These 2 Pharma Giants Are Trading at Steep Discounts

Description

Following a year-long period of consolidation, healthcare stocks are off to the races again — up 21% since the start of 2017.

Yet there are two large-cap pharmaceutical companies, **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) and **Teva Pharmaceutical Industries Ltd. (ADR)** (NYSE:TEVA), which have lagged behind the pack, as each company works to sort out its problems.

Valeant, down a whopping 95% since mid-2015, but flat so far in 2017, has been forced to undergo some significant restructuring charges after a series of acquisitions failed to produce expected results.

Teva, which is down 60% since the start of August, is facing increasing competition in end markets, as its customer base has undergone a period of consolidation and is now negotiating better terms from Teva and other generic drug manufacturers.

Making matters worse, both companies have a lot of debt on their balance sheets, bringing into question matters of liquidity and insolvency.

Valeant has debt approaching $28 billion, which dwarfs the company's market capitalization of $4.9 billion and essentially means the debtholders own most of the company.

Teva's situation isn't quite as bad; it owes $33 billion of long-term debt compared to $18.4 billion in market capitalization.

But while both company's balance sheets are extended, liquidity is a different story, as each company generates billions of dollars in cash flow each year. Over the past 12 months, Teva generated in excess of $4 billion in operating cash flow, while Valeant generated $2.3 billion in cash flow from operations.

If the two companies can exercise discipline in scaling back on research and development and capital spending, and use some of their available cash to retire outstanding debt and get their balance sheets back in order, the potential upside is massive. That's because the implied valuations for Valeant and

Teva today are pricing in what is seemingly a worst-case scenario.

Valeant trades at a 0.5 times price-to-sales ratio, while Teva trades at a 0.8 times price-to-sales ratio.

Cutting through the jargon, this means that, at today's prices, the market does not expect either company to reach neither previously enjoyed levels of profitability nor growth. Yet there is compelling evidence to suggest this may not be the case.

While Teva disappointed in its most recent quarterly conference call, sales are up 6.7% over the past 12 months on the back of the company's large-scale acquisition of Actavis from **Allergan plc Ordinary Shares** over a year ago.

While it's expected to take years for the pipeline of drugs acquired from the Actavis deal to materialize, the size and scale of Teva following the deal suggests that if generic drugs are going to be a profitable business for anybody, Teva has as good a chance as anybody to make it.

Meanwhile, Valeant is already showing signs of turning the corner. Following a very difficult period that saw five consecutive quarterly losses, the company is showing improvement so far in 2017.

While the company is unquestionably smaller than it was two years ago, both Q1 and Q2 saw improvements in operating profit and net earnings growth.

If management at Valeant can continue to right the ship and keep the company on its current trajectory, the sentiment surrounding the company's stock today is going to feel like a distant memory in a few years' time.

Conclusion

A rising tide tends to lift all boats, and with the S&P 500 reaching all-time highs and healthcare stocks helping to lead the way, this bodes well for the future of both these companies valuations.

Foolish investors may want to consider if the current perceptions of Teva and Valeant could get much worse than they already are and, if not, if these two stocks warrant a closer look.

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