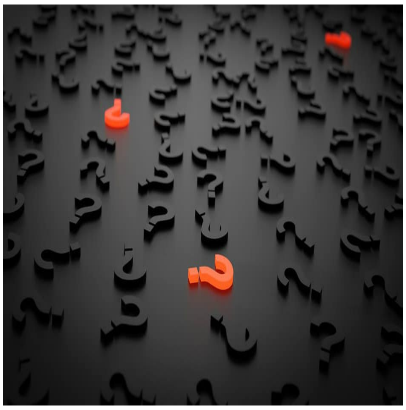

Will Investors Finally See the Demise of This Company in 2018?

Description

The past year has been a positive one for investors of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX), as shares have increased by close to 35% for the year. Many shareholders may now feel that the company's turnaround is only beginning.

The company was previously facing a US$2 billion lawsuit for alleged insider trading, but Valeant and Bill Ackman have agreed to settle the matter out of court. The good news for the company, which had less than US$975 million in cash available on the balance sheet, is that it could cost only US$100 million to put this in the past. Now, the new challenge that company management will face is the lack of "distractions," which took attention away from their day-to-day decision-making abilities. Going forward, however, it will be a different story, as the company may finally be done dealing with Bill Ackman and the noise that the lawsuit created.

In 2015, the interest expense as a percentage of revenues accounted for only 12%, which increased to 17.8% in 2016; throughout the first three quarters of the 2017 fiscal year, it was 21.5% of revenues. As revenues have declined due to the company selling off numerous asset to pay down debt, the result is the proportion of revenues needed to sustain the amount of debt is higher. Rising interest rates will not help.

When considering the 2018 fiscal year, it is not so far-fetched to anticipate that 25% of revenues will be needed to keep the company afloat if we include the US$100 million settlement as part of the calculation.

In spite of what many believe is a fixable problem, the long-term business model of drug companies is typically to invest money in the development of new drugs that are then brought to market as older ones fall off patent. In the case of Valeant, there have traditionally been very few drugs brought to market by the company; the company has preferred to purchase competitors or the rights to new drugs.

As revenues continue to shrink, and the interest expense remains consistent (or increases), the truth is that the company is fighting a losing battle, which will become evident throughout the year.

The drugs currently under patent will expire, leaving the company's pipeline empty, as it lacks the funds to develop anything new. The debt is not going to disappear over time. No matter how challenging the task may be, management will eventually have to repay the money that the company has borrowed (plus the interest expense) or potentially face bankruptcy. If bankruptcy does not happen in 2018, then it may be something that short sellers can look forward to in 2019, as the company does not have sufficient long-term revenues to keep itself afloat.

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