



Is Kevin O'Leary Right About Valeant Pharmaceuticals Intl Inc.?

Description

During a recent appearance on *Business News Network*, market pundit and celebrity investor Kevin O'Leary weighed in on the **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) drama. Needless to say, he was not bullish.

O'Leary told host Catherine Murray, "The way I look at it is this ... I think the stock is a zero. My thinking on this is that any equity value left has to go through the process of paying off all the debt, which is north of \$35 billion right now. The only prime asset is Bausch and Lomb, which they're not wanting to sell."

Later in the same interview, O'Leary was much blunter: "Would I buy the stock? Never. This thing is so tainted it's radioactive waste. You've got all this criminal investigation stuff and you've got so much debt and you've got a pricing environment that's changing ... Whenever you get accounting teams on a company, the best thing you can do is get a spatula, scrape up the whole board, [and] change the name of the company."

O'Leary is certainly known for his controversial views. Is he right about Valeant, or will bulls get the last laugh? Let's take a closer look at each argument.

The bull case

The bull case is simple. Underneath all the scandals, Valeant owns good assets with great pricing power.

Valeant continues to lose money from an earnings-per-share perspective, but it has ample cash flow. Over its last four quarters, it has posted cash flow from operations of US\$570 million, US\$448 million, US\$557 million, and US\$598 million. That translates into cash flow of nearly US\$2.2 billion in cash flow over the last year.

Remember, Valeant doesn't develop drugs, so it doesn't spend much in capital expenditures. It only spent US\$303 million in capex in 2015 and is on pace to spend a similar number in 2016.

The company is also aggressively paying down its debt, stating recently it had already paid down US\$1.6 billion in debt thus far this year, putting it on pace to hit its goal of paying down US\$1.7 billion worth of borrowings in 2016. Management also plans to pay down up to US\$5 billion more in the next 18 months as it sells some non-core assets.

Finally, the company is doing what O'Leary suggests. Although it doesn't appear a name change is imminent, the company does have a new management team that is very focused on transparency and getting things right.

The bear case

We've already talked about debt issue, which is the big thing investors need to worry about. Selling off assets to pay down debt is a fine strategy, but investors need to remember that this action impairs earnings over the long term. Every time a division is sold, the company shrinks a little bit.

There's also upcoming litigation. Valeant's legal problems are well known, and even if it's able to negotiate favourable terms with regulators, defending a corporation from those kinds of issues isn't cheap.

Finally, there's the taint factor. Many investors don't want anything to do with Valeant. It will take years for investors to get past that; many have pledged to never buy shares again. That kind of pressure is bound to keep the share price down.

The bottom line

I like to think I'm a contrarian value investor. When the market hates a stock, I'm usually pretty interested. And there are certainly things to like about Valeant, like its solid cash flow, its low valuation, and management's turnaround plan.

But at the same time, I just can't get past all the scandal. I'm just not brave enough. The debt is a major issue too.

I think it comes down to this: there's value in Valeant; there's no question about that. But there's also value in other parts of the market that you can get without all the baggage. That's why I agree with O'Leary. My money won't be investing in Valeant anytime soon.

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