Should You Buy Valeant Pharmaceuticals Intl Inc.?

Description

Valeant Pharmaceuticals Intl Inc. (TSX:VRX)(NYSE:VRX) fell almost 90% from a high of $330 to $42. Should investors catch this falling knife, or is it a value trap to be avoided?

First, let's explore its business

The business

Valeant is headquartered in Quebec and has a diverse product portfolio that focuses on branded pharmaceuticals, branded generics, and over-the-counter products.

It develops, manufactures, and markets a variety of pharmaceutical products predominantly in the fields of dermatology, gastrointestinal disorders, eye health, and neurology. The pharmaceutical company sells its products in North America, Europe, the Middle East, Latin America, and Asia Pacific.

Why did shares fall hard?

Valeant is under scrutiny on multiple fronts. Firstly, its aggressive acquisition strategy seems to be falling apart. Its debt-to-cap ratio is 80%. Its heavy debt load is weighing down on the shares. Some of its debt has variable interest rates, so as interest rates rise, the company's interest expenses increase.

Valeant's use of specialty pharmacies, especially Philidor, and its drug-price increases are in the spotlight. The effects of the Philidor issue on Valeant's financial statements is not yet clear, but will be reflected in the company's 10-K form, which Valeant expects to file by April 29.

Furthermore, Valeant recently reduced its revenue and earnings expectations. It now expects its revenue to be about 12% lower than it previously thought. Specifically, it expects revenue to be US$11-11.2 billion instead of US$12.5-12.7 billion.

It also expects its earnings per share (EPS) to be more than 23% lower than its former guidance. Specifically, it anticipates EPS of US$9.5-10.5 instead of US$13.25-13.75. We do not yet knowwhether the revenues and earnings will further erode or not.

Additionally, the board is looking to replace the current CEO, which adds more uncertainty to the company's future.

Conclusion

At US$33 or CAD$42 per share, Valeant is trading at 3.1-3.5 times its forward earnings, which is dirt cheap. However, the global pharmaceutical company is subject to headline risks. Any news can lead to huge price swings, so it's not an investment for the faint of heart.

Most importantly, the company's future is full of uncertainty, which adds more risk to an investment in Valeant. The company has a leveraged balance sheet, so any interest rate hikes will increase the company's interest expenses.

Further, Valeant is plagued with pricing issues and is about to change its CEO; because we don't know who it will be yet, we can't predict what kind of vision the next CEO might have for the company.

Overall, Valeant has many problems to solve. However, if it's able to turn around, its shareholders will be rewarded handsomely as it could rise at least 300%. Investors can consider investing in Valeant by taking on above-average risk in return for a potentially higher reward.

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