Facts get in the way of Biovail's good story

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Eugene Melnyk has learned a thing or two about courting the media. He once used **Biovail's** corporate jet to fly a reporter to Barbados for a round of golf and dinner (barbecued dolphin), and earned a fawning newspaper profile for his trouble.

But this latest campaign -- this is something else. When you can get a sympathetic ear from *60 Minutes*, as Mr. Melnyk did last week, you have hit a public relations home run. The television piece, titled "Betting on a fall," has put his enemies on the defensive. **Gradient Analytics**, the research outfit that allegedly took dictation from hedge funds shorting Biovail stock, comes off looking corrupt. **SAC Capital Management** founder Steven Cohen appears shady. **Banc of America Securities** gets off with barely a scratch from CBS, but said Friday it will stop covering the stock, to concentrate on defending itself against lawsuits by Biovail and a shareholder.

And Biovail? "One of the largest companies in Canada," *60 Minutes* called it, fighting "a battle of the titans" with SAC. Cue Mr. Melnyk and grab your handkerchief. "There's a group of people that got together and essentially attacked the company by putting out false reports. And we're just fighting back for our shareholders," he told correspondent Lesley Stahl.

"What do you say to people who say that Biovail was overvalued and that the hedge funds actually performed a service here in pointing this out?" she asked him.

"I don't think there was any service that was performed here. . . . There is virtually no analyst out there that thought that the stock was overvalued," he replied.

Well, he's got a point. Few analysts had "sell" ratings on Biovail when the alleged SAC-Gradient plot was hatched. But that is as much a statement on the quality of sell-side research as anything else, and it's also beside the point.

What matters is whether SAC and Gradient, by poking holes in Biovail's accounting, were responsible for driving its share price to $22 from $68 in less than six months in 2003.

To believe that, you'd have to believe that Gradient's reports that summer -- reports Biovail calls "bogus" -- were shocking enough to cause mass dumping of its shares. Mr. Melnyk believes this, but is he right? Before Gradient, were investors oblivious to the company's accounting practices?

Let's examine the evidence.

Veritas Investment Research in March, 2001: "Considerably strange accounting must be waded through with respect to Biovail."

Timothy Mulligan of Forensic Advisors, discussing the company's financials in January, 2002: "I'm not saying this is a huge smoking gun, there's just some things that left me scratching my head."

Veritas again, November, 2002: "Accounting distortions, varying tax rates and the use of unique pro forma performance measurements infect the earnings and beg the question: Should earnings even be used as a metric?"

Douglas Miehm, RBC Dominion Securities, April, 2003: "The quality of Biovail's first-quarter results were disappointing."

André Uddin, Research Capital, July, 2003, with the stock still near $65: "We believe Biovail has been utilizing aggressive accounting and, unlike its peer group, has been funding its revenue stream primarily via financings."

Yet Biovail's stock weathered this onslaught amazingly well. In fact, the shares were still above $50 on Sept. 30, 2003. Few people, it seemed, were paying any attention to Gradient or anyone else. Then, on Oct. 1, a truck carrying a large shipment of drugs crashed on a highway near Chicago. Biovail, which had planned to book the revenue in the just-ended third quarter, was forced into a profit warning, the stock plummeted, and all hell broke lose.

The next month the Securities and Exchange Commission began what is now a formal investigation, and soon after, Biovail stopped its acquisition spree and repaid debt. Mr. Melnyk stepped aside for an outside CEO with drug company experience and installed a new chief financial officer. **Veritas** analyst **Anthony Scilipoti** says the accounting and the disclosure are "still
among the most aggressive we have seen" -- but the governance and balance sheet have improved immensely. The new Biovail looks a lot better than the old one.

Yet, the stock, which closed at $28.59 yesterday in Toronto, is still miles below its value in the spring and summer of 2003. Why? Stock manipulation? That hardly seems plausible now -- conspiracies tend to lose their punch once exposed. Because David Maris, Banc of America's analyst, doesn't like the company? He changed his "sell" rating to "neutral" almost two years ago.

So, even if SAC and Gradient were playing loose with the facts, as Mr. Melnyk alleges, they couldn't have caused the damage he claims. Biovail's stock fell because it was richly valued and the market lost faith. It's too bad that doesn't make a very good tale for *60 Minutes*.