Valeant Pharmaceuticals Intl Inc. Crushed by Citron Research: Find Out Who's Next

Description

For short-sellers looking for another opportunity to capitalize on accounting manipulations and scandals to reap a massive pay day, as with **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), Andrew Left from Citron Research has another top pick for you.

Mr. Left has asserted that now may be the time to short **TransDigm Group Incorporated** (NYSE:TDG) according to a report his firm released January 20.

The report outlined a number of reasons why TransDigm is headed in a similar direction as Valeant and why right now may be the right time to initiate a short position in this company.

Who is TransDigm Group Incorporated?

The TransDigm CEO has stated that he believes TransDigm is one of the biggest unknown companies out there — operating largely under the radar. For a company with a market capitalization of over $12 billion, Citron Research appears to have created massive value for internal shareholders and the company's CEO, who is now pulling in more than double the vast majority of his peers.

Over the past five years, *Bloomberg* has reported that TransDigm's CEO has raked in $278 million with the closest two CEOs in a group of companies representing TransDigm's competitors pulling in $150 million and the remainder making far less.

This newfound scrutiny is largely viewed by analysts as a negative for TransDigm, as the company has not had to deal with the proverbial "microscope" and the pitfalls such related short-side pressure may provide.

Unlike Valeant, which operates in the pharmaceutical industry, TransDigm is an aerospace parts supplier for the U.S. government and large aerospace manufacturers such as **Boeing Co.** and **Lockheed Martin Corporation**.

Like Valeant, TransDigm's playbook involves acquisitions and price hikes to boost margins in an industry where margins and profitability are king. Acquisitions, such as the 2013 purchase of vibration panels maker Aerosonic for $39 million dollars, show how TransDigm chooses its targets: it picks companies with unique replacement parts that are rarely produced and it hikes prices post-acquisition.

The problem with this corporate strategy

As investors discovered with Valeant, the major problem with implementing a corporate strategy of "acquire first, hike prices shortly thereafter" is that eventually, the resulting debt load gets to the point where raising money for acquisitions becomes very expensive, and the number of companies to acquire will thin out, presenting fewer "low-hanging fruit" opportunities for bolt-on acquisitions.

TransDigm's bond rating appears to be stable for now; **Moody's Corporation** assigned a Ba2 rating to the company's most recent bond issue for $1.2 billion.

That said, the company's largest outstanding bond for $1.6 billion is coming due at the end of 2018, meaning management will need to decide at that time whether raising more debt to make the bond repayment makes the most sense or if it has to use its earnings to pay out a portion of the bond due.

In 2016, the company earned $586 million on $3.17 billion in sales, meaning additional debt raises are likely to come in the next few years.

Right now, it makes sense to just wait and see how accurate Mr. Left's prediction will be over the next few quarters.

Stay Foolish, my friends.

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