Is Valeant Pharmaceuticals Intl Inc. Next up on Warren Buffett's Shopping List?

Description

Last week, news broke that the world's most famous — and most successful — investor Warrant Buffett had bought a $358 million stake in Israeli-based pharmaceutical manufacturer, **Teva Pharmaceutical Industries Ltd (ADR) ADR** (NYSE:TEVA).

Many pundits were quick to question the move by the "Oracle of Omaha," as TEVA has become particularly unloved in the investment community of late. At one point, shares had fallen 80% from their all-time highs after the company was forced to cut its dividend not once, but twice in 2017 after the company came under pressure from creditors.

TEVA has become saddled with a nearly unbearable debt load thanks to what in hindsight was the disastrous acquisition of Actavis in generics in 2016.

The company, then under the leadership of president and CEO Erez Vigodman, spent close to US$40 billion to purchase the Actavis generics division from **Allergan plc**.

The deal saw TEVA take on an additional $25 billion of debt, which seems all for naught now, given that it has taken on more than US$20 billion in asset impairments since the purchase.

With TEVA's debt load looking more and more unsustainable, especially given the declines it was experiencing in some of its most profitable products, short sellers began piling in on the stock, and institutional investors all but gave up on the company, not wanting to have anything to do with the risk involved, but it wasn't enough to scare away Warren Buffett and **Berkshire Hathaway Inc.** (NYSE:BRK.A)(NYSE:BRK.B).

Sound familiar at all?

If any of this sounds familiar to you, you may already know the story of **Valeant Pharmaceuticals Intl Inc.** (TSX:VRX)(NYSE:VRX).

Like TEVA, Valeant is another former pharmaceutical giant that has seen its business model put in jeopardy in recent years. Valeant too has seen profits from its key drugs roll off, as the company has been unable to reinvest in vital R&D spending. Valeant has also come under pressure from creditors for having what they believe to be an unsustainable balance of financial obligations. But Valeant still has great underlying cash flows to support its business.

Despite the fact that Valeant has struggled to post a net profit in recent years, that hasn't stopped the company from generating billions of dollars in cash flows annually.

And because Valeant's business isn't particularly capital intensive, that means it has the ability to use the available cash flow to retire outstanding debt maturities, helping to get its balance sheet back in order.

This strategy has allowed Valeant to reduce the value of its total liabilities by US$5 billion over the past four quarters, while adding an extra $500 million to its cash reserves.

While Valeant still has a long way to go — with more than $26 billion in long-term debt outstanding — the market tends to take a "what have you done for me lately" attitude when it comes to these kinds of things, and so the latest actions taken by Buffett and Berkshire may go a long way to restoring investor confidence in the former pharma giant.

Bottom line

The average price-to-earnings (P/E) ratio for the market today is about 23 times; meanwhile, Valeant trades at forward multiple of under five times, or a nearly 80% discount to the market average.

Before the Buffett deal, TEVA traded at a similar discount.

It will certainly be interesting to see if Buffett — or another investor with deep pockets — will be willing to step up and take a gamble on Valeant in 2018.

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