Billionaire Bill Ackman Just Sold Valeant Pharmaceuticals Intl Inc.: Should You Sell Too?

Description

It hasn't been a good couple of years for billionaire investor Bill Ackman.

In 2016, Ackman's hedge fund Pershing Square Capital Management lost 13.5% of its value. **The S&P 500** was up 11.9% in the same period of time. And 2015's results were even worse with Pershing Square losing 20.5% versus the S&P 500's gain of 1.4%.

In Ackman's defence, he did kill the market in 2014; Pershing Square increased 40.4% that year versus a S&P 500 return of 13.7%. Pershing Square has also still significantly outperformed since its debut on January 1, 2004, increasing 503.1% versus a total return for the S&P 500 of 163.4%.

Several of Ackman's large positions had a miserable 2016. Shares of **Mondelez International**, **Chipotle Mexican Grill**, and **Nomad Foods Limited** all sank in 2016, and his well-publicized **Herbalife** short position spent much of the year under water before shares cooperated.

But none of those losses come close to Ackman's **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) debacle. Shares of the controversial drug maker nosedived in 2016, falling from a high of $134 each on the Toronto Stock Exchange to a low of $18. Shares have fallen even further thus far in 2017; they closed on Monday at $16.21.

After the markets closed on Monday, sources confirmed that Ackman has thrown in the towel on his Valeant position and sold every last share. Valeant shares promptly tanked on the news, losing some 8% in after-hours' trading.

Should investors join Ackman and dump their shares? Or are things bound to get better? Let's take a closer look.

The case for selling

Perhaps the biggest issue facing Valeant today isn't the fallout from its much-publicized 2015 accounting scandal, nor the accusations of price gouging. It's the company's massive US$30 billion debt load.

Yes, the company is taking steps to reduce its obligations. It recently announced the sale of two different non-core divisions, which should free up about US$2 billion to throw towards debt. CEO Joseph Papa has pledged to pay down US$5 billion by the middle of 2018 as well.

There are two problems with this plan. The first is it just isn't happening as fast as Wall Street would like. And second, the company is forced to sell assets to pay for the debt. This impacts its long-term profitability.

In short, once the debt is at a favourable level, much of the company's good assets may be gone.

The case for buying

Valeant's bull scenario comes down to two words: adjusted earnings.

In 2016, the company reported adjusted earnings of US$5.47 per share, or a loss of US$6.94 on a GAAP basis.

Why such a difference? Valeant has a number of moving parts, of course, but much of the gap comes down to the amortization of intangibles from its many acquisitions. Remember, amortization is an expense, but not a cash expense. This means that Valeant delivers plenty of cash flow, despite posting big losses on an income basis. The company highlights adjusted earnings for just this reason.

Many investors don't trust Valeant's earnings, especially after the accounting scandal involving Phildor. This is why shares have a current market cap of US$3.75 billion, despite generating US$2.1 billion in cash flow in 2016. Shares are exceptionally cheap as a multiple of cash flow.

The bottom line

With Valeant shares likely to make new lows during Tuesday's trading, it's easy for investors to throw in the towel. After all, Bill Ackman, one of Wall Street's most respected investors, just did the same.

But those investors are ignoring an important point: Valeant shares are incredibly cheap on a price-to-cash flow basis. It also has other potential upcoming catalysts, including more asset sales, a potential settlement with the SEC, and further debt repayment.

Ultimately, Valeant is incredibly risky. It could declare bankruptcy in 2017 if things don't go right, or it could end the year much higher than today. It's just too tough to call.

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