



Has Valeant Pharmaceuticals Intl Inc. Proven it Belongs in Your TFSA?

Description

The pharmaceutical sector is notoriously volatile, because revenues can dry up quickly when a competitor elbows its way in, a patent expires, a drug is not approved, and various other sources of uncertainty.

Valeant Pharmaceuticals Intl Inc. (TSX:VRX)(NYSE:VRX) is a prime example of volatility. Founded in 1983 and headquartered in Laval, Canada, this drug and device company was a darling stock, producing huge gains, until the wheels fell off in 2015 amid controversy surrounding its anti-fungal medication, which was priced astronomically and unfairly high.

Picking one pharma stock for your portfolio is tough. If you asked an investor to pick one stock in this sector to buy, chances are good that they would say **Johnson & Johnson** ([NYSE:JNJ](#)). JNJ is a recognizable name with incredibly diverse business. Comparing JNJ and Valeant is timely, because the former has taken on water (with earnings down), and Valeant appears to be making a [comeback](#).

Metric	JNJ	VRX	Favours Valeant?
Market cap	US\$355 billion	US\$6 billion	no
Revenue growth	6%	-10%	no
Dividend	2.5%	0%	no
Free cash flow	US\$18 billion	US\$2 billion	no
Debt to capital	33%	81%	no
Price to book	5.9	1.0	yes
EV/EBITDA	15.6	9.4	yes
Return on equity	2%	53%	yes
Trailing price to earnings	339	2.5	not applicable

Sources: TD Waterhouse, Morningstar; EV/EDITDA=earnings before interest, taxes, depreciation and amortization.

In this comparison — admittedly, only a starting point — there are reasons to like Valeant over JNJ. I have to pinch myself. Despite falling hard and becoming a very cheap stock, sentiment on Valeant is still very mixed, and I am revealing my bias.

Sentiment is an important factor in this sector, whereas the trailing price-to-earnings ratio (P/E) is less relevant. Why? Because, as above, things can change drastically in this sector. JNJ's P/E has ballooned to the hundreds, making it look rather overvalued. That metric alone could send investors running for the aisle. Fear not. Blue-chip JNJ is still robust. The bottom line is that previous earnings can have little bearing on future guidance for this sector.

Things to like about Valeant right now

Although Valeant's debt to capital is considerably higher than JNJ's, this number has come down quite drastically in the last year.

Valeant has just added a seventh product to its arsenal of FDA-approved drugs via its subsidiary Bausch & Lomb. The drug is called Vyzulta and is used to treat intraocular pressure; this helps solidify Valeant's influence in eye care/ophthalmology amid more intense competition for drugs that treat other medical conditions.

CEO Joseph Papa has been at the helm since May 2016 after departing his position at **Perrigo Company plc**. He seems to be getting his sea legs and confidence in his company. In March 2018, he and other insiders added new share positions. More skin in the Valeant game is a bullish sign. Papa bought 30,000 shares for ~\$20.90 (US\$16.05).

The size of the company has shrunk dramatically, but this alone cannot explain Valeant's above-average return on equity.

Take-home message

One agnostic way to invest in the pharmaceutical sector is the **iShares Nasdaq Biotechnology ETF (NASDAQ:IBB)**. Could Valeant be a [winning](#) 2018 pick? Yes, it *could*. I would not be surprised if the share price dropped down to \$20-21 per share, however, testing support one more time, and a good price to snatch it up. Just remember that Valeant is now a relatively small fish in this competitive and volatile big pond. So, stay Foolish and don't bet the farm.

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