



Oct 2, 2015

Appendix 1:

Valeant's Price Increases on Isuprel and Nitropress

From a spreadsheet perspective, here's how the Isuprel and Nitropress price increases of Feb 10, 2015 impacted Valeant's first quarter results.

	Price			Marathon Q1 Rev if no price raise	Q1 Days	Q1 Days	Q1 Days
	Marathon's Price	Increase %	Valeant's Price	Q1 2015 Revenues	Marathon	If Marathon	Valeant
					40	49	
Isuprel	215.46	525%	1346.62	72	18.52	8.32	10.20
Nitropress	257.80	212%	805.61	62	28.63	12.87	15.76
							63.73
							49.18

We wonder why the run rate for these drugs **fell so drastically** in Q2. Unsustainability of this violent price increase strategy may have hit its limits.

Revenue From Price Jack	Q1 Run Rate per Day Valeant	Q1 Run Rate per Day Valeant (*)	Q2 2015	Q2 Run Rate per Day Valeant	Run Rate Net Change Q1 to Q2	Run Rate Net Change Q1 to Q2 (*)
				91		
53.53	1.30	1.47	49	0.54	-58.60%	-63.38%
33.42	1.00	1.27	64	0.70	-29.93%	-44.46%
86.95						

How Valeant made its quarter Q1 2015 on the back of Isuprel and Nitropress price jacks

				86.95	
Net tax rate				2.20%	
Price Jack Rev Net of imputed tax rate				85.03	
Outstanding Shares				343.4	
Impact per Share of price hikes				\$0.248	
Q1 Earnings			(beat 4c)	2.36	
Debt and share impacts of all acquisitions				0.03	
Without price jacks			Miss	\$2.142	-9.22%

The Algebra

Valeant says Isuprel and Nitropress did \$72M and \$62M, respectively, in 1Q15 revenue. [We assume this is for the full quarter (not just the stub period for 2/10/15 - 3/31/15 that VALEANT owned these drugs, if in fact these revenues were just for the stub, the effect would be magnified even more)].

Algebra solves for how much revenue (and earnings since price hike revenue is 100% margin) VALEANT gained from jacking price on these two drugs. Here's the math:

There were 89 days in 1Q15. Valeant owned the two drugs for 49 of 89 days and the prices of the drugs were 525% higher and 212% higher during this 49 day period than their respective prices during the first 40 days of the quarter prior to the Valeant buyout. Here are the equations to solve for the price increase benefit:

Isuprel

y = Isuprel revenue for all of 1Q15 as if Valeant had not raised price by 525% on 2/10/15

x = Isuprel revenue for all of 1Q15 as if Valeant had raised price by 525% on 1/1/15

$$(40/89)*y + (49/89)*x = \$72$$

$$x = 6.25*y$$

$$\rightarrow (40/89)*y + (49/89)*6.25*y = \$72$$

Solve for y and you get \$18.52M. This means that if Valeant had not increased the price for Isuprel, Isuprel revenue would have been \$18.52M for all of 1Q15. Valeant owned Isuprel for 49 of 89 days in 1Q15, so if they had not raised price for Isuprel, Valeant would have recognized $(49/89)*\$18.52M = \$10.2M$ of Isuprel revenue in 1Q15.

But Valeant raised Isuprel's price by 525% immediately upon taking ownership, so instead Valeant recognized $\$10.2M*(1+525\%) = \$63.7M$, meaning that Valeant generated $\$63.7 - \10.2

= \$53.5M of revenue and EBIT in 1Q15 from this Isuprel price hike (because price hike revenue comes in at 100% margin). Now we'll do the same for Nitropress:

Nitropress

y = Nitropress revenue for all of 1Q15 as if Valeant had not raised price by 212% on 2/10/15

x = Nitropress revenue for all of 1Q15 as if Valeant had raised price by 212% on 1/1/15

$$(40/89)*y + (49/89)*x = \$62$$

$$x = 3.12*y$$

$$\rightarrow (40/89)*y + (49/89)*3.12*y = \$62$$

Solving for y yields \$28.63M. If Valeant had not increased the price for Nitropress, Nitropress revenue would have been \$28.63M for all of 1Q15. Valeant owned Nitropress for 49 of 89 days in 1Q15, so if they had not raised price for Nitropress, Valeant would have recognized $(49/89)*\$28.63M = \$15.8M$ of Nitropress revenue in 1Q15.

But Valeant raised Nitropress's price by 212% immediately upon taking ownership, so instead Valeant recognized $\$15.8M*(1+212\%) = \$49.2M$, meaning that Valeant generated $\$49.2 - \$15.8 = \$33.4M$ of revenue and EBIT in 1Q15 from this Nitropress price hike.

So taken together, Valeant generated $\$53.5M$ (Isuprel) + $\$33.4M$ (Nitropress) = $\$86.9M$ of revenue and EBIT solely from jacking up the price of Isuprel and Nitropress in 1Q15 during the stub period in which it owned the drugs. This $\$86.9M$ represented 8.5% of 1Q15 adjusted EBIT and 10.5% of VALEANT's cash EPS metric. If Valeant had not taken these price increases, it would have missed the 1Q15 Street consensus EPS estimate by 9%. Here's the math:

1Q15 cash EPS reported by VRX: \$2.36

1Q15 sell side consensus cash EPS estimate (FactSet): \$2.32

1Q15 VRX cash tax rate: 2.2% (= $(\$80.9M - \$62.6M)$ of cash taxes/ $(\$155.4M + \$673.0M)$ of adjusted pre-tax income, from 1Q15 earnings release:

<http://www.sec.gov/Archives/edgar/data/885590/000119312515154227/d916861dex991.htm>)

Cash EPS contribution from Isuprel & Nitropress price hikes = $\$86.9M$ of EBIT contribution.

Adjust pre-tax by overall tax rate: * $(1-.022) = \$85.0M$

Then divide this by 343.4M diluted shares outstanding = $\$0.248$ of cash EPS contribution.

So without these price hikes, Valeant would have reported 1Q15 cash EPS of $\$2.36 - \$0.25 = \$2.11$, **9% below Street consensus of \$2.11.**