



The Real Reason Why Bill Ackman Still Holds Valeant Pharmaceuticals Intl Inc.

Description

Bill Ackman has admitted that he regrets his initial investment in **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) that lost about 90% of its value. Despite his regret, he joined Valeant's board of directors with the hopes that he and the new CEO Joseph Papa could turn the stock around.

There's no question that ex-CEO Michael Pearson had a huge flaw in his business model; hiking prices on recently acquired drugs is both immoral and won't last thanks to government regulation measures. It was inevitable that Pearson would leave Valeant considering that he had no answer to the stock dropping into a bottomless pit.

It's clear that Pearson had only the short term in mind when he was running the business, and he never considered the fact that Valeant's over-leveraged business model would come crashing down thanks to many different factors.

Joseph Papa is a very suitable replacement; he has the experience needed to run a pharmaceutical business and the hands-on knowledge of how the drug-distribution process works. If Valeant is to turn around, then there's no better fit than Joseph Papa as CEO.

This June, Valeant lowered its 2016 sales guidance from \$11-11.2 billion to \$9.9-\$10.1 billion due to lower dermatology sales. I believe dermatology sales will eventually rebound because of the Walgreens partnership, which will give Valeant the boost it needs to get out of the hole it's currently in. Bill Ackman knows this business has some very promising drugs in its pipeline, and once the business shifts its focus towards more of an R&D model than a price-gouging model, we may see Valeant slowly start to rally.

Still a risky stock despite its great valuation

The stock is very inexpensive at current levels. Valeant currently trades at a ridiculously cheap 1.3 price-to-book, a 0.7 price-to-sales and a three price-to-cash flow, all of which are much cheaper than the industry average values of 1.7, 2.8, and 4.4, respectively. The stock is dirt cheap, and there are some fantastic assets that Valeant owns, such as Bausch and Lomb.

The reason why Valeant is still dropping is because a huge amount of uncertainty still exists with this company. There are investigations into accounting irregularities adding to the uncertainty, and I believe the stock will remain volatile until these issues are sorted out.

What about Valeant's tarnished reputation?

There's no question that Valeant's reputation has been badly hurt. As Warren Buffett once said, "It takes a long time to build up a good reputation and only a few seconds to ruin it." I believe the reputation may be permanently damaged and might always be a headwind facing this company, even though the business starts getting back on track.

If the allegations of fraud are false, we might see the stock rally, as the company stabilizes its business model and pays back its massive debt that's owed from its M&A spree. There's no question that Papa can turn the business around, but, personally, I follow one investment rule: if there's any sign of fraud involved with a business, I am out.

Bill Ackman still holds shares because the worst has already happened, and although it's unlikely that Valeant will rebound to its high, Ackman can still recoup some of his losses with Joseph Papa at the helm.

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