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## Valeant shares plunge after report of 'phantom sales'

[Richard Blackwell](#)

Shares of Valeant Pharmaceuticals International Inc. took another steep plunge Wednesday after questions were raised about the company's complex and puzzling relationships with specialty drug distributors in the United States.

Short-seller Citron Research released a report alleging the company set up a series of pharmacies to hide "phantom sales," book revenue and deceive auditors, while comparing Valeant to collapsed energy distributor Enron.

Laval, Que.-based Valeant denied the accusations, calling them "erroneous" and an effort to drive down its stock. It said it records sales only when drugs are actually dispensed to patients, not when they are shipped to pharmacies.

Valeant stock, which fell dramatically in early trading Wednesday and at one point had lost one-third of its value, gained some ground after the company's response. At the end of the day, the shares were off 19 per cent, down \$36.64 to \$154.21 on the TSX – less than half their high in August.

The price drop prompted one of Valeant's biggest shareholders, Bill Ackman's hedge fund, Pershing Square Capital Management, to buy two million more shares Wednesday, bringing its holding to 21.5 million shares.

The volatile day came as broader questions emerge about how deeply U.S. investigators are looking into Valeant's operations and how little the company has disclosed about its links to drug-distribution firms.

The crux of the current controversy is Valeant's relationship with a mail-order pharmacy called Philidor Rx Services.

Philidor is one of a number of specialty pharmacies that, according to an article in The New York Times this week, help patients get hold of complex drugs and arrange insurance payments. But, the paper said, these pharmacies also circumvent efforts to get patients to use generic equivalents or over-the-counter products that might be cheaper. Other reports said these mail-order pharmacies also aggressively push customers to renew prescriptions.

Valeant disclosed only this week that it is closely linked to Philidor, calling it "one of our specialty pharmacy partners" that provides prescription services to patients, along with administrative services.

"We have a contractual relationship with Philidor and late last year we purchased an option to acquire Philidor," the company said on Monday, when it revealed its third-quarter financial

results. It also said it “consolidates the financials” of Philidor and inventory held there remains on Valeant’s books.

The situation was made even more complex by the allegation in a California court filing that Valeant made an improper claim of \$69-million (U.S.) against another mail-order pharmacy company called R&O Pharmacy. Valeant called R&O “one of the specialty pharmacies in our network” and said it was trying to get back funds for drugs sold through R&O.

In its report, Citron Research said Philidor and R&O are the same company, share management and are part of “an entire network of phantom captive pharmacies” set up “to avoid scrutiny from the auditors.” Valeant, in its response, said Philidor provides services to R&O and the two have a common call-centre phone number serviced by Philidor.

Analyst **Dimitry Khmelnitsky** of **Veritas Investment Research Corp.** in Toronto said he is concerned with both the complexities of the distribution network and the lack of disclosure.

“It certainly raises significant questions as to why Valeant needs such a chain of different pharmacies that seem to be all related to Philidor,” he said. “Why do they need such a complex relationship?”

In addition, “why didn’t the company disclose that they have an option to buy Philidor and why didn’t they disclose that they actually consolidate this mail-order pharmacy, Philidor, onto their statement,” **Mr. Khmelnitsky** said. “It seems that they have significant exposure to Philidor, which is material information that should have been disclosed long ago.”

The latest concerns also raise questions of just how deeply U.S. investigators are looking into Valeant’s operations. Last week, Valeant said it received subpoenas from the U.S. Attorney’s offices in Manhattan and Massachusetts, asking for information about pricing, distribution and patient support programs.

The pricing issue was seen as central because Valeant and other pharmaceutical companies have recently come under criticism for dramatically jacking up the prices of some drugs. Valeant tripled the price of its heart drug Isuprel and raised the price sixfold for heart drug Nitropress after acquiring them in February.

Now, it looks likely that the U.S. investigation “could be much broader than two specific drugs,” **Mr. Khmelnitsky** said. “Prosecutors asked for information about distribution channels and Philidor is Valeant’s distribution channel. This is taking it much beyond the pricing issue.”

On Monday, Valeant chief executive officer Michael Pearson said the company plans to do more research and development and will reduce its reliance on the purchase of “mispriced” drugs for which the prices are subsequently raised.

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