

Jun. 13, 2016

## I know how to turn this company around,' Valeant CEO says on eve of AGM

NICOLAS VAN PRAET

As he prepares to face shareholders Tuesday after nine months of corporate trauma that saw his predecessor ousted and the stock collapse, Valeant Pharmaceuticals International Inc. chairman and chief executive officer Joe Papa is focused on what he sees as the fundamental truth about the business after all else is stripped out: The drug maker has good people that make life-changing products. And he says its problems are fixable.

Just how hard investors will push Mr. Papa and his revamped board as he tries to turn around the maker of contact lenses and dermatology remedies is another question. Three big pension funds have said they are voting against the company's say-on-pay vote. British Columbia Investment Management Corp. said it was "holding the former members of the compensation committee accountable" for ratifying compensation practices it believes don't sufficiently align pay with performance.

"There is clearly a lot of noise" surrounding Valeant, Mr. Papa said in a brief interview at Valeant's Laval, Que., headquarters. "But I go back to 'Do we have good products?' And I think the answer to that is yes. We have great brands that make a difference in patients' lives. ... [Given that], I'm very comfortable we'll be successful. I've always found that the most important thing to focus on."

His view, and his motivation for taking a job few others would touch, is built on personal experience. When he was 11, he became very ill after his wrist and knee swelled suddenly and for no apparent reason. Doctors made a diagnosis he didn't want to specify but it was high doses of antibiotics and aspirin that made him healthy again. "I saw first hand how pharmaceuticals could make a real difference in people's lives," he said.

Valeant shares rose 2 per cent in early morning trading Monday after Mr. Papa disclosed he bought 202,000 shares of the drug maker. The average price of the trades was \$24.48 a share, putting the value of the purchase at roughly \$5-million.

Such a move is typically seen by the market as a vote of confidence in a company's prospects. Mr. Papa, a pharmacist by training who formerly led drug maker Perrigo Co. PLC, has been in the job for just over a month.

"This company has more noise than I've experienced, I'll be candid. But it's very similar to things I've done before," he said. "I know what to do here. I know how to turn this company around."

The hurdles to restore Valeant's previous growth trajectory are immense.

The formerly high-flying company last week slashed its financial projections for this year and reported first-quarter earnings that fell well short of expectations as it disclosed fresh problems with its business including a sales force turnover. Its stock lost 15 per cent on the day.

The shares have lost about 90 per cent of their value since peaking at \$347.83 in August, 2015. The months that followed were marked by crisis after a short seller's allegations of fraud against the company.

That added to revelations about the questionable selling practices of its mail order pharmacy Philidor, sparking external investigations by government authorities including the U.S. Securities and Exchange Commission.

The company has also faced criticism for its business model and ethics, and how Mr. Papa will handle that and break from a corporate culture built by his predecessor is still unclear. Mr. Papa has said his first priority will be to stabilize the company, a three- to six-month job, after which he'll engineer a turnaround.

That might be tougher than it looks.

The Philidor debacle has hurt Valeant's credibility with U.S. pharmacy benefit managers, **Veritas Investment Research** analyst **Dmitry Khmelitsky** says. And with the recent lawsuit by certain health benefit plans accusing the company of involvement in mail and wire fraud, its controversial past isn't going away, he says. Staff retention is also an issue.

"Valeant continues to fend off a barrage of regulatory investigations and legal claims, which based on our estimates may cost the company approximately \$5-billion to settle," **Mr. Khmelitsky** said in a June 8 research note.

The company's debt, as well as ongoing investigations and lawsuits, will become more important in coming months, Wells Fargo Securities analyst David Maris says. Although the company expects to meet its financial covenants through 2016 even with its lowered guidance, the cushion on those covenants will be thin, credit company Standard & Poor's said in a June 8 note that affirmed Valeant's single-B corporate credit rating and double-B-minus senior secured debt rating and removed the ratings from credit watch.

Valeant's strategy is largely the work of Mike Pearson, a Canadian-born former McKinsey consultant who shunned the traditional pharmaceutical business model. Under his command from a base in New Jersey, Valeant became the bête noire of the industry by obsessively buying pharmaceutical companies and then cutting all their perceived fat that didn't directly contribute to profits, which included most of their research and development activities. Valeant also bought new drugs and raised their prices, earning the scorn of U.S. lawmakers and corporate leaders alike.

Hedge funds and other investors, including Bill Ackman's Pershing Square Capital Management, initially applauded Mr. Pearson's outsider mentality and aggressive deal making, which delivered returns. But it proved too much for them in the end and they forced changes in senior management that saw Mr. Pearson shown the door this spring. The board has also been revamped.

Analysts have complained constantly about Valeant's accounting methods, which they said make it difficult to track the company's progress. The company continues to decline providing a generally accepted accounting principles earnings forecast for investors but Mr. Papa has said his "hope is to provide greater transparency over time."

At the annual meeting this year of U.S. holding company giant Berkshire Hathaway, Warren Buffett said Valeant was "a Wall Street scheme." His partner, Charlie Munger, has said Valeant's former strategy of buying smaller pharmaceutical companies and raising their drug prices is "deeply immoral," calling the company "a sewer."

It will take time to replace some of the perceptions people have of Valeant, Mr. Papa admitted in his interview with The Globe and Mail.