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Valeant denies fraud allegations, but investors still wary

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CEO defends business model after allegations last week that Valeant uses specialty pharmas to hide 'phantom sales'

Valeant Pharmaceuticals International Inc. chief executive officer Michael Pearson tried to defuse the crisis that has blown up at the Canadian drug maker over its ties to a mail-order pharmacy, but investors are showing that they are still anxious about the company's prospects.

Shares in the drug maker fell again in both New York and Toronto trading on Monday in the wake of a pivotal 8 a.m. conference call by Mr. Pearson and members of his executive team and board. The call was held to refute allegations of fraud levelled against Valeant last week by U.S. short-seller Citron Research, which sent Valeant stock toppling and shook the company to its core.

While Mr. Pearson said the claims are "completely untrue" and maintained that the company's accounting is fully legal, he acknowledged that issues have been raised about the practices of specialty pharmacy Philidor Rx Services that warrant review. Valeant mandated an ad hoc committee of directors to look into the relationship with Philidor and brought back a key early backer, ValueAct Capital president G. Mason Morfit, as an independent director on that committee.

"They're trying their best" to win back the trust of investors, said ***Anthony Scilipoti***, whose ***Veritas Investment Research*** in Toronto has been a long-time critic of Valeant's debt-fuelled acquisition and tax strategies. "It'll be tough. At 20,000 feet, the business model and the accounting didn't add up to us. Now that we hear more about what lies beneath, we get more and more concerned."

Unrelated to the Philidor issue, Valeant, based in Laval, Que., disclosed in a separate filing with regulators on Monday that it is the subject of four separate investigations in the United States. Chief among them is a probe by the Department of Justice's civil division and the U.S. Attorney's Office for the Eastern District of Pennsylvania into possible false claims on pricing made by Biovail, Valeant's predecessor company.

Citron, run by Andrew Left, said Valeant is using Philidor to store its drug inventory and record that activity as revenue when, in fact, they are simply "phantom sales" designed to fool auditors. Valeant says the allegations are false and that it records revenue only when its products are sent to patients. The financial results of Philidor and the Philidor network are consolidated into Valeant's own, Valeant says.

"The sensational claims made by the short-seller Andrew Left through his entity Citron are completely untrue," Mr. Pearson said on the call. "His motivation is the same as someone who runs into a crowded theatre to falsely yell 'fire.' He wanted people to run. He intentionally designed the report to frighten our shareholders to drive down the price of the stock."

Valeant has asked the U.S. Securities and Exchange Commission to investigate Mr. Left and Citron, Mr. Pearson said. Lawyers for the company have met with the SEC, he said.

In a statement, Mr. Left suggested that he merely raised the possibility of danger.

"Yelling 'fire' in a crowded theatre is a lot different than walking into a theatre, smelling smoke and yelling, 'Hey everyone, there could be a fire,'" he said. "Now the information is out, people have had an opportunity to inspect the theatre and they have chosen to leave. ... Maybe there is a fire."

Although it has paid $100-million (U.S.) for an option to acquire Philidor, Valeant said the pharmacy is currently independent and it does not control it.

There is "no way" for Valeant to stuff inventory into the pharmacy because all inventory remains on Valeant's balance sheet until it is dispensed to patients, the drug maker said in an online presentation, adding that it does not believe that it has legal liability for Philidor.

Valeant reaffirmed its previous earnings guidance.

Sales made through Philidor represented 6.8 per cent of Valeant's revenue in the third quarter and 7 per cent of earnings before interest, taxes, depreciation and amortization, the company said. Valeant said the reason it did not disclose its relationship with Philidor before was because, at less than 10 per cent of overall revenue, the accord is not material.

Based on the results of the review by Valeant's ad hoc committee of directors, the company will weigh its options with respect to Philidor. Buying it or breaking ties with it are among the choices, the company said.

Analysts say Philidor helps to increase Valeant's profit by filling its brand-name drug prescriptions whereas an independent pharmacy might substitute a less expensive alternative. The company is allegedly superaggressive in prescribing drugs, raising potential concerns for insurers.

Mr. Morfit, who served as a Valeant director for seven years to 2014, is returning to the board immediately. During his previous tenure, Valeant went on a buying binge that dramatically increased its revenue and share price and ValueAct was instrumental in drawing the attention of other major investors to the drug maker. Mr. Morfit's appointment now signals that ValueAct, one of Valeant's largest shareholders, will be watching the company more closely again after decreasing its board representation last year to one seat from two.

"There are still numerous uncertainties remaining," analyst Jeffrey Loo of S&P Capital IQ said, noting a report in The Wall Street Journal on Monday suggesting questionable ties between Philidor and Valeant that included Valeant employees working at Philidor and using fictitious e-mail names in an effort to mask their employment with the drug maker. He maintained his "buy" rating on Valeant shares.