Why You Shouldn’t Own Valeant Pharmaceuticals Intl Inc.

Description

Do you know what the definition of insanity is? It’s doing the same thing over and over again and expecting a different outcome.

The SEC put the **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) proxy statement online March 23 to great fanfare. The highlight of the 111-page document most definitely was the news CEO Joseph Papa and his CFO, Paul Herendeen received US$62.7 million and US$31.4 million in compensation in 2016, respectively.

Is that not high enough for you?

Add to that US$10.5 million in severance paid to former CEO Michael Pearson along with US$60.5 million in option awards vested to Pearson in 2016, and you’ve got Valeant paying out US$165.1 million to just three executives in the past year with the possibility for a whole lot more in the future.

Just reading this, Bill Ackman has got to be seething given his US$3 billion loss on VRX stock. It’s a painful reminder of just how big a mistake the billionaire made.

However, it’s hard to feel sorry for him; he was on the board and, although not a member of the talent and compensation committee, he would have understood and been aware of the general terms of all three executives’ compensation agreements with the company.

It doesn’t seem to matter how many studies come out that show unequivocally that greater compensation rarely leads to greater financial performance. Public companies, regardless of their financial health, continue to dole out compensation like it’s Halloween 365 days of the year.

The last time I checked, Valeant had almost US$30 billion in debt and its future survival was very much up in the air. Not convinced? Read this recent article from Fool.ca contributor Demetris Afxentiou; it will surely provide sober reflection.

If you’re still not convinced, consider that Valeant has an **Altman Z-Score —** a mathematical calculation that predicts the likelihood of a company’s bankruptcy in the next 12-24 months — of 0.47, less than half that of **Sears Holdings Corp.**, another struggling business headed for the corporate graveyard.

FYI, a score less than 1.8 suggests bankruptcy is very possible. A score barely a quarter of that means bankruptcy is a virtual certainty.

When it comes to compensation, I understand that you have to pay people, especially talented ones, a lot of money to get them to take on a task as great as righting the good ship Valeant, but nowhere is it written that you have to be obscene about it.

Like actively managed mutual funds, where the best performers charge lower fees, there are plenty of examples of CEOs that are paid below-average compensation yet deliver above-average shareholder returns.

Why couldn't Valeant hire one of them?

Perhaps Lars Rebien Sørensen, CEO of **Novo Nordisk AS (ADR)** (NYSE:NVO), who *Harvard Business Review* (HBR) ranked number one in its 2016 review of the 100 best-performing CEOs in the world.

Sørensen was paid the equivalent of $5.7 million in 2016 with just 23% of the total generated from stock awards. He's been with Novo Nordisk for 34 years and spent the last 16 as CEO.

HBR asked Sørensen and a couple of the other top CEOs a number of questions including this one:

> **HBR:** What's something that people aren't aware of that's critical to a CEO's success?
>
> **Sørensen:** To be honest, I think we're highly overrated. At least in my business, success is far more of a team effort than the public would like to believe, especially in America.

I can definitely say with conviction that these words would never have been spoken by former CEO Michael Pearson. I don't enough about Papa, but because he's in line to make upwards of US$500 million if VRX hits $270 by 2020, I doubt it.

Seriously, solely on the basis of the outrageous 2016 compensation, you should run as far from Valeant as you possibly can. It just doesn't pass the sniff test.

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