Saving Face at Valeant Pharmaceuticals Intl Inc.

Description

When looking at certain situations, it can sometimes be difficult to differentiate the forest from the trees. In the case of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), a reputed short seller named Andrew Left at Citron Research tried to do exactly that in October 2015.

Unlike most short sellers who publish reports, this report was more than a little white noise. In October 2015, shares began the month trading at $235.43 and finished the month at a price of only $122.04. Although it was a bad period for long investors, the worst was yet to come.

In March of this year, shares took another nosedive, moving from over $85 per share to under $35 per share. Currently, the share price is approximately $20 per share. From a technical level, the 10-day and 50-day simple moving averages (SMA) may have caught up to one another in the past three months, but they have not held. The company may still be trading in a long-term downtrend, and it's easy to see why.

The financials

For pharmaceuticals companies, it is not uncommon to have very little tangible equity in the company. In the case of this company, however, the concern lies not on the intangibles line, but on the goodwill line. The difference between these two categories is extremely important.

When the company purchases a drug or patent from a competitor, there is an exchange of cash for the right to produce a drug for a certain period of time. This can also be referred to as a patent, which will eventually expire. Since the useful life is known, the intangible asset is amortized over its useful life, eventually reaching zero. The true fair value of the asset is known and properly reflected in the company's balance sheet.

Goodwill is created when a company is bought for an amount of money which exceeds the tangible value of the identifiable assets. This means the premium paid by the buyer creates goodwill, which is an asset listed on the balance sheet.

The main difference between goodwill and intangible assets is the requirement to amortize the intangible assets, whereas there is no requirement to amortize goodwill.

Goodwill is required to be “tested” at least annually for impairment, but if management does not believe it has been impaired, there is no requirement to include any expense relating to the goodwill, and tomorrow is just another day.

What’s really happening here?

In this case, the intangibles are listed on the balance sheet at $20.5 billion, while the goodwill is carried at $17.5 billion. It seems that through the acquisition of both individual drugs and entire competitors, the fate of Valeant Pharmaceuticals Intl Inc. is not in the hands of management, but instead in the hands of the accountants and the hedge fund managers such as Bill Ackman.

Wouldn’t it be fun to be a fly on the wall in those annual meetings?

CATEGORY

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