Valeant Pharmaceuticals Intl Inc.: Value Trap or Opportunity?

Description

Among the dizzying array of investment opportunities on the market, **Valeant Pharmaceuticals Intl Inc**. (TSX:VRX)(NYSE:VRX) continues to attract significant attention from both buying and selling pundits.

After an epic collapse two years ago, Valeant has been striving to rebuild itself, with investors stuck on either side wondering whether the company is a viable investment opportunity or not.

Here’s a look at both options.

Why is Valeant a buying opportunity?

In the past three-month period, the stock has dropped nearly 10%, but it’s not quite down to 52-week lows. As the stock currently stands, it has a market cap of $4.8 billion, which — when considering some of the assets that continue to garner significant revenue — is quite cheap.

There’s no doubt that investors are factoring Valeant’s massive debt load into that depressed price, and investors burned by the drop a few years ago are left with a bitter feeling towards the stock.

The two factors keeping Valeant down relate to the prior business model the company used and the mountain of debt Valeant continues to be straddled with. From a debt standpoint, Valeant has stated on more than one occasion that the intent of the company is not to eliminate all debt, but rather get it to a more manageable level, which CEO Joseph Papa has said falls between US$15 billion and US$20 billion.

That’s a smaller mountain to climb, but it still represents a challenge for the company, leading to my second point on operations.

One of the main criticisms of Valeant was that the business model the company adhered to was unsustainable. Taking out cheap loans, acquiring drug companies, hiking drug prices, and then repeating those steps provided an avenue for both rapid growth and massive debt.

Valeant has since distanced itself from that model, setting up new distributor agreements and ceasing acquisitions for the moment. The company has also made several deals to sell off non-core assets to raise funds to pay down that mountain of debt, making progress towards debt obligations maturing over the next two years.

Proponents of Valeant see the company as a work in progress that could, in time, become a feasible investment option.

Why you shouldn't buy Valeant

The other side of the story is less optimistic. Valeant has already amassed a massive amount of debt that rivals some third-world nations. The sheer amount of debt makes a turnaround difficult, but the solution that Valeant has suggested will only snowball the issue.

By selling off non-core assets, Valeant is raising money to pay down the debt, but there are two issues:

First, once sold, that asset no longer contributes to Valeant's revenue stream, effectively making the selling price a one-time boost at the cost of long-term revenue.

The second point relates to the selling price itself. Rival pharmaceutical companies are more than aware of Valeant's predicament and will likely leverage that desperation for a sale in price negotiations. What would have been an otherwise quick sale of assets can become a long-winded, drawn-out process that will yield a lower sale prices.

Finally, there are new drugs to consider. Valeant is no longer in an acquisition mode, and while the current crop of products provides a revenue stream for the company, the lack of new advancements and acquisitions could leave the company behind competitors over the long run.

Final thoughts

Investors looking for long-term growth with a massive appetite for risk may want to consider Valeant, but doing so is not for everyone. This is no longer the same company that traded +$200 per share, and it will likely never return to those levels.

In my opinion, there are far better, more stable investments on the market that can provide better growth for your investment.

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Date
2025/07/03
Date Created
2017/09/27
Author
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