

Long-Term Investors: Valeant Pharmaceuticals Intl Inc. Looks to Ease Debt Burden

Description

Valeant Pharmaceuticals Intl Inc. (TSX:VRX)(NYSE:VRX) is in the news again. It's making a big move aimed at reducing its massive debt burden. The company is in talks with Japan's Takeda Pharmaceutical Co., one of two potential bidders for Salix, a company that produces gastrointestinal products, such as Pepcid for stomach ulcers and Zegerid for heartburn. The second potential bidder has not been disclosed publicly.

The details of the transaction are still being discussed; however, individuals familiar with the potential deal have noted that the transaction would likely come in at US\$8.5 billion in cash along with future royalties associated with Salix's drug portfolio. The total present value of the deal, around US\$10 billion, would come in close to Valeant's purchase price of Salix in 2015 of US\$11 billion.

Debt-load reduction

This sale is reported to reduce the company's burgeoning debt load by one-third; a Salix sale would reduce the company's debt burden from US\$30 billion to US\$20 billion. This is a great thing for long-term investors looking at key measures such as net return on assets and operating profitability.

What we are interested with (in looking specifically at the sale of key assets) is how this reduction in debt and assets will affect future free cash flow. One positive we can point to is the fact that this deal would likely improve the future quality of profits, meaning ultimately that less of the future free cash flows generated by the business will be required to go back to debt holders and can be instead redistributed to equity holders.

Replicating free cash flows a positive

Another aspect of this deal we like is the company's focus on replicating cash flows into the future via royalties. If the deal is structured in such a way that the company can maintain the free cash flows from the Salix assets for a period of time without holding the debt associated with the assets, we view this potential deal very favourably.

Further analysis of the specifics of the deal will be needed for any long-term investor to make a decision one way or another on how such divestitures will affect Valeant.

More deals to come?

Speculation is now abounding from analysts suggesting the proposed sale of Salix may be one of many divestitures. We will continue to monitor the company's asset portfolio and future divestitures, placing significant emphasis on the structure of the Salix deal. If this divestiture is completed in a fashion favourable to equity holders, we will see future divestitures as increasingly positive for the company.

Stock price reaction

In recent days, the company's stock price has fluctuated significantly, initially moving higher after news of the company's debt-reduction initiative, then moving lower on news of weak Q3 earnings. We view the potential for future positive "shocks" to the stock price as a more likely scenario than downward movements and will continue to monitor this stock accordingly. default

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