Valeant Pharmaceuticals International Inc. Q3 Earnings Preview: It's Gonna Be Ugly

Description

Valeant Pharmaceuticals International Inc. (TSX:VRX)(NYSE:VRX) will report its Q3 earnings on November 8. If you are expecting this quarter to usher in a turnaround for Canada's most (in)famous company, don't hold your breath. While recent developments under Joseph Papa's helm have been promising (such as the rumoured Salix divestiture), expect Valeant to report a guidance cut and further pricing woes as it looks to clean up its balance sheet.

Guidance cut on the horizon

Valeant reaffirmed its guidance of $9.9-10.1 billion for FY 2016 in its last earnings call, but, to be frank, the fundamentals tell a different story. While I am certainly cheering for the new management team, with revenues from heavy hitters such as Jublia, Xifaxan, or its GI segment overall either flat or down quarter over quarter, I just don't see how this target can be met. On that note, others evidently shares the same sentiment; for example, RBC Capital Markets has also projected a guidance cut to $9.7-9.9 billion.

Pricing pressures will weigh on margins

Another snag that can lead to a less than stellar quarter is the headwinds surrounding generic pricing. Valeant is expecting generic pricing pressures to increase in the next few months; this is evident in generics Nitropress and Isuprel, which saw year-over-year revenue declines of 46% and 19%, respectively, last quarter.

Furthermore, the current political environment in the United States, along with Valeant's lack of exclusivity for some of its most popular drugs, are not exactly conducive towards any future price hikes. In other words, shareholders can expect further margin erosion in this coming release and a possible deviation from prior guidance of 26% selling, general and administrative expenses for 2016.

Expect further deleveraging and asset sales

Finally, we have the debt burden. Prior to the Philidor fiasco, Valeant's debt-fueled acquisitions were lauded by the market as management's effective use of leverage. Now, the $31 billion worth of obligations on the balance sheet has become the company's riskiest liability. In August of this year, Valeant managed to renegotiate its covenants from EBITDA of 2.75 times interest coverage to two.

The new covenants have managed to allow Valeant to stave off bankruptcy for the time being, albeit by the thinnest of margins, while it funnels off its "non-core" assets. Currently, management is aiming to pay down $5 billion over 12-14 months, and any sign of further deleveraging this quarter would be approved by the market.

By the way, non-core in this case is entirely a misnomer, as Valeant is supposedly in talks to sell off its Salix assets for $10 billion to an as of yet unannounced suitor. If the rumour proves to be true, it can mean two things: Valeant is looking at a loss of only $1 billion or so against the $11 billion it paid for Salix; Valeant's balance sheet is worse than we thought, as the company is willing to sell such a prized "core" asset to deleverage.

The bottom line

Patient investors might eventually see a Valeant rebound, but don't expect anything earth shattering from next week's earnings, or within the next two years, for that matter. Instead, the preview for Q3 includes a guidance cut and further pricing pressures, but that's weighed against much-needed debt repayments.

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