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Valeant Shares Plunge on Short-Seller Scrutiny of Pharmacy Revenue

By REUTERS

NEW YORK — Valeant Pharmaceuticals International Inc plunged as much as 40 percent after an influential short-seller accused the company of using specialty pharmacies to inflate its revenue, an allegation that the drugmaker denied.

Citron Research, a short-selling firm run by Andrew Left, alleged that Valeant's previously undisclosed ties to specialty pharmacies - including Philidor and R&O Pharmacy Inc - helped the company create "phantom sales" of its products or push more product through distribution channels than sales would warrant.

“Citron believes the whole thing is a fraud to create invoices to deceive the auditors and book revenue,” the note said.

Valeant said in response that it does not record sales of drugs that are stocked as inventory at such pharmacies in its consolidated financial reports.

"Sales are only included when the product is dispensed to the patient," Valeant said in a statement.

Nevertheless, the Citron report accelerated investor concerns over drug pricing and sales practices in the pharmaceutical industry, which have come under scrutiny in Congress and from U.S. presidential candidates.

Valeant is viewed as the most aggressive among drugmakers for buying rivals and raising prices on their medications to boost sales, a strategy that has made it a darling among investors including billionaire Bill Ackman. Last week, it disclosed that such practices are under investigation by federal prosecutors in New York and Massachusetts.

The Citron Research report hit shares hard shortly after 10 a.m. EDT (1400 GMT) in New York trading. The shares cut their losses and were last down 16 percent at $123.05, representing about a roughly $500 million loss for Ackman's Pershing Square Capital Management, which holds a 5.7-percent stake in Valeant.

Pershing did not have an immediate comment. CNBC reported Ackman added to his stake on Wednesday.

Shares of some key Valeant competitors, including Allergan Inc, Endo International Plc and Mallinckrodt Plc also fell sharply. Allergan and Endo each said that the majority of their drugs are distributed through traditional wholesale and retail channels, not specialty pharmacies.

Len Yaffe, an investor at StocDoc Partners, who is short Valeant, said that he is not yet sure of what to make of Citron's claims. He said the notion that Valeant would need to resort to phantom sales to juice revenues heightens existing widespread concerns about the company's ability to produce growth in an increasingly hostile pricing environment.

SPECIALTY PHARMACIES

Valeant disclosed last Wednesday that the government requested information on pricing and on programs that help patients cover their out-of-pocket expenses for Valeant's drugs. Those drugs are often distributed by specialty pharmacies.

This Monday, during a conference call with investors, Valeant defended its pricing and declined to comment further on the federal investigations, saying it was cooperating with authorities.

But the company disclosed new information about its dealings with the two pharmacies, which distribute specialty drugs to patients. It said it had purchased an option to acquire Philidor and was already consolidating its results. Valeant also said it sought to recover about $69 million from R&O pharmacy for medicines it provided.

Chief Executive Michael Pearson also told investors that the company was moving away from growth based on pricing increases to focus on volume of sales. It vowed to commit more to research and development in 2016 and said it was trying to sell one of its businesses dependent on price increases for growth.

Independent Canadian equity research firm ***Veritas*** said it saw significant unquantifiable risks overhanging Valeant.

Analyst ***Dimitry Khmelnitsky*** sees Valeant at risk of losing its "secret sauce" that made it a darling of many investors due to the pullback in its share price. Valeant has traditionally used its highly-valued shares to pursue accretive acquisitions and tack on debt.

The Wednesday selloff knocked off about $8 billion in market capitalization from Valeant, which was valued as high as $90 billion in early August. It has since lost more than half of its value.

The Philidor and R&O connections were also examined by Bronte Capital, another hedge fund that, like Citron, has been critical of Valeant.

Valeant, based in Canada for tax reasons, tried to acquire Allergan in a hostile takeover and failed, drawing investor scrutiny.

The latest data indicates that short interest positions in Valeant's stock in the U.S. market have more than doubled since mid-August, jumping to 7.1 million shares at the end of September, about 2 percent of the company's outstanding float.

Traders who sell securities “short” borrow shares and then sell them in the hope the price will fall, so they can buy them back more cheaply, return them to the lender and pocket the difference.

(Reporting by Caroline Humer and David Gaffen; Additional reporting by Carl O'Donnell, Euan Rocha and Ransdell Pierson; Editing by Michele Gersberg and Nick Zieminski)