



Valeant Pharmaceuticals Intl Inc.: Still a Risk or on the Way up?

Description

It may take another few years before analysts and investors stop talking about **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) as a colossal risk and instead talk about it as a major opportunity. That's not because Valeant is a great buy, but because there are still inherent risks that need to be discussed.

Nevertheless, if we cut back the risks, there is the potential for a company that could reach levels that it has not seen in a few years — just don't expect insane numbers like the ones the company once traded at.

The biggest risk, at its core, is its debt. And this risk only compounds with central banks beginning to test what increasing interest rates will do to the economy. In its quest to become one of the largest pharmaceutical companies in the world, Valeant borrowed a lot of money to acquire other companies, then jacked up the price of drugs at the acquired company.

In 2020, Valeant has US\$5.8 billion due and an additional US\$10.5 billion is due by 2022. So, between now and 2020, the company needs to find a way to pay off that debt because if it doesn't, interest payments will eat into its cash flow.

Fortunately, the company has worked on a strategy for some time now to get out of debt. As of August 15, the company has paid off the remaining US\$500 million of its outstanding 6.75% senior notes that were due 2018. This follows US\$4.8 billion since the end of Q1 of 2016, so the company has been aggressively getting rid of its obligations.

Valeant has achieved this through a multitude of asset sales, some which were incredibly fruitful. The latest is the sale of Dendreon Pharmaceuticals LLC. Valeant then used the funds of the sale to pay off US\$811 million in debt. It is also selling iNova Pharmaceuticals and Obagi Medical Products for US\$930 million and US\$190 million, respectively, which should close in the second half of 2017.

But there is a negative reaction to this strategy. If you get rid of cash flow-generating assets, you've got less cash to make loan payments. You're effectively balancing selling assets to pay back debt without selling too much and selling assets but not having enough to make loan payments.

Valeant brought in US\$2.2 billion compared to US\$2.4 billion in Q2 2016. Its net loss was only US\$38 million compared to US\$302 million in Q2 2016. So, it had less revenue, but it also lost far less money than it has in the past.

Is Valeant a buy?

This remains a tough one for me. On one hand, if Valeant succeeds, it's still a very strong company that generates a lot of cash flow. As debt reduces, the company's ability to generate a profit will grow. And there's always the possibility that it's organic pipeline will start to generate some strong drugs; this hasn't been a good strategy in the past, though.

But on the other hand, the 2020 and 2022 debt walls are daunting. And if interest rates continue to increase, the amount it owes will increase by hundreds of millions per percentage point. That'll cut into the cash flow. At this point, a small position to start might be the most prudent opportunity, but skipping it entirely is also a fine strategy.

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