Valeant Pharmaceuticals Intl Inc.: Stay on the Sidelines

Description

Sometimes when an investor sees a stock that once traded at $335 a share trade at under $19, the greed kicks in and they imagine the stock riding a huge wave and turning the average investor into a millionaire. But when it comes to **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), my advice is to sit on the sidelines. Valeant didn't ever deserve to trade at $335, and it is highly unlikely it will ever experience that again.

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But at one time, investors were convinced that Valeant would keep going up. It was known as a hedge fund hotel; all the major hedge funds would put their money in it because it was experiencing incredible growth. On January 2, 2015, it was trading at $169.99 a share. By July 31, 2015, it had appreciated to over $335 a share. But then September 2015 hit, and suddenly the stock tanked from over $300 to just about $100 a share by the middle of November. And it has basically been bad news ever since.

The cause of the drop was due to controversy about drug-price hikes as well as the use of specialty pharmacy Philidor Rx Services to distribute its drug. Specifically, it was revealed that it had an option to buy Philidor and had former Valeant employees working there. By controlling the services, it could drive Philidor's customers to use Valeant's expensive drugs.

Since then, though, Valeant has been doing all it can to try to reverse the negative trend.

J. Michael Pearson, the former CEO, left the company, and Valeant brought in Joe Papa, an experienced pharmaceutical operator to try to turn the company around. And according to his compensation package, he was heavily incentivized to turn things around. If the stock returns to US$150 a share, he'll get nearly US$100 million in performance-based stock units. And if Papa can get the stock back to US$270, he'll get US$500 million in performance-based stock units.

Unfortunately, things have not been going well for Papa since he took over. The stock continues todrop and is now under $20 a share. There are a couple of reasons for this. The first is that Bill Ackman,one of the big hedge funders who pushed Valeant as high as it went, finally started cashing in hisshares to give his investors tax benefits from having such a large loss. The other reason is becausethe company is sitting on US$30 billion in debt and hasn't been able to get rid of it.

Management had talked about selling non-core assets to try to pay some of that debt down, and it even had an offer for approximately US$10 billion to buy Salix Pharmaceuticals, but that fell through. If Valeant can't get its debt under control, it will be in serious pain for many more years.

I ultimately believe Valeant will turn around. It will be able to sell some of its assets, pay down some debt, and ideally push more resources into organic growth. However, right now, I believe investors are best to sit on the sidelines and wait to see if the stock can return to its prime. Even if you miss some returns, it's best to just wait.

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