

Case Study March 2016

“Valeant the pharmaceutical Enron”

Special Situation: Valeant Pharmaceutical International (\$VRX)

Cramer: Accounting irregularities = SELL

Example: Valeant’s Philidor scandal and SEC investigation

Jim Cramer always abides by one simple rule. When there are accounting irregularities, you do not ask questions, you do not make excuses, you do not wait for clarity — you just sell.

"**Accounting irregularities equals sell**. That has been one of my cardinal rules for decades now, and if you want to know why, you only need to look at [Valeant](#)," the "Mad Money" host said.

A dark cloud has hung over Valeant ever since speculation began that it may use unorthodox methods to sell drugs. Cramer traced the initial charge of accounting irregularities to **Andrew Left, of Citron Research**.

"You never want to get behind some stock when the accounting is being challenged, unless you have total comfort that the short-seller is wrong." -Jim Cramer

"While unorthodox and inflammatory, Left has done some pretty good work, and I thought his allegations seemed well documented," Cramer said, "even as it seemed a little rash to call Valeant the pharmaceutical Enron."

At the time Left's statement was published, Valeant traded in the \$120s and he gave it a \$50 price target. Cramer had heard a lot of talk about price gouging at Valeant, but a lot of companies were raising drug prices at the time. So, he assumed Valeant was just more aggressive.

As soon as Cramer read Citron's report, he recognized that any potential upside simply was not worth it.

"You never want to get behind some stock when the accounting is being challenged, unless you have total comfort that the short seller is wrong," Cramer said.

The most promising bullish thesis on Valeant that Cramer found indicated that even if Philidor was being used to move inventory in a shady way, it would not hurt earnings that bad. And if Valeant slowed down price increases, it would still have amazing cash flow.

But Cramer stood by his rule firmly. He had not yet heard anything that the accounting was cleared, and when the stock plummeted he was glad his rule did not fail him.

Even as [Walgreen's](#) announced a deal with Valeant for discounted drugs, Cramer did not budge.

"Sorry, as much as we all may like and respect Walgreens ... the fact is, they are not the U.S. government, and it is the government we need to be worried about here," Cramer said.

The second accounting bombshell dropped on Feb. 22 when the company said it had mistakenly recognized too much profit in 2014 and needed to have some of that shifted to 2015. Cramer knew to stay far away, as the SEC hates restatements and almost always opens an investigation into them.

Valeant now trades at roughly half of where it was when the first potential accounting irregularity surfaced.

Cramer has often been criticized for his rule, especially those that kept investors out of companies that were legitimate but tarred unfairly with accounting charges.

"It is true. I have been too cautious at times and have missed opportunities," Cramer said.

However, the pain in Valeant should be a constant reminder of how right his rule is. This stock has been a nightmare that simply could have been avoided by following one straightforward principle.

Valeant Pharmaceuticals International Inc (VRX:NYSE)

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Real Time Quote | NYSE | USD

Last | 04/02/2018

Volume

52 week range

15.07 **-0.85 (-5.34%)**

7,687,011

8.31 - 24.43

1D

5D

1M

3M

6M

YTD

1Y

5Y

ALL

+ Comparison

1W

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