Valeant Pharmaceuticals Intl Inc. Has Thrown in the Towel: Should You?

Description

This past week, **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX) announced it had abandoned efforts to relaunch a libido-enhancing product for the female market called Addyi; instead, it sold the division, called Sprout, and abandoned the potential revenue stream.

Although many investors are perplexed as to why the company would give up on the potential to increase revenues and the bottom line, the aggregation of investor sentiment has sent shares higher on the news. The reason that shares are higher given that the company is walking away from a drug is due to the fact that very few investors have any faith in the company's ability to develop and execute a marketing strategy for this or any other drug. As a reminder, the company is very well known for acquiring other drugs or companies and then cutting costs to generate value for shareholders.

Although I've written many articles about Valeant over the past few months, the important thing to realize is the needle has yet to move in any material way. At a current price of $15 per share, investors are still climbing aboard a sinking ship, as the amount of debt continues to overwhelm the company. As of June 30, 2017, the balance sheet boasted assets in excess of US$41 billion with liabilities of almost US$38 billion. Given that shareholders' equity (book value) is almost US$4 billion, or approximately CAD$14 per share, many investors may believe that they are getting a fantastic deal at current market prices.

But are they?

Although there is substantial book value listed on the balance sheet, it is important to remember that both goodwill and intangibles are going to be written down with time in addition to when the company sells any assets. As of the most recent quarterly report (June 30), the amount of tangible book value on the balance sheet (calculated as assets – liabilities – goodwill – intangibles) is approximately negative US$29.4 billion. Essentially, the company can be seen as a big black hole.

When considering if it is possible for the pharmaceutical giant to get back to zero, investors need to consider the amount of revenues required to fund the interest expense of the debt. For the past quarter, the company spent no less than 20.5% of revenues on maintaining its debt amid the lowest interest rate environment of the past century. Clearly, investors are taking a huge risk.

Although there is always a very small chance that the company will make it over the long term (in spite of increasing interest rates), investors will have to weigh the risk/reward and decide what is right for their own portfolios.

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