Valeant Pharmaceuticals Intl Inc. Will Do Almost Anything to Lower Debt

Description

Valeant Pharmaceuticals Intl Inc. (TSX:VRX)(NYSE:VRX) has gotten almost fanatical about its debt-reduction plan.

Nothing, it seems, is safe from the chopping block, and while this might lower debt levels slightly in the short term, it's possible the fire sale could do irreparable damage to its long-term success.

Here's why.

Fire-sale prices

Valeant announced July 17 that it was selling Obagi Medical products for US$190 million to a Chinese investment fund using the net proceeds to pay down its debt.

"The sale of Obagi marks additional progress in our efforts to streamline our operations and reduce debt," said Valeant CEO Joseph Papa. "As we continue to transform Valeant, we will remain focused on the core businesses that will drive high value for our shareholders."

Mike Pearson, Papa's predecessor, paid US$344 million to buy the company in April 2013.

At the time, Obagi, a company that specializes in dermatology products, had US$120.7 million in annual revenue and US$29.0 million EBITDA. Today, revenues are US$85 million and EBITDA, on an adjusted basis, is approximately US$30 million.

Valeant has mismanaged the business over the past four years to the point where it can only get half what it paid in 2013, but it's reducing debt, so who cares?

Shareholders should

Fool.ca's Jacob Donnelly recently reminded investors of Papa's drive to pay down US$5 billion in debt by February 2018.

If I didn't know any better, I'd swear Papa's employment agreement includes significant incentives for reducing Valeant's heavy debt, which currently sits at US$27.2 billion after paying down US$811 million in debt from the sale of Dendreon and the proceeds it gets from Obagi's sale.

While I can't find anything in Papa's compensation arrangement with Valeant, it's clear that investors are very interested in its debt-reduction plan, which has had a positive effect on its share price in 2017 — it's up 30% since June 1.

If Valeant's stock price hits US$270 by May 2020, the CEO gets 1.8 million shares valued at US$486 million.

That suggests he's got $486 million reasons to do whatever it takes to move the share price, including paying down debt.

Bottom line

I'm the last person that would complain about paying down debt, but every time Papa sells another piece of the business to do so, Valeant's chances of generating consistent and growing operating profits diminish slightly.

Valeant has yet to prove that its core businesses are being run anywhere near efficiently enough to generate the cash flow necessary to cover almost US$2 billion in interest expense, and I, like Fool.ca's Ryan Goldsman, are left to wonder if these asset sales and subsequent debt repayment are only delaying the inevitable.

At least in the case of **Sears Holdings Corp.** (NASDAQ:SHLD), it's got real estate backstopping its debt and not some agglomeration of drug products that may or may not grow in value in the future.

It might be worth the risk for John Paulson, but average investors should continue to steer clear of Valeant. There's still too much risk associated with its stock.

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