated

Most fund managers keep too many holdings in their portfolios, meaning they end up owning lowconviction ideas. But Mr. Ackman only has eight long holdings, meaning that any mistakes have a big impact on overall returns.

For an individual investor, this isn't always such a big deal. But in Mr. Ackman's case, when a stock moves against him, Wall Street starts speculating that he'll have to reverse his bets to deal with fund redemptions or margin calls. This causes his positions to move further in the wrong direction.

For example, we've seen **Herbalife Ltd.** shares increase throughout this whole saga, feeding a vicious cycle for Mr. Ackman. This wouldn't have happened if he were properly diversified.

3. Admit your mistakes

Admitting mistakes is never an easy thing to do, especially while investing. In Mr. Ackman's case, it may be even harder simply because he has had so much success in the past.

We've seen other successful investors unable to admit mistakes. Bill Miller clung to financial stocks as the financial crisis unfolded. Eric Sprott stuck too much to junior mining companies. Like Mr. Ackman, both of these people may have been a victim of their past success.

As for the rest of us, when a stock moves in a big way against us, we must re-evaluate our position. And that means asking a very simple question: "If I didn't already own the stock, would I buy it?" If the answer is no, then it's time to sell.

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