

BITTER PILL

THE WILD RISE AND FALL OF VALEANT PHARMACEUTICALS



REUTERS BREAKINGVIEWS

CONTENTS

Introduction.....	3
• Valeant may strain to engineer way out the in door	
From \$2.5 billion to \$25 billion.....	5
• Biovail sale oddly leaves its owners in control	
• Hasty hostility costs Valeant its Cephalon quarry	
• Sometimes extra-rich pay packages actually do work	
• Valeant shows how some M&A favors the brave	
From \$25 billion to \$90 billion.....	9
• Dawn raid makes comeback via activist drone strike	
• Valeant’s M&A machine may soon overheat	
• Valeant’s slashing could trigger FDA lashing	
• ValueAct’s Valeant return hints at value trap	
• Valeant’s activist deal too clever by half	
• Deal junkie Valeant shoots up on \$10 bln fix	
• Valeant pops risky \$1 bln libido pill	
From \$90 billion to \$25 billion.....	17
• Valeant’s back-foot problem flares up in Congress	
• Valeant’s platform trembles beneath Ackman’s feet	
• Valeant sets tone for post-M&A accounting scrutiny	
From \$25 billion to \$10 billion.....	21
• The illusion of debt-fuelled earnings	
• Valeant CEO gets called on \$100 mln excess	
• Valeant poised to cause much collateral damage	
• Valeant’s latest fix reinforces its challenges	
• Valeant plays chicken with death spiral	
• Valeant’s multiple organ failure puts it in ICU	
• Valeant’s new CEO a good choice for a dim future	
About us.....	32

INTRODUCTION

Valeant may strain to engineer way out the in door

By Robert Cyran

Valeant Pharmaceuticals International is a classic case of how Wall Street clings to the power of an idea, and just how hard it can be to let go. Consultants and hedge funds used the drug company as a vessel to redesign a huge segment of the American economy, ostensibly to make it more efficient, while extracting profit in the process. As Valeant embarks on the next phase, with its first results under a new chief executive, the question is whether Valeant can financially engineer its way out the same way it got itself into trouble.

At its peak, Valeant grew to become a \$90 billion company on the back of a debt-fueled acquisition binge, gigantic price hikes on the drugs it bought and cost cuts that largely slashed research and development of new therapies. Early investors enjoyed a 30-fold return. Valeant inspired a slew of copycats, many beyond the pharmaceuticals industry.

Compensation consultants clamored to see how the executive team, led from 2008 until earlier this year by former McKinsey consultant Michael Pearson, rewarded themselves while turning a sleepy firm originally formed by the ex-prime minister of Yugoslavia into one of the world's biggest drug companies. More recent deals for Salix Pharmaceuticals and Bausch & Lomb, for which Valeant paid more than \$27 billion combined, including debt, captured the imagination of investors - and ultimately Congress, but it was a smaller acquisition back in June 2010 when the company's market value was less than \$3 billion that first attracted Valeant to Breakingviews.

In many ways, that transaction foretold the troubles that were yet to come. It was a complicated mess of a merger where Valeant combined with Biovail, a drug company that had been accused of accounting fraud by the Securities and Exchange Commission, to reduce its tax bill by relocating to Canada.

It would take half a decade before the downfall took hold. Along the way, various subsidiaries and associated firms sued each other, employees were revealed to have used superhero aliases in emails, pushy investor Bill Ackman became Valeant's de facto spokesperson and the company fired its chief financial officer but couldn't remove him from the board of directors.

The company, with its shrunken \$10 billion market value, in April hired Joseph Papa from rival Perrigo to lead a turnaround. In some ways, it signals more of the same. Papa merged Perrigo with an Irish rival a few years ago to reduce the company's taxes and later spearheaded a rejection of unwanted suitor Mylan, only to have the company's stock tumble by more than half.

Nevertheless, investors may be counting on more financial wizardry. Japanese rival Takeda and buyout shop TPG recently offered to buy Valeant and break it up. Valeant could sell big businesses on its own, too. The trouble now is that \$30 billion of debt coupled with the neglect of R&D could make it hard for private-equity firms or other suitors to make deals work. That doesn't mean all concerned won't try, though.

Valeant timeline



Source: Thomson Reuters Datastream, data to 5/4/2016

Vincent Flasseur | @Breakingviews

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FROM \$2.5 BILLION TO \$25 BILLION

Biovail sale oddly leaves its owners in control

By Robert Cyran

It's a neat trick to sell a company at a premium and keep a controlling interest. But Biovail is pulling it off. Specialty U.S. drug group Valeant is effectively paying 15 percent over the market price for Canadian rival Biovail - yet the latter's shareholders are ending up with 50.5 percent of the merged group. There is a rationale, but the danger is it's too complex.

There is strategic logic. Valeant, whose chief executive Michael Pearson will head the combined company, thinks \$175 million of annual cost cuts are there for the taking. If so, these savings could be worth more than \$1 billion today - against the combined market capitalization of the two firms of \$5.8 billion.

Yet tax problems could have killed the deal. Biovail's operating subsidiary is based in Barbados. To preserve its low tax rate, that company needed to be the entity doing the acquiring. Meanwhile, also for tax reasons Valeant needed to end up owning less than half the combined entity. As the bigger company by market capitalization before the deal, that meant making a cash payout for its own shareholders part of the deal.

The result is a curiosity. In return for giving up their collective control, Valeant shareholders end up with cash and shares in Biovail worth \$42.77 for each Valeant share - about \$3 less than their value before the deal - plus a promise of another \$1 in the form of a dividend before the end of the year. For Biovail shareholders, the merger values their shares at a premium.

Valeant shareholders may figure that their share of the mooted synergies should be worth slightly more than the premium they are ceding to Biovail's owners. Furthermore, Valeant gets to appoint the tie-breaking director on the combined board - subject to Biovail approval.

Even so, Biovail's checkered past justifies a certain skepticism. A few years back the firm accused hedge fund SAC Capital and others of conspiring against it - but ended up facing Securities and Exchange Commission charges, which it settled. That may all be in Biovail's past now. And on one interpretation, Valeant's clever structuring has allowed the business benefits to trump pesky tax problems. But it would be a shame if it turns out strategic discretion was neglected in that valiant effort.

Published on June 21, 2010

Hasty hostility costs Valeant its Cephalon quarry

By Robert Cyran

Hasty hostility has cost Valeant Pharmaceuticals its quarry. The drugmaker hoped to snaffle rival Cephalon in weeks with a proxy fight it launched late in March. But Valeant made it clear

it wouldn't get in a bidding war. That left plenty of room for white knight Teva Pharmaceutical to swoop in for Cephalon with a higher, \$6.8 billion offer.

Hostile deals are difficult to seal. Instead of quiet backroom conversations, everything is played out in public. Valeant's effort to dismiss the managers of Cephalon was a recipe for rancor. There was also an element of opportunism about the \$73 a share offer it took directly to Cephalon's shareholders. Valeant said if it didn't get enough support by mid-May, it would walk away. At best, the would-be acquirer indicated it would increase its offer only slightly if Cephalon opened its books.

The result was merely to flush the quarry into the open, where it has now been bagged by Teva. The white knight is stumping up \$81.50 a share, a 12 percent premium to Valeant's price, partly based on the belief that its target's pipeline has value - something Valeant didn't recognize. A softer approach by Valeant might have made Cephalon less reflexively hostile.

Alternatively, a higher initial bid might have scared off rivals. But Valeant missed that trick, too. Sure, it offered a 24 percent premium to Cephalon's market price, but health companies often attract twice as much. And figures from its past mergers suggest Valeant low-balled the annual cost savings that the combination would have created. The fact that investors marked down Valeant's stock by 7 percent when it said it was abandoning its bid implies value may have been left on the table.

Even though it misplayed its hand along the way, Valeant is right to fold now. Engaging in a bidding war, or overpaying, would have set a bad precedent for future transactions. The company thinks buying up rivals, cutting costs and selling their undeveloped drugs is a recipe for value creation. There are still plenty of targets, such as Forest Laboratories and Endo Pharmaceuticals, which fit the bill. Next time, expect Valeant to play its cards more patiently.

Published on May 2, 2011

Sometimes extra-rich pay packages actually do work

By Robert Cyran

In just about three years, Michael Pearson has received about \$200 million in stock as chief executive of Valeant Pharmaceuticals. Sound outrageous? Not to shareholders of the drugs group which last week walked away from a bid battle for rival Cephalon. Indeed, the incentives may very well explain that sensible decision.

Consider the way Valeant pays Pearson. At its most basic, Pearson is motivated in the way a private equity firm might be. To begin with, Pearson had to put some of his own money at risk. When he took the job in 2008, he was required to personally buy \$3 million of the company's stock. He bought \$5 million.

Then he was rewarded a form of restricted equity that would pay him as much as \$4 for every \$100 of value created on his watch. But there was a hitch. The stock only vested if

shareholders were treated to a 15 percent return annually. That's like the hurdle ratios common in private equity - though they are usually much lower than 15 percent.

Moreover, if the return for shareholders hit 30 percent per annum, his rewards doubled, and they tripled if returns were more than 45 percent per annum. That meant more shares for outperformance, which mathematically keeps his share of all value created for shareholders at about 4 percent.

The incentives seem to have worked brilliantly. A dollar invested when Pearson came aboard Valeant's predecessor company in 2008 would be worth about four times as much. Valeant stock is up more than 80 percent this year alone. As a result, Pearson is now sitting on securities worth some \$200 million.

This, more than anything else, may explain why Valeant last week walked away from its attempt to acquire Cephalon for \$5.7 billion. As originally, and hostilely, pitched, the deal made sense for Valeant, which would have reduced Cephalon's heavy spending on R&D and prioritized selling the company's existing drugs.



Michael Pearson poses following their annual general meeting in Laval, Quebec, May 19, 2015.
REUTERS/Christinne Muschi

But when Teva Pharmaceuticals waltzed in with a 12 percent higher bid, Valeant didn't get distracted. Rather than engage in a capital-destructive bidding war, it walked. Investors liked

the discipline - the shares are almost 15 percent higher than where they were before the company made its initial bid. That's reward enough for Pearson.

Published on May 10, 2011

Valeant shows how some M&A favors the brave

By Robert Cyran

Valeant Pharmaceuticals shows how some M&A favors the brave. Buying \$8.7 billion Bausch & Lomb is the biggest deal yet for the acquisitive company, but it comes with huge cost savings that investors glorified. Chief executives elsewhere should take note.

A big part of Valeant's success has been its ability to find drugs in the marketplace instead of the lab. Its shares have gained 10-fold over the past five years compared to just 50 percent for the sector at large.

The industry spends huge sums on research and development because the prospect of developing a blockbuster is so alluring. Unfortunately, lab productivity has lagged, broadly delivering a poor return on overall investment. The internal rate of return for the top 12 pharmaceutical companies last year was only 7 percent, according to a study by Deloitte and Thomson Reuters.

Instead, Valeant buys up smaller firms and deeply slashes costs. Whatever expertise it may lack with test tubes it more than makes up for with the accounting ledgers. Valeant's tax rate is only about 5 percent. The combination has been potent, especially when new purchases are thrown into the mix.

Valeant estimates it can cut \$800 million of costs by uniting with Bausch & Lomb. It's an impressive sum - amounting to about half its target's R&D and administrative costs - considering the eye-care company was already owned by notoriously stingy private equity. Applying a standard corporate tax rate of 30 percent would make the savings worth about \$5.6 billion today, or about the same amount added to the company's market value following the deal's announcement. If Valeant can keep its tax rate down, the value created will be greater.

Chief Executive Michael Pearson sees room for more takeovers, particularly in ophthalmology and dermatology. He even alluded to the idea that Valeant isn't yet as large or diversified as \$250 billion Johnson & Johnson. That's plenty of ambition for a company almost a tenth the size. So long as Pearson adheres to the same financial logic, investors will stay on side. And with M&A activity broadly stagnant, CEOs elsewhere might consider the lesson from Valeant.

Published on May 28, 2013

FROM \$25 BILLION TO \$90 BILLION

Dawn raid makes comeback via activist drone strike

By Robert Cyran and Richard Beales

Remember the dawn raid, when a would-be acquirer built up a stake before the target realized it was under attack? Activist investor Bill Ackman has come up with a kind of drone strike version. His Pershing Square Capital Management hedge fund and Valeant Pharmaceuticals have teamed up to grab a potential 9.7 percent stake in Allergan, with a hostile takeover by Valeant ready for deployment.



Activist investor Bill Ackman at the post where Valeant is traded on the floor of the New York Stock Exchange, November 10, 2015. REUTERS/Brendan McDermid

The acquisitive Valeant has reasons to be receptive to such an arrangement. For one thing, it's essentially the creation of an activist hedge fund, ValueAct Capital, which set it on the path of serial dealmaking. Slashing research and development costs and applying its low tax rate to acquired businesses has served investors well. Its stock is up more than tenfold since it started buying rivals in 2008. The prospect of another deal kicked its shares 10 percent higher after regular market hours on Monday, taking its market capitalization up to \$46 billion.

Moreover Valeant, which contributed \$76 million to Pershing Square's Allergan war chest, knew that nearly 10 percent of shareholder votes were in deal-friendly hands before it had to announce its intentions. Ackman has also committed to buy \$400 million of Valeant stock at a discount and to hold considerably more for at least a year if the company does manage to buy Allergan.

For his part, Ackman gets to skip the step in which, after buying a stake in a company he thinks is ripe for a shake-up, he then tries to make something happen. Instead he has a ready-made buyer. The result so far is a gain of at least \$1 billion on paper -and he hasn't even yet had to turn cost-effective call options, through which Pershing Square has acquired the bulk of its economic interest, into shares.

A successful outcome isn't assured for a hostile Valeant offer for Allergan. The two companies compete in the plastic surgery area, so antitrust regulators may ask questions. And after Allergan's shares popped 20 percent on Monday, it's now larger than its suitor with a market value north of \$50 billion.

There are rules that would have forced a Valeant disclosure much sooner had it started accumulating stock in Allergan for itself. Of course, Ackman is putting up most of the capital and there's no suggestion anything should have been revealed sooner. Even so, another set of watchdogs may wonder whether this novel battlefield tactic is too stealthy for comfort.

Published on April 22, 2014

Valeant's M&A machine may soon overheat

By Robert Cyran

Valeant's M&A machine may soon overheat. Some of the brain trust behind its hyper-acquisition strategy is leaving the board just as the pharmaceutical company embarks on its biggest deal. Buying Allergan would swell Valeant to about \$75 billion in market value with a gargantuan debt load. Finding meaningful targets will be much harder.

Fred Hassan, the former Schering-Plough boss and current private equity honcho, and Mason Morfit, of activist hedge fund ValueAct Capital, are leaving the board along with Lloyd Segal from Persistence Capital. Valeant says its size and scope now creates conflicts with their day jobs. Morfit, in particular, was instrumental in picking Michael Pearson to be chief executive and setting the company on its takeover trail.

Valeant's growth presents other, perhaps bigger, problems. In 2008, its market capitalization was about \$1 billion. That meant buying a firm like Dow Pharmaceutical Sciences for \$285 million - many of similar size still exist in the sector - was a big deal back then. Today, it would barely register.

Bill Ackman, Valeant's hedge fund partner in the Allergan transaction, points out that there are 58 drug or device companies worth more than \$10 billion apiece, for a sum of \$3.2 trillion.

Most of them would make poor targets, though.

Valeant's acquisitions

Valeant made over 60 acquisitions worth close to \$39 bln since 2008



TOP 5 TRANSACTIONS

Feb. 2015 - Salix Pharma.	\$15.9 bln
May 2013 - Bausch & Lomb	\$11.6 bln
Sep. 2012 - Mediciis Pharma.	\$2.8 bln
Aug. 2015 - Sprout Pharma.	\$1.0 bln
Jul. 2015 - Amoun Pharma.	\$0.8 bln

Source: Thomson Reuters

V. Flasseur, 06/05/2016



The strategy at Valeant is to slash research and development. That works at places where drugs are difficult to make, sales are too small to interest rivals or there's brand loyalty. Most of the companies on Ackman's list - and all the ones worth over \$50 billion - invest heavily in R&D or eventually face shriveling sales.

At Valeant, sales of existing products increased just 2 percent last year. It reckons there's growth for Allergan in emerging markets, but that may be harder in practice than in theory. And if revenue starts to decline, Valeant could find the expected \$30 billion of net debt post-Allergan to be rather imposing.

Together, the two companies reported less than \$4 billion of EBITDA last year. Even after the promised \$2.7 billion of savings from the merger, it would leave the combined company with debt of eight times EBITDA. That's on the extreme end for leverage at a pharmaceutical group. For Allergan shareholders being offered Valeant stock, it's a good reason to inspect the deal apparatus closely.

Note: Thomson Reuters values include net debt of the target company.

Published on April 24, 2014

Valeant's slashing could trigger FDA lashing

By Robert Cyran

Valeant Pharmaceuticals' promised slashing of Allergan's costs could trigger a Food and Drug Administration lashing. If the Canadian takeover machine succeeds in its \$47 billion hostile acquisition of Allergan - in cahoots with activist hedge fund manager Bill Ackman - Valeant expects to cut its target's research and development spending by 80 percent. How it could do so without eating into required regulatory spending is a puzzle.

The two companies have totally different models. Valeant thinks R&D is often wasted: Cut it, and the profits will flow. There's something to this idea. The return on investment in a typical biopharmaceutical portfolio often fails to cover its cost of capital, according to McKinsey - the old employer of Valeant Chief Executive Michael Pearson.

Allergan, more old-school, is committed to finding new drugs. Alongside some failures, it has had big successes such as expanding the medical uses of blockbuster Botox. Over half the wrinkle remover's sales now come from treating migraine headaches, overactive bladders and the like.

Wall Street seems to favor Valeant's method. Its stock is up more than tenfold since 2008. Allergan's share price has merely tripled. But Valeant needs more and bigger deals to keep growing. That can't go on forever, perhaps a reason why Pearson told big investors Valeant would consider a break-up if it became too large, according to Reuters. Going after Allergan so aggressively -including promising an improved offer on May 28 - could indicate that the Valeant CEO is feeling the pressure to deliver growth. Perhaps haste and incomplete information explain why, according to news reports, he told analysts Allergan had a golf course that Valeant could get rid of to save money. There's no such golf course.

A shortage of data also might help explain why Valeant thinks a \$200 million R&D budget is sustainable, let alone sufficient to expand the uses of Allergan's existing products and develop some late-stage drugs. Allergan spent \$550 million last year on trials for these purposes, and an additional \$200 million on studies of drugs already on the market.

Even with outsourcing and contributions from Valeant's laboratories, it's hard to see much scope to fund expansion or research and testing of new drugs. There's even a risk of underfunding mandated studies of already-approved drugs. Skipping those allows the FDA to pull them off the market. That really could throw a wrench into Valeant's financial machine.

Published on May 20, 2014

ValueAct's Valeant return hints at value trap

By Robert Cyran

ValueAct's valiant return to Valeant Pharmaceuticals hints at a value trap. The departure of the activist fund led by Jeff Ubben from the drug company's board in May set off a slide in Valeant stock, the currency so critical to its M&A-driven strategy. ValueAct is rejoining the board, and may buy more shares. Some good investments, it seems, are harder to leave than they are to make.

The San Francisco activist hedge fund is in large part responsible for Valeant's success. It helped appoint Chief Executive Michael Pearson and drew up the lucrative compensation scheme that encouraged him to go on a massive shopping spree, which Valeant then capitalized on by slashing R&D and other spending at its targets. Wall Street loved the story, sending the stock up about 10-fold.

While Ubben's fund has done extraordinarily well, cashing out may be proving problematic. Valeant is now a \$43 billion company and saddled with lots of debt - to bag the big game it needs to grow, it needs to use its stock as currency. About 60 percent of its proposed \$50-billion-plus takeover of Allergan comes in the form of equity. If Valeant's stock weakens, so

does the appeal of the deal.

Ubben says his fund never sold any stock. He has consistently defended Valeant's business model. The perception that the smart money was considering cashing in, however, encouraged a self-reinforcing spiral downward - helped by criticism of Valeant's business model by short sellers such as Jim Chanos, and Allergan's bruising defense.

ValueAct's return, and its promise to buy more stock, will dampen these attacks. Valeant's stock rose 3 percent on the news. Yet Valeant's business still needs big acquisitions to grow - and that requires a strong stock. Leaving may be just as difficult - maybe even more so - when ValueAct does actually decide it's time to move on.

Published on Sept. 20, 2014

Valeant's activist deal too clever by half

By Richard Beales and Robert Cyran

Valeant has tried a seven-month M&A experiment that boss Michael Pearson - and other corporate chiefs - should think twice about repeating. The \$45 billion drug company's failed tilt at Allergan alongside Bill Ackman's Pershing Square landed a \$400 million windfall. But with Actavis snatching the quarry, Ackman and Allergan's owners have made out best. Valeant lost time and risked legally questionable tactics.

There's nothing new or problematic about an investor buying a stake in a company, as Pershing Square did with a 9.7 percent stake in Allergan, and then agitating for a sale. Activism has been a money-spinner in recent years, delivering among the best returns of all hedge-fund strategies in 2012, 2013 and so far in 2014, according to indexes maintained by Hedge Fund Research. Ackman's fund was up a very strong 31 percent this year through the end of October, Reuters reported earlier this month.

What was novel was Ackman's agreement ahead of time with Valeant, a potential buyer of Allergan, to work together. Valeant must have known the move would put Allergan in play, but with Pershing Square's votes and market clout Pearson would have hoped to have the edge.

That's not how it turned out. Instead, Valeant and Allergan exchanged potentially damaging critiques in a long conflict. That has cost Valeant the chance to pursue other targets, in line with its strategy of growth through acquisitions. Pearson has a consolation prize, largely thanks to a 15 percent share of Pershing Square's profit on its Allergan shares. But that may not be enough to make the scars worth bearing.

The legality of the deal Valeant made with Ackman is also uncertain. A judge ruling on whether Pershing Square could vote its Allergan shares found earlier this month that the plaintiffs in the lawsuit had raised "serious questions" about whether the arrangement violated U.S. securities rules on insider trading. That may never be settled for this case, but a

successful bidder indulging in similar tactics could find itself in a legal morass, at best.

Sure, Allergan might never have contemplated an approach from Valeant alone. But an activist hedge fund doesn't share the same goals as a corporation, even a serial acquirer. Ackman's \$2 billion or so of profit may encourage him to look for other similar opportunities. Companies would be better off acknowledging the tactic as too clever by half.



Actavis CEO Brenton Saunders (L) and Allergan CEO David Pyotton pose together on the floor of the New York Stock Exchange, November 17, 2014. REUTERS/Brendan McDermid

Published on Nov. 17, 2014

Deal junkie Valeant shoots up on \$10 bln fix

By Robert Cyran

Deal junkie Valeant Pharmaceuticals has shot up on a \$10 billion fix. The drugmaker's pledge last year to focus on organic growth and debt reduction didn't last long. Cost cuts and tax savings from buying Salix Pharmaceuticals proved irresistible. What Valeant's injecting isn't clear, though. Salix's numbers are fuzzy after it admitted pumping clients full of inventory. Valeant reckons it can quickly cut at least \$500 million in costs. Moreover, the combined company's tax rate should be around 5 percent. The present value of these savings, when

capitalized on a multiple of 10 - assuming its low tax rate is sustainable - surpasses \$4 billion.

That's partly why Valeant's market value rocketed up almost \$8 billion to \$66 billion. It helped that the company's fourth-quarter results, also announced on Monday, were better than expected. Revenue grew 11 percent compared to the same period last year and executives' comments about the growth of existing drugs this year may also have excited investors. There's also relief among Valeant's backers that the company is back to signing deals, after its long chase of Allergan left it empty handed. Rival Actavis won with a \$66 billion bid.

Valeant's problems from its deal binges have not gone away. After whittling down its debt by about \$2 billion over the past year, the new deal will nearly double its load to close to \$30 billion. Questions about the company's sustainability have not been answered either.

This deal may intensify them. Salix has been growing fast, and Valeant says this will continue after the deal closes. Yet the cost cuts Valeant is proposing equate to two-thirds of what its target spent on sales, administrative costs and R&D over the past 12 months.

Moreover, frenzied deal-making in pharma over the past few years means there are fewer high-quality assets available at reasonable prices. Salix's reputation and market value took a hit after executives admitted in November that its stellar growth had been partially fudged as a result of overstocking clients with its drugs.

The sale values the company at slightly less than its market worth prior to the accounting scandal. Valeant is confident it understands the problem. What observers can say with more certainty is this deal junkie is going to keep on looking for more fixes.

Published on Feb. 23, 2015

Valeant pops risky \$1 bln libido pill

By Robert Cyran

Valeant Pharmaceuticals is popping a risky \$1 billion libido pill. The acquisitive drug firm is buying Sprout Pharmaceuticals, the maker of Addyi, the so-called "female Viagra" that received U.S. Food and Drug Administration approval for treating low sexual desire in premenopausal women just two days ago. Valeant will have gotten a bargain if the pink pill hits its sales hopes. Snag is, the drug isn't very effective, has bad side effects and regulatory restrictions may crimp sales.

Valeant Chief Executive Mike Pearson told CNBC that annual sales will be "in the hundreds of millions, but hopefully it's in the billions." There may well be a lot of demand for such a pill, but such blockbuster sales would be an accomplishment. Pfizer, for example, only sold \$2 billion of Viagra at its peak.

Addyi would not need to be that successful for Valeant to pat itself on the back. A rule of thumb in biotech is that companies sell for five times revenue. Even if it takes Valeant a few

years to crank \$300 million in yearly revenue out of its newest acquisition, the company's deal will look smart.

The drug has several drawbacks, though. First, its efficacy is mediocre. The drug only helped about 10 percent more patients than a placebo in clinical trials -and increased the number of times they had sex by just 0.5 to one time per month. Such figures suggest that many patients will try the pill, but not renew their prescription.

It also carries significant adverse effects. The FDA slapped a black box, its strictest warning, on Addyi because it can cause severe low blood pressure and fainting. The regulator also requires that both doctors and pharmacists be trained and certified before they administer it. That's to ensure patients know to avoid alcohol and certain medicines like birth-control tablets that raise the risk of side effects.

Finally, during the FDA's approval process, Sprout promised not to advertise the drug for 18 months on television or radio. All these limits may leave Valeant with a bitter pill.



An art handler places drugs for an art installation by British artist Damien Hirst in Munich, Germany, May 6, 2009. REUTERS/Alexandra Beier

Published on Aug. 20, 2015

FROM \$90 BILLION TO \$25 BILLION

Valeant's back-foot problem flares up in Congress

By Robert Cyran

Valeant Pharmaceuticals' back-foot problem has flared up in Congress. The drug company keeps fighting through chronic skepticism about its acquisitive ways and the related borrowing. Now, U.S. lawmakers have raised questions about pricing that cost Valeant \$11.3 billion in market value on Monday. Always being on the defensive could eventually take its toll.



U.S. Democratic presidential candidate Hillary Clinton during a campaign stop in Sylmar, California, United States, June 4, 2016. REUTERS/Mike Blake

The \$57 billion company's business model is aggressive. It buys unwanted drugs and developers, and slashes costs. Because Valeant spends so little on R&D, it is heavily dependent on M&A and how much it charges for growth. For example, after Valeant bought two heart drugs from a private company earlier this year, it raised the price of one by more than 200 percent and the other 500 percent.

These sorts of increases have attracted the attention and ire of politicians. Democratic presidential contender Hillary Clinton sparked a debate last week that hit biotech valuations and prompted rollbacks on some rare-drug prices. Democrats on a House committee want to subpoena Valeant and its chief executive, Michael Pearson, over prices. Although the Republicans in charge could ignore the request, it was enough to send Valeant's shares tumbling by 17 percent.

Although the odds are low that lawmakers would allow the government to use its heft to negotiate harder terms with the industry or impose price caps, Valeant may decide to be more conservative with its pricing anyway. The effect on its profit is unclear, but Pearson was quick to reject the "bear thesis" in a letter to employees. He said the company is "well positioned for strong organic growth, even assuming little to no price increases." Pearson also noted that Valeant expects to generate 30 percent of its sales overseas in 2016 and that in businesses such as contact lenses price increases tend to be small.

Though Valeant's shares have swelled by 500 percent over the last five years despite concerns about the acquisitive strategy, Pearson has more convincing to do over the price scare. Valeant already has accumulated about \$30 billion in debt, or five times what analysts are forecasting for EBITDA. Combined with a weaker stock, deals may be harder to strike. If Valeant can't raise prices or buy big rivals, the company could find itself reeling.

Published on Sept. 28, 2015

Valeant's platform trembles beneath Ackman's feet

By Robert Cyran

Valeant Pharmaceuticals' platform is shaking beneath Bill Ackman's feet. The hedge fund manager's Pershing Square Capital bought a 5.5 percent stake because Valeant offered a cure for poor capital allocation by drugmakers. Now the company is facing the limits of its business plan. It is scaling back on acquisitions, investing more on research and limiting price increases on its drugs. Outsiders missed the political logic of pharma's spending.

Valeant, which has a market value of \$59 billion, has been a voracious acquirer. Chief Executive Mike Pearson diagnosed the difficulty of big companies in efficiently discovering drugs, and so Valeant slashed research and development spending at acquired firms and spent little itself. And it seasoned resulting profits by raising prices for many of its drugs.

Ackman and Valeant were correct that much of pharma R&D spending is wasted, but they missed the bigger picture. Drug company values are built upon patents and heavily regulated markets. These are creations of society. The discovery of cures to diseases shores up goodwill, and gives politicians and the courts virtuous reasons to support the industry.

Companies like Valeant have chipped away at this goodwill. Democratic presidential front-runner Hillary Clinton said last month that she had her sights on companies that jacked drug prices but spent little on R&D. Republican presidential candidate Senator Marco Rubio

slammed drug companies for “pure profiteering” in raising drug prices in a speech Monday. Formerly anathematic measures such as allowing the government to use its negotiating heft to procure drugs on the cheap for Medicare could soon be on the table and attract bipartisan support.

Valeant has felt the wind shift. It will limit realized price hikes on its drugs to less than 10 percent next year. The company is mulling disposing of its “neurology and other” business, which is more reliant on price inflation. R&D spending may double next year, to \$500 million.

That would mean Valeant spends about 4 percent of sales on drug development. Peers like Merck spend four times as much proportionally. Investors worry this may not be enough to escape Washington’s ire. The stock is off about 40 percent from its high this summer. That has forced the company to admit that using its shares to acquire rivals is now out of the question. Valeant’s platform looks shakier by the day.

Published on Oct. 19, 2015

Valeant sets tone for post-M&A accounting scrutiny

By Robert Cyran

Valeant Pharmaceuticals sets the tone for intensifying accounting scrutiny once merger activity slows. The drugmaker’s stock ended Wednesday down 19 percent after a short-seller and others questioned its bookkeeping and relationships with other companies. The \$40 billion serial acquirer’s history may make it an obvious target, but as growth and mergers slow a renewed investor focus on companies’ figures is a logical shift.

Valeant has bought several dozen firms since 2008. The company’s stock rose more than 20-fold after Chief Executive Michael Pearson took the helm that year to a peak this past summer as deal after deal transfixed Wall Street. Since then, though, the shares have tumbled by more than half. Democratic presidential frontrunner Hillary Clinton’s stance against drug companies that raise prices but do little research and development put Valeant’s business model in the spotlight. During its latest earnings call, the company said that it would undertake fewer acquisitions, limit price increases and invest more in R&D.

Investors are now examining much more closely the stalled Valeant deal machine. There are discrepancies, for instance, in statements from the various parties about how the company is connected to two specialty pharmacies which help dispense drugs and assist patients with payments - Philidor Rx Services and R&O Pharmacy. To make it more convoluted, R&O is suing Valeant. The confusion has sparked questions about Valeant’s bookkeeping for drug sales through pharmacies like these. Valeant has categorically denied any improper accounting.

American healthcare reimbursement is complex, opaque and sometimes prone to fraud. There could be an element of confusion over similar company names. Or it may just be that Valeant’s multiple deals have created a web in which one strand has little idea what another

is doing. When chief executives like Pearson do a dozen deals a year, they may spend too little time getting their new charges to work together.

Either way, the Valeant turbulence is a sign of a cyclical change in investor thinking. When growth through acquisitions dries up, there's greater focus on the reality of sales and profit. Watchdogs, too, have shifted their attention from insider trading to accounting issues. The Securities and Exchange Commission's newish audit task force, for example, is using special software to spot unusual numbers, dodgy off-balance sheet transactions and auditor changes. As the recent surge of M&A dies down, both investors and regulators may find they have their number-crunching hands full.



A Peruvian Health Ministry worker shows counterfeit pills in Lima, August 5, 2010. REUTERS/Mariana Bazo

Published on Oct. 22, 2015

FROM \$25 BILLION TO \$10 BILLION

Valeant CEO gets called on \$100 mln excess

By Robert Cyran

Valeant Pharmaceuticals Chief Executive Mike Pearson has been called on his \$100 million excess. That's how much stock he put in hock to do everything from paying taxes to donating to charity to buying more shares in the company -he even helped finance a community swimming pool.

Now he has been forced to repay the debt. Compensating bosses in equity is supposed to nudge them to serve shareholder interests. In this case it serves as an apt example of the skewed incentives that have rocked Valeant.

The pharma giant required that Pearson buy a substantial amount of stock when he took the job in 2008. It then granted him lucrative restricted equity worth \$4 for each \$100 of value created on his watch. The board made more such grants in subsequent years so that essentially all of Pearson's pay came in equity and cash incentives tied to performance.

Pearson owned about 3 percent of Valeant as of its last proxy statement. His serial-acquisition strategy yielded riches for a while as the stock rose about 20-fold since he took over. The fact he has never sold any of his holdings makes the story seem even more appealing to those investing alongside him. One reason he has kept his shares, though, is because the company allowed him to use his stock as collateral to borrow money.

That can distort executive incentives. In Valeant's case, management's focus on rapid share appreciation has played a role in its aggressive accounting and M&A strategy. Investors have now grown disenchanted with the results and are questioning whether Valeant has grown too fast. The company's involvement with a specialty pharmacy that has been accused of seeking improper insurance reimbursement and altering prescriptions has added to investor skittishness. The stock has lost 70 percent of its value from its high.

The drop prompted Goldman Sachs to call Pearson's loan and sell 1.3 million of shares it held as collateral. That has put investors even more on edge, not helped by the company's silence about whether the stock sale occurred during a blackout period, when executives can't sell. It's a mess that better board oversight could have prevented.

Published on Nov. 6, 2015

Chancellor: The illusion of debt-fuelled earnings

By Edward Chancellor

Low rates have forced investors into a dangerous search for yield. Just look at the surge in junk-bond and emerging-market corporate debt sales over recent years. Cheap money has also driven record levels of stock buybacks in the United States and fuelled a boom in corporate mergers.

This is evidence of what the Japanese call “zaitech” - the use of cheap capital to boost reported profitability. Like all grand experiments in financial engineering, though, this one too will come unstuck.

Japan’s infatuation with zaitech arose in the late 1980s, at a time when economic growth was slowing and the rising yen threatened corporate profits. Many companies responded to those headwinds by issuing warrant bonds in the eurodollar market, swapping the proceeds back into the domestic currency and investing in Japanese shares, which were held in special trust accounts.

While the Tokyo stock market soared, these companies enjoyed rising earnings and a negative cost of debt funding. However, after interest rates rose and stocks plummeted in the early 1990s, it was game over. Many enthusiastic zaitech players, such as Hanwa, reported large losses.

The mid-1960s witnessed an earlier experiment with financial engineering in America. This was the era of the conglomerate boom. Companies such as ITT, Gulf + Western, Saul Steinberg’s Leasco and Ling-Temco-Vought (LTV) expanded rapidly through acquisitions. Between 1966 and 1968, conglomerates accounted for more than 80 percent of U.S. takeovers. These conglomerates often adopted dubious accounting techniques to boost profits.

Take LTV, cobbled together by the ambitious Oklahoman James Ling. The company expanded from a core electronics business into meat packing, sporting goods, airlines, insurance and eventually steel manufacturing. Ling understood that investors -in particular, the “gunslinger” fund managers of the “go-go” era -were focused on earnings per share.

To deliver EPS growth, Ling issued convertible bonds and bank debt to finance his acquisitions. He also enticed shareholders to exchange stock for convertible securities, which further boosted EPS. Ling would often float shares in acquired companies (like today’s tracking stocks) and use the proceeds to retire debt.

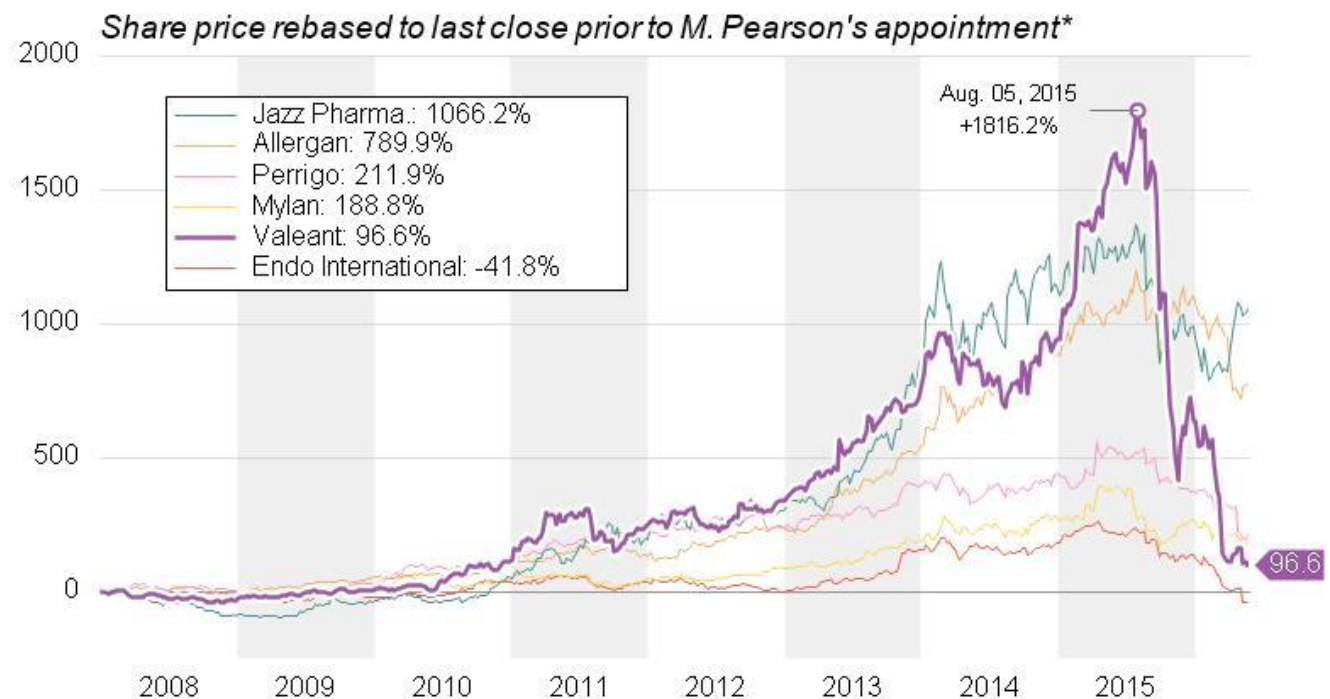
As long as the stock market continued rising, these feats of financial engineering worked wonders for LTV’s shares, which climbed 17-fold between 1964 and 1967. After interest rates rose towards the end of the decade and the stock market turned down, the conglomerate bubble burst. LTV was forced to divest companies to pay down debt, Ling was fired, and his company ended up as a second-tier steel concern, eventually going bankrupt in the mid 1980s.

In a presentation at the Grant's Conference in New York last month, Chicago-based hedge-fund manager James Litinsky drew an intriguing parallel between the 1960s conglomerates and today's so-called platform companies, businesses which have grown rapidly through M&A.

Unlike the conglomerates, they are not diversified but focused on a single industry. Like the conglomerates, however, they have thrived in an era of financial repression, when interest rates have been kept below the rate of inflation. Like their predecessors, platform companies have been using debt to generate EPS growth. Similarly, they have been egged on by investors, with activist hedge funds replacing the gunslinger generation.

Litinsky highlighted companies from various sectors, including brewing (Anheuser-Busch InBev) and consumer staples (Kraft Heinz). But pharmaceutical companies dominate. One of them, Valeant, resembles a modern-day LTV. The firm has grown rapidly through acquisitions, such as of Bausch & Lomb, and slashing costs to meet cost-cutting targets.

Valeant's share price vs other platform companies



Source: Thomson Reuters Datastream, data to 5/26/2016

*Feb. 01, 2008

Vincent Flasseur | @Breakingviews

Valeant promised to take \$900 million from Bausch's \$1.2 billion of operating expenses. Valeant's takeovers have been funded by cheap debt - interest expenses relative to long-term debt have averaged below 6 percent in recent years. Cost-cutting, takeovers and low-cost loans have boosted Valeant's EPS, which climbed from 29 cents (on a diluted GAAP basis) in

the fourth quarter of 2012 to \$1.56 in this year's third quarter.

Like LTV, Valeant has adopted complex financial structures. Its ownership stake in specialist pharmacy Philidor, which distributed some of its drugs, was held through what's called a variable interest entity. Critics claim this structure, which Valeant is now unraveling, kept contingent liabilities off the balance sheet. What's clear is that Valeant has borrowed a lot - long term debt has grown from around \$10 billion in late 2012 to over \$30 billion today.

Corporate roll-ups, from LTV to Tyco International, have tended to come unstuck when they stop growing. Valeant's stock is down more than 70 percent since its peak earlier this year. Its high-yield bonds are now trading below par. Valeant's days of acquisitive growth would appear to be over.

The Valeant story is not an isolated case of aggressive financial engineering. At a time of ultra-low debt costs, announced global M&A activity this year has reached a record \$3.9 trillion, according to Thomson Reuters. Global non-financial investment-grade debt issuance has climbed to \$1.3 trillion so far this year. Acquisition-related debt reached a record \$365 billion, says Thomson Reuters.

Even more debt has been issued by U.S. corporations for share buybacks. Over the past five years, the top 100 share repurchasers have grown their EPS by 93 percent. Their return on equity has climbed to 19 percent from 13 percent during this period, according to Thomson Reuters Worldscope, and their shares have handily outperformed the broader market.

This may look impressive. But the buyback leaders have also seen their sales growth slip and leverage rise. Their median capital spending (relative to cash flow) is below the S&P 500 average. To deliver EPS growth, these companies have been leveraging up and eating their seed corn.

Valeant's fall from grace is just another example of how debt-fuelled growth creates only an illusion of value. Real worth comes from companies investing wisely for the future and acquiring shares - whether their own or in other companies - at low valuations. While corporate revenue is declining and debt is cheap, financial engineering is an easy way out - until it all falls apart.

Published on Nov. 18, 2015

Valeant poised to cause much collateral damage

By Robert Cyran

Beware the collateral damage from Valeant. The acquisitive drugmaker's travails have so far wiped out some two-thirds of its market value, vaporized fortunes of its investors, damaged reputations and dusted the pharmaceuticals industry with political radioactivity. The indirect effects could be even larger, as Valeant will incinerate belief in so-called platform companies, "adjusted" accounting and the genius of hedge fund managers.

SMOKING ROLLUPS

Valeant's intellectual underpinning was that it was a platform. Its market capitalization, which reached a peak of about \$90 billion, derived not only from the assets it controlled, but also from management's ability to buy companies, add them to the mix and enhance their collective value.

The success inspired several other drug rollups, including Mallinckrodt, Endo International, and Horizon Pharma. The combined value of the four companies swelled from about \$20 billion to over \$130 billion in just a few years. Copycats have proliferated in other sectors, including cable where Patrick Drahi's Altice is hoovering up operators around the world. The Brazilian masterminds behind 3G Capital are doing it in beer with Anheuser-Busch InBev and food with Kraft Heinz.

Avago Technologies has joined the platform party in semiconductors while in chemicals, investors Martin Franklin and Pershing Square's Bill Ackman went so far as to tout the strategy right in the name: Platform Specialty Products.

For these enterprises to succeed, bosses need to consistently identify good targets, pay a cheap price and manage the resulting assets effectively. Valeant failed on all three counts.

In August, it bought a barely effective drug for low sexual desire in women for \$1 billion. Initial sales, when such "lifestyle" pills typically fly off the shelves fastest, indicate a glacial start. Valeant won an \$11 billion bidding war for Salix Pharmaceuticals, which was embroiled in an accounting scandal. And Valeant Chief Executive Mike Pearson acknowledged recently, in response to a question about possible fraud at a subsidiary, that for a company the size of Valeant it's "impossible to have full knowledge of everything at any one time."

Some of the other platform companies are probably built on similarly shaky ground. Few have the patience required to succeed in serial dealmaking. It's even harder when investors hunger for growth and executive compensation packages encourage an orgy of debt-driven acquisitions. Tightening credit markets, in particular, could expose the dependence on easy financing.

BRINGING TO ACCOUNT

Valeant's profitability is mediocre. The company also has gilded the figures with non-standard metrics that omit important costs such as compensation, legal fees, and acquisition and integration expenses. Over the past nine reported months, Valeant earned \$75 million using generally accepted accounting principles. Using the company's self-created measures, it has generated a bottom line of \$2.7 billion. The company-adjusted pro forma EBITDA estimates performed a similar optical trick with credit metrics when the company acquired rivals.

These puffed-up and pleasingly named "cash" earnings, and the stock's steady upward progress, appealed to unsophisticated investors. Yet the myriad adjustments -Valeant's

quarterly results contain dozens of footnotes -also paradoxically lured some of the best minds on Wall Street. They convinced themselves that within the complexity was contained opportunity, and that the two sets of figures would converge once Valeant stopped making acquisitions.

Owners big and small are now cottoning onto the reality that at Valeant “one-time” charges have a habit of repeating themselves, amortization is a real cost in a business built on intellectual property and compensation comes out of the pockets of shareholders.

The valuations of many Silicon Valley startups -there are now 145 unicorns worth at least \$1 billion apiece, according to CB Insights -and even many more mature technology companies also prefer non-GAAP figures that strip out stock compensation and other “non-cash” charges. They, too, could be in line for reappraisal.

WHEN GENIUS FAILS

The involvement of ValueAct Capital, one of the best activist funds, on the board acted as a seal of good housekeeping for Valeant. Other star investors piled in, and the great returns they made -Valeant’s share price increased more than 20-fold from 2008 to its height - encouraged still more to join in, turning the stock into a hedge fund hotel. The fall in Valeant’s stock has erased much of those returns, and left many late followers sitting on some ugly paper losses.

There’s nothing wrong with copying a good idea. The belief in Valeant, however, became pernicious group-think accompanied by hubris. Risk management suffered, as big investors took concentrated positions. Valeant’s stock accounted for almost of third of Sequoia Fund this summer, and the manager recently bought more. It wasn’t alone, as Ackman raised his stake to 9.9 percent last month. Ackman even held a conference call about Valeant in late October. About 10,000 people listened to him back the company for four hours. That’s more than twice as many as dialed into the company’s own defense a few days earlier.

Most specialized healthcare funds knew enough to avoid the carnage. They guessed correctly that Valeant’s model of slashing R&D and jacking up prices would result in shrinking prescription counts and pushback by insurers and politicians.

Pershing Square, Sequoia and other funds put their faith in spreadsheets and access to management instead. The numbers they inputted were overly optimistic. There’s little value in asking a CEO, “Is there any fraud happening?” as Ackman did of Pearson. A more cautious approach to the limits of their expertise would have served these investors well. It’s yet another worthwhile reminder for those who would believe in the supposedly smartest investors with a solid track record: past performance won’t always guarantee future returns.

Published on Dec. 7, 2015

Valeant's latest fix reinforces its challenges

By Robert Cyran

Valeant Pharmaceuticals' latest fix reinforces its challenges. The drug company has appointed three executives to take the reins while Chief Executive Mike Pearson is on medical leave and three board members to oversee and guide them. The double triumvirate shows how reliant on one man Valeant has become.

Pearson, who has been hospitalized with a serious case of pneumonia, is the architect of the company's serial-acquisitions strategy. This business model and Pearson's leadership have come under intense scrutiny. Critics have attacked the company's accounting, its stifling \$30 billion debt load and its price hikes on acquired drugs. As a result, Valeant's market capitalization has plummeted by 60 percent since August. This loss of faith by investors has forced the company to switch to integrating businesses, instead of buying new ones, and paying off debt.

The company's prompt action in addressing Pearson's illness by disclosing and appointing interim leadership is commendable. And there's a good chance Pearson could be back shortly. But the structure is convoluted.

General Counsel Robert Chai-Onn, company Group Chairman Ari Kellen and Chief Financial Officer Robert Rosiello will share management responsibilities in a newly created Office of the Chief Executive Officer. The board has also created a committee to "oversee and support" the office of the CEO. This, too, comprises three members - lead independent director Robert Ingram, president of big stakeholder ValueAct Capital Mason Morfit, and former Chief Financial Officer Howard Schiller.

The company says this reflects Valeant's non-traditional organizational philosophy. It relies on what it says is a deep bench of qualified executives working in areas of expertise rather than a traditional hierarchy with roles such as a chief operating officer. Chai-Onn has been at Valeant for a decade; Rosiello advised the company for eight years before joining the firm as finance boss. Moreover, the additional board oversight could augur better corporate governance if it leads to the company eventually separating the roles of chairman and chief executive.

Investors are more worried that this structure reflects the fact Pearson can't be replaced easily, and the risk of executive and board infighting. These fears sent the stock down 10 percent on Monday morning. More turmoil is the last thing Valeant needs.

Published on Dec. 28, 2015

Valeant plays chicken with death spiral

By Robert Cyran

Valeant Pharmaceuticals is playing chicken with a death spiral. The company's failure to file audited results has started a countdown to default that vaporized over 40 percent of its market value in early trading. Executives are mulling selling assets. But with so many questions about its financials unanswered, Valeant's outlook is bleak.

It's never good when the conversation on a company's earnings conference call focuses on its liquidity and ability to meet debt obligations. The now \$12.5 billion company has about \$30 billion of debt, thanks to a string of acquisitions; with over \$1 billion of cash on hand executives argue it can meet its remaining scheduled debt and interest payments this year.



Michael Pearson prepares for Valeant's annual general meeting in Laval, Quebec, May 19, 2015.
REUTERS/Christinne Muschi

That becomes irrelevant if it cannot produce audited results within 60 days, as investors can then demand Valeant repay a chunk of its debt. The company says it's trying to file as fast as it can.

There are more than a few other discordant notes, however. The bullish case for Valeant always centered on its ability to throw off lots of cash. Yet that's shrinking. Chief Executive Michael Pearson, back in charge after a couple of months of sick leave, now thinks it will produce about \$5.7 billion of adjusted EBITDA this year, almost a fifth lower than its previous estimate. Moreover, while the company wants to patch up its balance sheet, it now thinks it will only pay down about \$1.7 billion of debt this year, compared to its previous estimate of more than \$2 billion, and had already drawn down \$1.5 billion on its revolver by the end of December -about double what it had tapped just three months earlier.

Investors were already skeptical about Valeant's adjustments to the financial figures it trumpeted. They are more so today. Valeant press release stated that adjusted EBITDA for the next four quarters would be around \$6.2 billion to \$6.6 billion. On the conference call, though, Pearson had to admit the company only expects around \$6 billion and had to defend himself against an analyst's accusation that the company had deliberately puffed up the numbers.

Valeant's old M&A business model is dead, customers are demanding big price cuts or not reimbursing various medicines and the company can't file audited financial statements. It's now impossible for an outsider to know exactly what is happening within the company -or if it can avoid falling to its doom.

Published on March 15, 2016

Valeant's multiple organ failure puts it in ICU

By Robert Cyran

Valeant Pharmaceuticals is running the risk of an Enron or WorldCom endgame. The beleaguered drugmaker has uncovered accounting impropriety, it said on Monday. It is booting Chief Executive Mike Pearson but Howard Schiller, formerly chief financial officer, has refused to quit as a director. The board, the numbers and the strategy are fractured. Add some \$30 billion of debt, and Valeant could easily crumble.

Take the company's organs in turn, starting with the board. Hedge-fund boss Bill Ackman will now join. His Pershing Square Capital Management, which owns about 9 percent of Valeant's stock, now has two directors. Another activist fund, ValueAct Capital, also has a nominee on the board. Schiller will still be there, too. The company pointed the finger at him for "improper conduct" in Monday's release. The ex-CFO, though, said in a statement he had done nothing wrong. The mixture looks toxic.

The financial glands aren't doing much better. The company's failure to file audited 2015 financial statements on time may put it in default and potentially force it to repay slugs of debt -something it might struggle to do. Raising new cash would be a challenge even without the other clouds hanging over the company now that its market capitalization has tumbled to a level that's less than a third of its debt load.

The company's latest update also criticized "the tone at the top of the organization" as a contributing factor, presumably referring to Pearson. And 2014 numbers are in question, too. It takes a leap of faith to believe that further problems won't emerge and that the figures can be corrected and cleared by auditor PricewaterhouseCoopers in short order. Even figuring out which Valeant executives should sign off may be difficult.

Then there's the company's strategic brain. Its indebtedness stems from the serial acquisition of sometimes mediocre assets at inflated prices, partly in a quest by senior executives to achieve aggressive targets -at any cost, it now seems. If anything, Valeant will have to become a seller of assets to reduce debt. The famous collapses of Enron and WorldCom involved similar multiple organ failures exacerbated by heavy borrowing. To be clear, Valeant so far hasn't been charged with fraud. Even so, it's in a fight for survival.

Published on March 21, 2016

Valeant's new CEO a good choice for a dim future

By Robert Cyran

Valeant Pharmaceuticals' new chief executive is a good choice for a dim future. Joseph Papa's skill running a tight ship at Perrigo is sorely lacking at his new company. Valeant needs to keep staff, sell assets and pay down the company's \$30 billion of debt, all while coping with drug pricing pressures that have also hit the rest of the industry.

Papa is parachuting into a mess. He will start in early May, by which point Valeant intends to have filed its delayed audited 2015 financial statements. Few things have gone according to Valeant's plans over the past year, however. Finding executives willing to sign the statements, for example, may be a challenge. Papa will at least have over a month to file them and cure the default.

That's just the start. Valeant's old boss, Mike Pearson, acquired mediocre assets at inflated prices and hiked drug prices. The company then slashed expenses but never fully integrated the grab bag of assets. The result was demoralized employees, crippling debt and a damaged reputation.

Asset sales will be an early step. Valuable brands such as Bausch & Lomb could do without being tarred by the Valeant association and may be worth more outside the company. The resulting smaller firm would be easier to manage and have some extra cash to pay down debt. This isn't a panacea, however. If Valeant appears desperate, it may not fetch high enough prices on cash-generating assets to cut enough of its liabilities.

Papa also must improve the businesses the company keeps. That's getting harder as insurers are pushing back on drug price increases. Perrigo on Monday warned these pressures will cause the company to miss analysts' revenue and profit estimates.

That may initially give Valeant shareholders some pause. Papa had, for example, promised

his previous investors a bright future. While the stock jumped fivefold under his decade-long reign, it has lost almost a third of its value since Papa and his assurances helped push away a hostile offer from rival Mylan late last year. Valeant, though, is a highly dysfunctional company where owners are likely to welcome even mediocre results and a modicum of adult supervision.



The headquarters of Valeant Pharmaceuticals International Inc., seen in Laval, Quebec, November 9 2015. REUTERS/Christinne Muschi

Published on April 25, 2016

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Cover top: Valeant CEO Michael Pearson testifies before a hearing on Capitol Hill in Washington, U.S. April 27, 2016. REUTERS/Jonathan Ernst

Cover bottom: William Ackman, founder and CEO of Pershing Square Capital Management, speaks to the audience about Herbalife company in New York, July 22, 2014. REUTERS/Eduardo Munoz