

## Valeant Pharmaceuticals

VRX: NYSE

**Analyst:** Peter Ostrowski

**Sector:** Healthcare

**Buy**

Price Target: \$44.20

### Key Statistics as of 4/8/2016

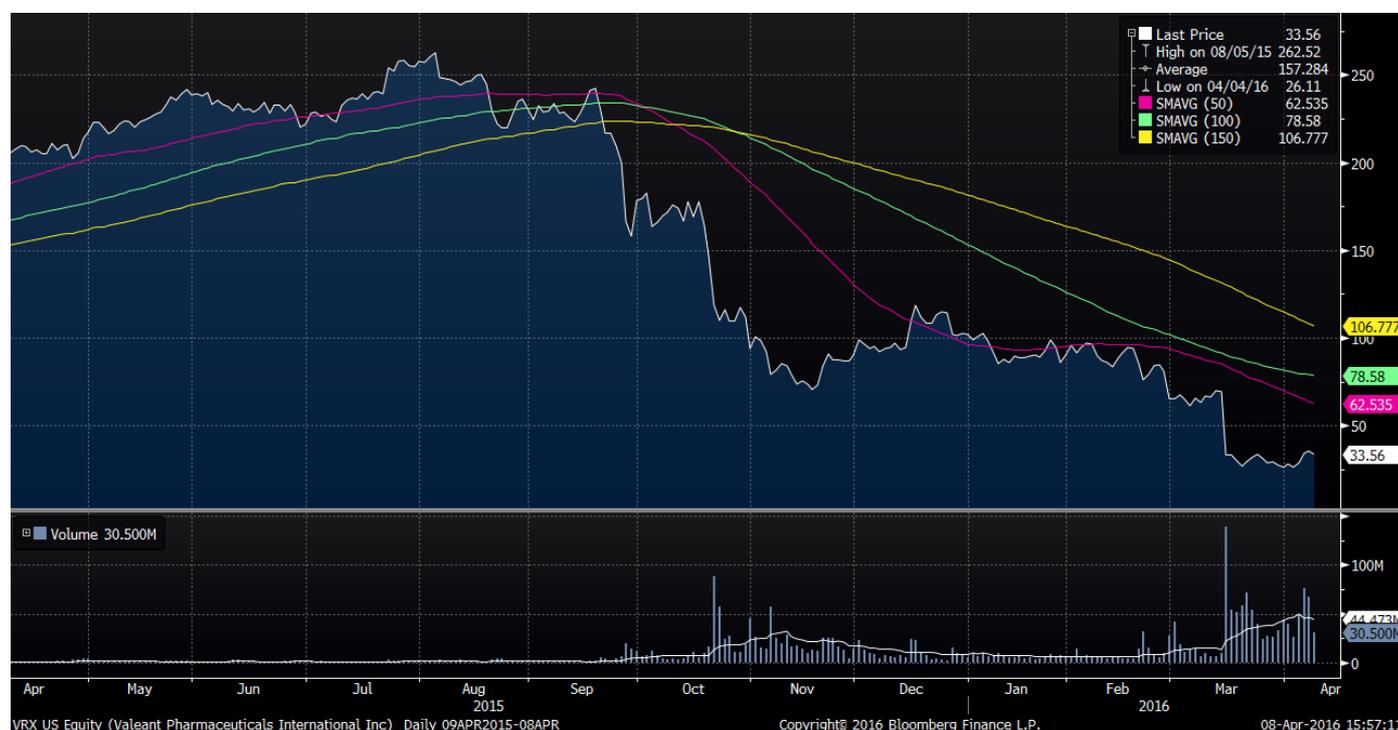
Market Price:	\$33.71
Industry:	Pharmaceuticals
Market Cap:	\$11.5B
52-Week Range:	\$25.27-\$263.81
Beta:	.6

### Thesis Points:

- Delayed 10-k undervalued stock immensely
- With new CEO in the midst; Valeant will reinvent itself
- Creditors recently instated a new debt deal; showing an increase in long term performance for Valeant
- Decrease in short interest combined with increase in ownership shows undervaluation

### Company Description:

Valeant Pharmaceuticals International, Inc. develops and distributes drugs. The Company develops drugs for unmet medical needs in central nervous system disorders; and distributes generic and branded generic drugs in Latin America and Eastern Europe.



## Thesis

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It is no secret that Valeant is currently experiencing internal troubles. After being caught using questionable accounting policies which showed issues in revenue growth; the market saw Valeant as the next Enron. The high amount of debt that Valeant currently holds is also a bit of a red flag to the market. With all of this going against Valeant; they have recently shown some light and have proved the skeptics wrong in a sense. With key personnel changes, a change in company policy and high level investors supporting them; the future for Valeant could be far greater than many have projected. A company of this size and market presence has one thing that many companies in their situation do not have; and that is a second chance which they have been given. The market believes that Valeant has bottomed out as my analysis will argue and that the future for them is immense. The delayed 10-k has hurt investor confidence for the short term; but the information given by many suggests that there will be no more bad news once it is published. This shows a high potential for short term earnings as I will explain. This company is currently experiencing very high trading volumes which suggests that positive news will produce more than favorable outcomes for this company. The credit facility has recently extended Valeant's debt; which has decreased the default probability dramatically. I personally believe that this stock is completely undervalued and has a high chance of short term gain.

## 10-K

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Historically, Valeant investors have reacted very favorably to good news. This is due to the high trading volume on this stock. Within the next few weeks Valeant are going to release their 10-K, which has been delayed since January to the public. This is due to the accounted changes on revenues from 2014 and 2015 that are currently being calculated. The price of Valeant's stock is damaged because of this. I am trying to argue that the price is currently trading at a discount because the market is not expecting the 10-K to provide good news. The reason why I am arguing this as a good thing; is because the company has ruled out uncertainty on the 10-K. Valeant have stated that they currently are meeting all terms with their creditors. They have also recently been given more leeway on

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their EBITDA coverage covenant. The new debt deal has decreased the coverage ratio from 3.0 to 2.75. This hints that there will be a shrink in earnings but this is not a problem. The market is currently pricing Valeant with an extremely high discount due to the high uncertainty associated with it. This alone shows that the company will not default in the near future and that the company may report lower earnings in the next few quarters. This is expected as they will be changing their business practices for the future. That being said Valeant has reported EBITDA coverage of 3.3. So they are currently generating enough profit anyway.

## Management Changes

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The biggest value driver to Valeant in terms of management in Bill Ackman. The well-known CEO of Pershing Capital who holds a 9% stake in Valeant has recently joined Valeant's board of directors. This immediately caused the price of the stock to surge as the market knows that Valeant is in need of a new management.

There have also recently been hints of a new CEO within the next few weeks. This is a favorable position to many people due to the fact that there are lower expectations than normal. By simply getting rid of the current CEO value and confidence can quickly be returned to the company.

## New Business Model

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Valeant was known for their old business strategy which received much scrutiny. They would acquire undervalued biotechs with cheap debt, slash their R&D and put a large premium on the drugs. Valeant was very good at this but to increase investor confidence in the company they have stated that they will begin to lower prices on their drugs. This has been shown with their deal with Walgreens. Though the deal is still in the early stages; Walgreens has recently given a positive review on their partnership with Valeant. They have stated, "The collaboration we have with them, though still in its early stages, is showing some very promising result[s] in terms of improved access and affordability of their product." When this deal was announced in December, shares increased dramatically. The fact that it is showing positive signs gives more reason to suggest Valeant is in the process of a comeback.

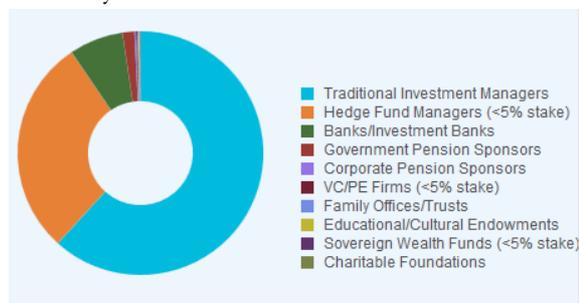
## Recent Changes in Ownership

It is important to look at short interest before viewing the increase in investments. This is because the increases in investments does not state whether the shares are bought long or short. As the graph below shows the short interest is currently 3.38%.



Comparing the short interest to share price is interesting in this case. The short interest is currently the lowest it has been since November when the stock was trading at \$90/share.

Below is the graph showing the current ownership summary:



This company is currently invested mostly by Investment managers. These are generally only long positions. Hedge funds are second with a 29% ownership. Over the past few weeks both hedge funds and investment managers have started increasing their position in this stock. Because the short interest is decreasing; it is safe to say that they are increasing their long position on this stock as they believe it is undervalued.

## Conclusion

I recommend an immediate buy for Valeant. This company is currently discounted immensely due to a poor market outlook. Negative information has sent this stock to its trough but there are strong indicators explaining that this stock has a high growth opportunity. After the 10-K is released and new CEO is brought into the company; the price has the opportunity to take off. The company has shown that they have learned from their mistakes and their lenders have extended their debts as a result. So not only is the chance of default much lower but the actual business is showing signs of growth and improvement. I believe the market jumped to conclusions and tried to group the stock with the likes of SUNE. This company is obviously fighting a bit of an uphill battle but the market is currently pricing it as a loser. The recent reports show signs of improvement and now have many seeing the incredible upside potential of this stock. As long as they are able to show that they are generating cash and paying off their debt; the stock will begin to show its growth.

**Valeant Pharmaceuticals International, Inc. (VRX)**

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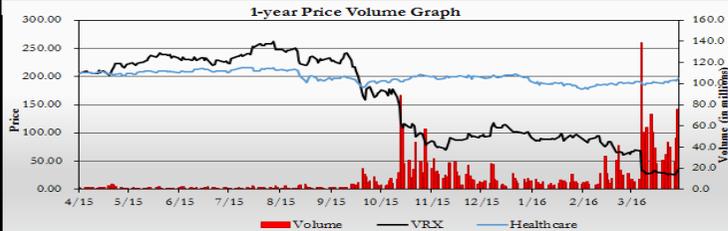
**BULLISH**

Analysis by Peter Ostrowski  
4/9/2016

Current Price: **\$33.67**  
Divident Yield: **0.0%**

Intrinsic Value: **\$30.74**  
Target Price: **\$44.20**

Target 1 year Return: **31.28%**  
Probability of Price Increase: **98%**

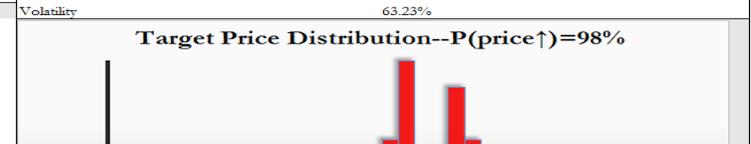


<b>Description</b>	
Valeant Pharmaceuticals International, Inc. develops, manufactures, and markets pharmaceuticals, over-the-counter products, and medical devices worldwide.	
<b>General Information</b>	
Sector	Healthcare
Industry	Pharmaceuticals
Last Guidance	November 3, 2015
Next earnings date	April 28, 2016
Estimated Country Risk Premium	6.50%
Effective Tax rate	34%
Effective Operating Tax rate	-37%

<b>Market Data</b>	
Market Capitalization	\$11,487.90
Daily volume (mil)	32.73
Shares outstanding (mil)	341.19
Diluted shares outstanding (mil)	345.85
% shares held by institutions	55%
% shares held by investments Managers	54%
% shares held by hedge funds	31%
% shares held by insiders	0.59%
Short interest	3.38%
Days to cover short interest	0.54
52 week high	\$263.81
52-week low	\$25.27
Levered Beta	1.40
Volatility	63.23%

<b>Past Earning Surprises</b>	
Quarter ending	Revenue
12/31/2014	2.13%
3/31/2015	1.54%
6/30/2015	7.95%
9/30/2015	0.54%
12/31/2015	0.95%
Mean	2.62%
Standard error	1.4%

<b>EBITDA</b>	
12/31/2014	2.24%
3/31/2015	-1.10%
6/30/2015	7.69%
9/30/2015	-2.40%
12/31/2015	-16.95%
Mean	-2.10%
Standard error	4.1%



<b>Management</b>	
Pearson, J.	Chief Executive Officer and
Chai-Onn, Robert	Chief Legal Officer, Executiv
Mirovsky, Pavel	President of Valeant Europe
Kellen, Ari	Executive Vice President and
Rosiello, Robert	Chief Financial Officer and
Butz, Robert	Vice President of Medical &

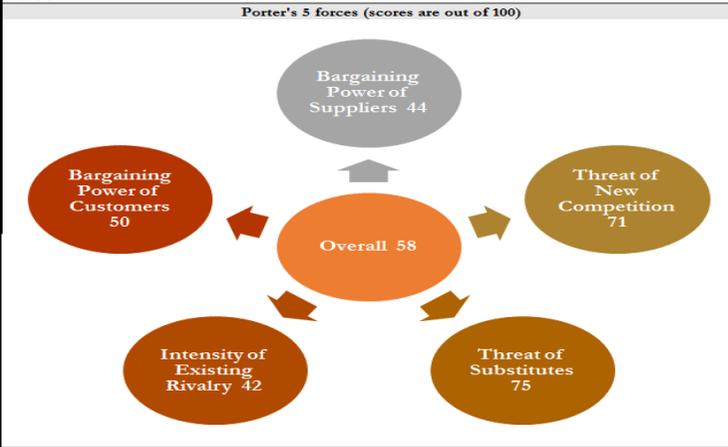
<b>Peers</b>	
Mylan N.V.	
Allergan plc	
Teva Pharmaceutical Industries Limited	
Bristol-Myers Squibb Company	
Eli Lilly and Company	
Perrigo Company plc	
Mallinckrodt Public Limited Company	



<b>Profitability</b>	
ROIC	38.0%
NOPAT Margin	110%
Revenue/Invested Capital	0.35
ROE	48.5%
Adjusted net margin	100%
Revenue/Adjusted Book Value	0.48
<b>Invested Funds</b>	
Total Cash/Total Capital	2.8%
Estimated Operating Cash/Total Capital	2.1%
Non-cash working Capital/Total Capital	3.1%
Invested Capital/Total Capital	99.6%
<b>Capital Structure</b>	
Total Debt/Common Equity (LTM)	0.51
Cost of Existing Debt	8.83%
Estimated Cost of new Borrowing	4.16%
CGFS Risk Rating	8.83%
Unlevered Beta (LTM)	5.75%
WACC	8.83%

<b>Total compensations growth</b>	
21.24% per annum over 4y	
70.6% per annum over 4y	
154.05% per annum over 2y	
N/M	
N/M	
N/M	
<b>Total return to shareholders</b>	
19.99% per annum over 4y	
19.99% per annum over 4y	
54.74% per annum over 2y	
0% per annum over 0y	
N/M	
N/M	

<b>Valuation</b>	
NOPAT margin	ROIC/WACC
24.1%	3.59
109.5%	0.57
25.3%	0.62
27.0%	0.61
26.9%	0.65
27.5%	0.73
27.6%	0.76
27.8%	0.60
26.0%	0.68
25.3%	0.76
25.1%	0.87
1.1%	0.76
25.3%	0.87
3.0%	0.97
25.7%	



<b>Revenue growth</b>	
Base Year	24.1%
9/30/2016	9.6%
9/30/2017	16.1%
9/30/2018	4.3%
9/30/2019	4.7%
9/30/2020	10.6%
9/30/2021	7.4%
9/30/2022	-14.9%
9/30/2023	-6.8%
9/30/2024	-3.3%
9/30/2025	1.1%
Continuing Period	3.0%
<b>Invested Capital</b>	
Base Year	\$10,200.95
9/30/2016	\$12,980.27
9/30/2017	\$17,749.86
9/30/2018	\$29,409.48
9/30/2019	\$28,787.18
9/30/2020	\$51,147.95
9/30/2021	\$57,826.77
9/30/2022	\$63,024.14
9/30/2023	\$64,459.90
9/30/2024	\$64,770.42
9/30/2025	\$67,592.24
Continuing Period	

<b>Net Claims</b>	
Base Year	\$31,334.99
9/30/2016	\$31,847.13
9/30/2017	\$35,330.38
9/30/2018	\$35,360.82
9/30/2019	\$34,247.18
9/30/2020	\$35,466.84
9/30/2021	\$35,579.10
9/30/2022	\$22,336.56
9/30/2023	\$14,690.18
9/30/2024	\$9,623.75
9/30/2025	\$7,061.04
Continuing Period	

<b>Price per share</b>	
Base Year	\$21.70
9/30/2016	\$42.24
9/30/2017	\$50.04
9/30/2018	\$57.89
9/30/2019	\$65.60
9/30/2020	\$72.82
9/30/2021	\$79.69
9/30/2022	\$85.89
9/30/2023	\$90.26
9/30/2024	\$93.29
9/30/2025	\$95.26
Continuing Period	