Why Shares of Valeant Pharmaceuticals Intl Inc. Plunged Yet Again

Description

The news release this week from **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) was more of the same and a reminder of the state of affairs at this company that was once riding high.

The company announced that it has paid down $1.1 billion in debt, which is progress, I guess, but the fact is that debt on the balance sheet still stands at almost $30 billion with a total debt-to-capitalization ratio of a whopping 90%. With this, Valeant Pharmaceuticals also announced that it will seek to refinance some debt, removing and modifying certain maintenance covenants and modifying certain provisions of the credit agreement.

The story over at Valeant Pharmaceuticals has not changed; it is just getting clearer that this is less of an investment opportunity and more of a company's desperate struggle to stay viable.

Let's review the main reasons why this stock should not be in investors' portfolios.

Legal matters

Valeant Pharmaceuticals is being investigated in the U.S. for pricing increases that it has instituted in the past and for its accounting practices. The company has a variety of class action lawsuits that were filed against it.

Balance sheet deterioration

Although it seems impressive when a company announces that it has paid off $1.1 billion in debt, it is less so when we think about the details behind this.

Firstly, the cash used for the debt repayment came from the divestiture or asset sale of its skincare products. While it was a necessary step that management had no choice but to take, when a company is in the position where it is forced to sell its assets to stay afloat, it is a textbook case of a disaster scenario that all companies need to avoid. It is hard to imagine this situation ending well.

The asset sales help with the short-term debt repayment, but they reduce future revenue, cash flow, and the earnings power of the company as well. And considering that Valeant Pharmaceuticals still has almost $30 billion of debt and a quickly deteriorating debt-to-EBITDA ratio and interest coverage ratios, the future revenue stream and earnings power is of vital importance.

These debt levels are dangerous levels, even for a company that is seeing increasing revenues. Valeant is experiencing declining revenues and pricing pressure, which makes the situation even worse — it's a situation that investors should definitely stay away from. The risk/reward relationship is not a good one; there's too much risk.

The stock has declined 23% since the beginning of the year, and from the looks of it, the decline is probably not over yet.

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