

Valeant Pharmaceuticals International

Where Is the Faith?

The business model is continuously evolving, which is good thing

Investors are concerned that there is a sig change in the b-model, which is confusing to us. Mgt has been continuously evolving the b-model. (1) This mgt team didn't believe in sig promotional spend to support its prods yet evolved its thinking when it acquired or developed prods that would really respond to DTC (Jublia/ Xifaxan). (2) This mgt team was focused on pharma and yet with B&L, Valeant is now materially in med tech. (3) This mgt team was only focused on internal R&D in derm and yet it will boost spending in Eyecare and GI through newly acquired capabilities. It was never anti-R&D. It was/is against inefficient spending. What has clearly changed is the strategy of acquiring assets (Marathon/Aton), and then putting in sig price increases on day one. But this has never been a core part of the strategy and, instead mgt has been opportunistic in these situations. But this really doesn't change the company's main strategy. Mgt has been reviewing the potential divestiture/spin of the Neuro biz with it Board for a few years, but given the sell-off in the stock, mgt is open to new ideas to drive value.

We believe it's a mistake to under-estimate this CEO

Mgt has no plans to use its equity for deals, but instead share repo has risen to the top along with more tuck-in BD for use of CF, followed by debt pay-down but with a focus of <4 leverage by YE 2016. We are still not sure why investors are disappointed that there won't be material M&A as a catalyst anytime soon given the leverage post the Salix deal. However, there is a slight change regarding price increases, as it appears that mgt will manage to smaller increases in the current environment. Mgt's comment was that for its 2016 forecast, no product has more than a 10% assumed net price increase, but its point was that biz is strong enough to make > \$7.5B of EBITDA.

Thoughts on the stock: No change to our thesis; patience should be rewarded

We get it. In the current environment, the "glass is half empty;" a focus on less price increases and no short-term major deals, instead of the strong B&L and Salix trends, and the very strong earnings growth. It's difficult to know when sentiment will shift, but we remain patient recommending VRX because we still believe in mgt.

Valuation: We maintain our Buy rating and PT of \$285

Our PT is based on a P/E of ~16x our 2017E EPS of \$18.00.

Equities

Americas
Pharmaceuticals

12-month rating **Buy**

12m price target **US\$285.00**

Price **US\$163.83**

RIC: VRX.N BBG: VRX US

Trading data and key metrics

52-wk range US\$262.52-124.78

Market cap. US\$56.5bn

Shares o/s 345m (COM)

Free float 100%

Avg. daily volume ('000) 455

Avg. daily value (m) US\$92.0

Common s/h equity (12/15E) US\$7.51bn

P/BV (12/15E) 7.5x

Net debt / EBITDA (12/15E) 4.1x

EPS (UBS, diluted) (US\$)

	12/15E			
	From	To	% ch	Cons.
Q1	2.36	2.36	0	2.36
Q2	2.56	2.56	0	2.56
Q3	2.70	2.74	2	2.70
Q4E	4.03	4.12	2	4.00
12/15E	11.65	11.78	1	11.63
12/16E	15.80	16.20	3	16.17
12/17E	17.65	18.00	2	18.69

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Highlights (US\$m)	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
Revenues	3,547	5,770	8,264	11,046	13,204	13,752	14,511	15,183
EBIT (UBS)	1,871	2,860	3,846	5,643	7,266	7,597	8,068	8,475
Net earnings (UBS)	1,412	2,046	2,850	4,100	5,611	6,225	6,861	7,464
EPS (UBS, diluted) (US\$)	4.52	6.25	8.34	11.78	16.20	18.00	19.96	22.52
DPS (US\$)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Net (debt) / cash	(10,252)	(17,368)	(15,255)	(30,393)	(26,173)	(20,452)	(14,535)	(13,517)
Profitability/valuation	12/12	12/13	12/14	12/15E	12/16E	12/17E	12/18E	12/19E
EBIT margin %	52.7	49.6	46.5	51.1	55.0	55.2	55.6	55.8
ROIC (EBIT) %	15.3	15.6	17.8	19.3	19.2	20.4	22.1	22.9
EV/EBITDA (core) x	8.7	8.4	10.5	10.8	9.5	9.2	9.0	8.6
P/E (UBS, diluted) x	11.6	14.2	15.5	13.9	10.1	9.1	8.2	7.3
Equity FCF (UBS) yield %	12.3	13.9	9.2	10.0	12.6	13.7	14.4	15.5
Net dividend yield %	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US\$163.83 on 19 Oct 2015 18:41 EDT

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Conference Call Takeaways

- Management expects GM to approach 80% and Salix sales of ~\$600M in 4Q.
- Management expects to spend \$400-500M in R&D for 2016.
- Jublia sales absorbed ~\$10M of destocking; hence; reported sales were weaker than Rx trends.
- DTC spend in 3Q was \$45M, lower than the \$60M in 2Q due to summer seasonality.
- Salix inventories should be down to 1.0-1.5 months by year end.
- Valeant expects to submit the marketing materials for Addyi to the OPDP shortly, and the 148 reps will use the package insert to detail to docs in the meanwhile.
- Management indicated that it has already exceeded its \$550M synergy target for Salix.
- The Xifaxan SSD study failed.
- The Phase 3 data for IDP-118 in psoriasis is expected in 2Q16.
- Management expects to file an NDA for brodalumab in November.
- Patient-assistance programs are expected to cost \$635M in 2015 and \$1B in 2016.
- Management plans many new product launches to help drive sales in Europe.
- For 2016 management indicated that the impact from new BD, better-than-expected dermatology and Salix volume growth, strong trends in contact lenses and growth in China should more than offset lower-than-expected Neuro/Other price increases and FX headwinds to drive over \$7.5B of EBITDA.

Figure 1: Valeant – 2015 Guidance

	Prior 4Q15 Guidance	New 4Q15 Guidance
Revenues	\$3.2-3.4B	\$3.25-3.45B
Cash EPS	\$3.98-4.18	\$4.00-4.20

	Prior 2015 Guidance	New 2015 Guidance
Revenues	\$10.7-11.1B (incl. ~\$1.2B from Salix)	\$11.0-11.2B (incl. ~\$1.35B from Salix)
Cash EPS	\$11.50-11.80	\$11.67-11.87
Adj. Cash Flow from Operations	>\$3.2B	>\$3.35B

Source: Company reports

Figure 2: Valeant Milestones

Date	Product	Indication/Description	Milestone/Event
2015			
November	Brodalumab	Psoriasis	NDA submission
4Q15	IDP-120	Novel acne combination	Initiate Phase II study
4Q15	Arestin LCM	Antibiotic treatment for periodontal gum disease	NDA submission
2016			
April 19, 2016	Reslistor Tablets	Pain Management	PDUFA Date for Opioid Induced Constipation
Mid-2016	Lotemax Next Gen 0.38%	Post-operating and inflammation and pain	US filing
Mid-2016	EnVista Toric	Intraocular lens	File PMA
July 21, 2016	Vesneo (Latanoprostene bunod)	Glaucoma	PDUFA
2Q16	IDP-118	Psoriasis	Phase 3 readout
3Q16	IDP-118	Psoriasis	NDA submission
2016	Luminesse (Brimonidine)	Eye whitening	US Launch
2016	Ultra Plus Powers	Contact Lens	Launch
2016	BioTrue Toric	Contact Lens	Launch
2016	Arestin LCM	Antibiotic treatment for periodontal gum diseases	Launch
2016/2017	Emerade	Anaphylaxis	US Launch
2017/2018			
2017	Lotemax Next Gen 0.38%	Post-operating and inflammation and pain	US Launch
4Q17	Rifaximin delayed release	Crohn's Disease	Potential readout of Phase 3
2017/2018	IDP-118	Psoriasis	Launch
2019			
2019	IDP-120	Novel acne combination	Launch

Source: Company reports

Figure 3: 3Q15 VRX Variance Analysis

	3Q15E		3Q15A		Variance	Comments
	Amount	% Chg	Amount	% Chg		
Products and Alliance						
Dermatology	468.3	53.4%	465.5	52.5%	-2.8	
Consumer	162.5	14.9%	151.0	6.8%	-11.5	
Ophthalmology Rx	132.4	12.4%	114.3	-3.0%	-18.1	
Contact Lenses	54.0	20.5%	60.4	34.8%	6.4	
Surgical	53.0	-1.9%	54.6	1.1%	1.6	
Neuro & Other	508.9	30.0%	546.5	39.6%	37.6	
Dental	55.0	69.8%	43.8	35.2%	-11.2	
Oncology/Urology	77.0	NA	69.3	NA	-7.7	
GI	371.3	NA	462.8	NA	91.5	
Geography						
US Market	1,882.5	74.5%	1,947.2	80.5%	64.7	
ROW	386.7	-5.1%	342.9	-15.9%	-43.8	
Developed Markets	2,269.2	52.7%	2,290.1	54.1%	20.9	
Emerging Markets	501.5	-6.6%	458.2	-14.7%	-43.3	
Total Product Sales	2,770.7	37.0%	2,748.3	35.9%	-22.4	
Alliance, Royalty, Service and Other	40.4	21.7%	38.5	16.0%	-2.9	
Total Revenues	2,811.1	36.7%	2,786.8	35.5%	-24.3	Consensus: \$2.78B
COGS + COS	630.8	18.2%	612.0	14.6%	-18.8	
Gross Profit	2,180.3	43.2%	2,174.8	42.9%	-5.5	
SG&A	743.0	48.4%	673.7	34.5%	-69.3	
R&D	76.9	30.8%	101.3	72.3%	24.4	
Operating Income	1,360.4	41.3%	1,399.8	45.4%	39.4	
Non-Operating Items	-372.0	71.2%	-402.2	85.1%	-30.2	
Pretax Income	988.3	32.6%	997.6	33.8%	9.3	
Tax Rate	4.0%	16.0%	3.4%	-0.8%	-0.6%	
Taxes	39.5	53.8%	34.1	32.7%	-5.4	
Net income from non-controlling interest	1.4	40.0%	2.2	120.0%	0.8	
Net Income	948.8	32.0%	961.3	33.7%	12.5	
Average Shares	351.9	3.1%	351.0	2.8%	-0.9	
Adjusted EPS	\$2.70	28.0%	\$2.74	30.0%	\$0.04	Consensus: \$2.72
Margin Analysis						
Sales	100.0%		100.0%			
COGS	22.4%		22.0%		-0.5%	
Gross Margin	77.6%		78.0%		0.5%	
SG&A	26.4%		24.2%		-2.3%	
R&D	2.7%		3.7%		1.0%	
Amortization	0.0%		0.0%		0.0%	
Operating Margin	48.4%		50.2%		1.8%	
Operating Margin (ex Amortization)	48.4%		50.2%		1.8%	
Pretax Margin	35.2%		35.8%		0.6%	
Cash Tax Rate	100.0%		100.0%		0.0%	
Net Margin	33.8%		34.5%		0.7%	

Source: UBS estimates, Company reports and FactSet Research

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