



Max Nisen

Follow @MaxNisen

June 9, 2016 10:31 AM EDT

With Valeant, things can always be worse, and the past is never buried.

For example, Valeant's controversial relationship with specialty pharmacy Philidor, which ended last year, has come back to haunt the company. This time, it's not the accounting issues and allegations of misconduct that led to the breakup. It's the way Valeant tried to fill the Philidor-sized hole in its drug-distribution plan: the desperate deal negotiated by ex-CEO Mike Pearson for Walgreens to sell Valeant's dermatology and eye drugs at a discount.

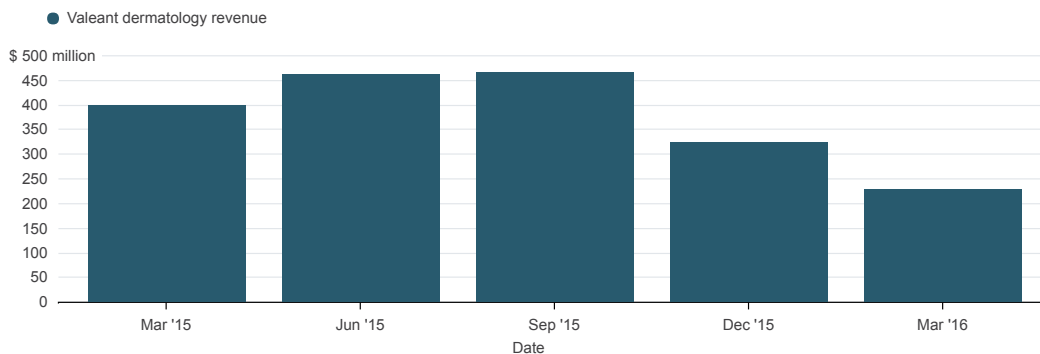
Valeant is losing money on sales of some of its drugs through Walgreens, according to its earnings call Tuesday. Mere months after the deal started, new CEO Joe Papa wants to rewrite it or get out, according to [the Financial Times](#).

But the deal isn't just disappointing because Pearson negotiated poorly, though he did. It's flopping because many of Valeant's drugs are old, expensive, or easily substitutable. Without Philidor doing [paperwork for doctors](#) and fighting payers for reimbursement, this glaring flaw is starting to show, big time. There's no easy fix for that.

One of the worst parts of Valeant's [awful quarterly earnings report](#) Tuesday was the 43 percent revenue drop from a year ago, to \$228.6 million, in its U.S. dermatology business. The decline was driven partly by struggles with the Walgreens deal. The unit made up about 24 percent of Valeant's U.S. sales and 17 percent of total sales at its revenue peak in the third quarter of 2015. It has since fallen to 10 percent of total sales. The company's prescription eye-drug business, which accounts for about 4 percent of total sales, is also covered by the Walgreens deal. Its sales fell 30 percent to \$90.7 million in the quarter.

Stepping Down

Valeant's dermatology drug revenue is falling rapidly and a turnaround will be tough.



Source: Company

Pearson pitched the Walgreens deal as the [company's salvation](#), saying it would restore the business to growth based on sales volume instead of controversial price hikes. Valeant's stock price jumped 16 percent on the announcement. Pearson said the deal "more than replaces Philidor" as a distribution strategy.

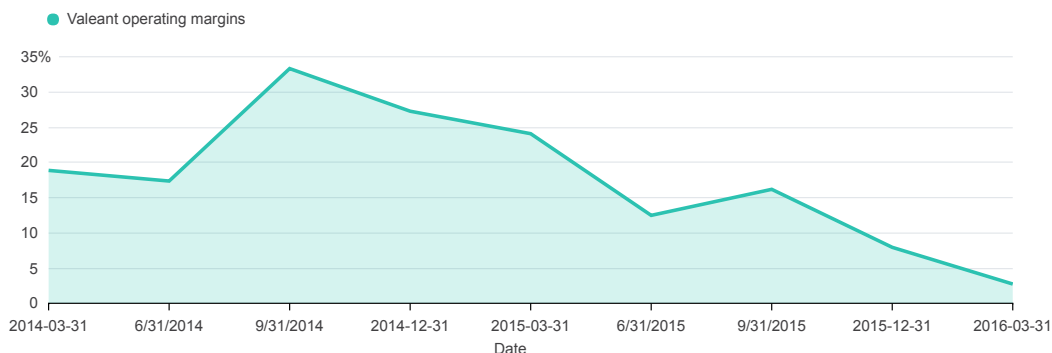
But the deal was lopsided in Walgreens' favor. Valeant pays the pharmacy a fee for offering its drugs, whether an insurer ends up paying for them or not. So if an insurer rejects a prescription after it is dispensed, then Valeant may never get reimbursed, apparently paying Walgreens for the pleasure. About a quarter of Valeant prescriptions being dispensed through Walgreens go out without insurer approval, [according to the FT](#).

Along with higher spending, Valeant's fights with insurers, its inability to increase prices, and its Walgreens disappointment are crushing operating margins, which are down more than 20 percent from a year ago.

Marginal

ACRUX DDS PTY LTD. et al
EXHIBIT 1634
JDR Petition for

Valeant's operating margins are plunging as new costs run into lower drug prices.



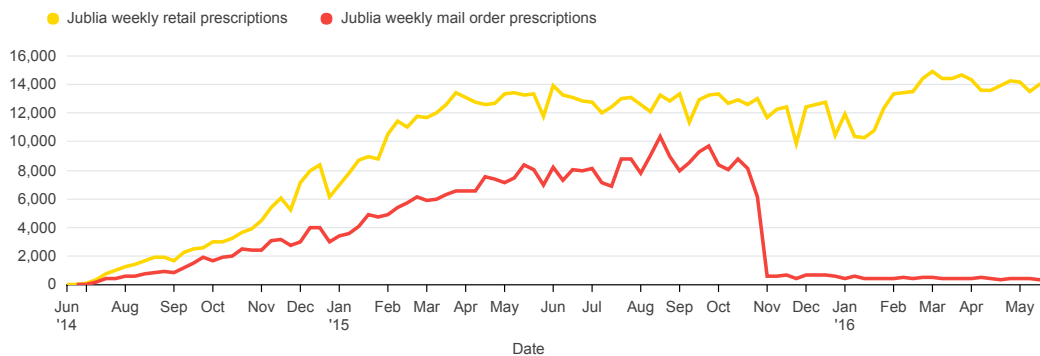
Source: Bloomberg Intelligence

Expensive Valeant drugs have seen their revenue plummet in part because insurers have balked. Sales of \$1000-a-vial toe-fungus drug Jublia have fallen 37 percent in the past year, for example. Jublia prescriptions have recovered only modestly from a steep plunge after Valeant a cut ties with Philidor last fall. Whether it's reimbursement troubles, reputation damage from the public controversy over Valeant's pricing practices, a slow ramp-up, or all of the above, the Walgreens deal doesn't seem to be providing the promised volume boost for Valeant's drugs yet.

In fact, the company said the average selling price for its medicines is far lower at Walgreens than it is anywhere else. So ramping up sales there might actually hurt margins even more, especially compared to what the company was used to with Philidor.

The Fungus Among Us

Valeant's Walgreens deal discounts have modestly boosted Jublia's retail prescriptions. But the pact has not made up for the loss of Philidor's mail order business, by any stretch.



Source: Bloomberg Intelligence/Symphony

Insurers and pharmacy benefit managers have gone out of their way to scrutinize Valeant's products -- which are often expensive, even with the Walgreens discount -- and push patients to cheaper or generic alternatives. Its dermatology drugs are a particular target. Valeant said it plans to contract with an unnamed third party to help it deal with reimbursements from payers.

Valeant's fix in the past was Philidor, which was said to be extremely aggressive about getting reimbursement. That helped fuel Valeant's ability to continually raise prices. Now Valeant's practices are in a very public spotlight, and it's not clear how a by-the-book third party can get around increasingly sophisticated, aggressive, and targeted insurer restrictions.

It's also hard to see what kind of leverage Papa has to modify the 20-year deal with Walgreens, or if he'll legally be able to get out of it.

A better solution might be focusing on drugs that can grow sales organically and aren't routinely rejected by insurers. But it's a little late for Valeant to go that route.

This column does not necessarily reflect the opinion of Bloomberg LP and its owners. To contact the author of this story:

Max Nisen in New York at mnisen@bloomberg.net

10/31/2017

Valeant's Walgreens Woes Have No Easy Fix - Bloomberg Gadfly

To contact the editor responsible for this story:

Mark Gongloff at mgongloff1@bloomberg.net
