BerkeleyLaw
UNIVERSITY OF CALIFORNIA

Berkeley Center for Law, Business and the Economy

University of California, Berkeley
School of Law
2850 Telegraph Ave, Suite 500
Berkeley, CA 94705-7220

Ph: 510.642.0532 – Fax: 510.643.7095
E-mail: BCLBE@law.berkeley.edu
http://www.law.berkeley.edu/bclbe.htm

Valeant's Financial Reporting Poses Problems for Investors
By Brigid McCurdy, J.D. Candidate 2017 | November 10, 2015

Already under fire for recent price hikes, pharmaceutical company Valeant is now facing criticism for its financial reporting methods.

Valeant presents two types of financial results when reporting its earnings: GAAP numbers that adhere to generally accepted accounting principles, and pro forma or non-GAAP numbers. These non-GAAP numbers are adjusted figures that exclude certain costs from calculations of a company's earnings. Companies have broad discretion in deciding which costs they want to leave out. Valeant typically excludes stock-based compensation expenses, legal settlements, and acquisition-related costs from its adjusted earnings. More specifically, Valeant does not recognize the diminishing value of the intangible assets it acquires when it buys another company.

While reporting adjusted earnings is a common practice among pharmaceutical companies, the large gap between Valeant's real and adjusted numbers is problematic because it could lead to over-valuation of the company's shares. Under GAAP accounting principles, Valeant earned $912.2 million in 2014, while under adjusted figures the company earned $2.85 billion. Even if both GAAP and non-GAAP figures are available to investors, the adjusted numbers tend to drive stock prices.

At their 52-week peak, Valeant shares were trading at $262 per share, or 98 times 2014 GAAP earnings. However, compared to non-GAAP earnings, Valeant shares were only trading at 31 times earnings. Using the adjusted figures as a basis of comparison makes Valeant stock appear more attractive to investors.

It seems that investors are becoming wary of Valeant's financial reporting methods, as the company's market value has fallen by almost $60 billion since August. Part of the decrease has also been driven by claims of fraud and criticism over drug price increases. Citron Research recently published a report claiming Valeant was secretly controlling two small drug distribution companies in order to create "phantom sales" and false revenues to deceive investors. Valeant responded by asserting that the Citron report was erroneous, but Valeant shares fell 19.1% to $118.61 per share on the day that the report was released.

In addition, a U.S. Senate panel recently announced a probe into a number of pharmaceutical companies, including Valeant. The Senate panel is particularly interested in drugs that have undergone recent drastic price hikes, such as Valeant's heart drug Isuprel. The price of Isuprel increased 820% to $36,811 for 25 pills. Valeant has agreed to cooperate with the Senate probe, and is also the subject of a federal probe into drug pricing in New York and Massachusetts.