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Markit Commentary

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Valeant bonds facing crisis of confidence

Valeant bonds crashed yesterday as a short selling research firm alleged it misrepresented sales; this has pushed the entire healthcare high yield sector in.

- CDS spread jumped to an all-time high of 657bps
- Valeant 2021 bonds trading at 88 cents to the dollar, with current yield 6.8% more than treasuries
- The Markit iBoxx USD Liquid High Yield Health Care index lost 1.5% yesterday

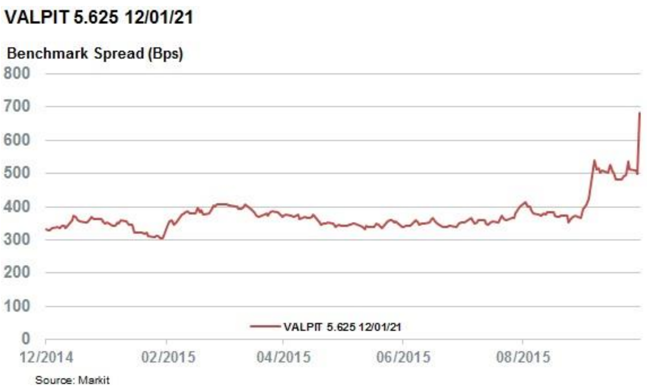
Yesterday's shock market development saw short selling research firm Citron allege that controversial biotech firm Valeant Pharmaceutical inflated its sales figures by selling to "phantom captive pharmacies" in a plot reminiscent of the Enron scandal of over a decade ago. These allegations were taken to heart by the market as evidenced by Valeant's shares slumping by over 40% in session lows. While Valeant shares rebounded somewhat in late trading to trim half their losses, the crash means that Valeant shares have lost over half their value from their highs in early August.

While most of the attention yesterday was focused on the firm's floundering share price, the fixed income market was also busy digesting the news and Valeant bonds are now facing the largest amount of investor scepticism on record.

This scepticism is evidenced by the firm's CDS spread, which is trading 177bps wider. Despite the spate of attention in recent weeks, stemming from allegations of price gouging, Valeant's CDS is still relatively illiquid. Only two brokers contributed prices, which earns it the second worst liquidity score on the Markit CDS liquidity scale.

Valeant's bonds have been much more liquid over the last few weeks as the 5.625% 2021 note has the most liquid note according to Markit's evaluated bond pricing service.

That note traded eight cents to the dollar cheaper yesterday to 88. That price crash means that investors are now requiring 6.8% of extra yield over benchmark US treasuries to hold the note, up from 3.5% earlier in the summer.

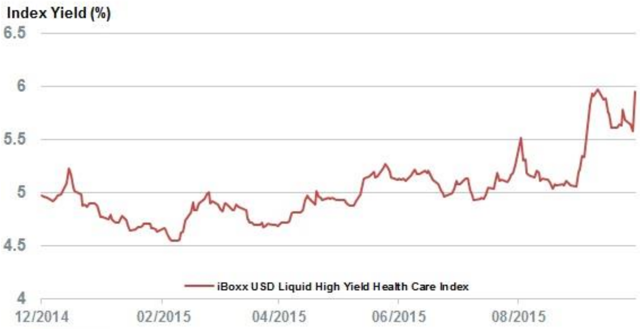


Valeant is a relatively leveraged player with $18bn of long term debt on its balance sheet so the firm will need to placate the bond market in order for the equity portion of its balance sheet to recover. Failure to do so could see the firm enter a pattern similar to the one seen in Glencore last month.

Impact on sector

Valeant's indebtedness means that it is the eight largest constituent of the Markit iBoxx USD Liquid High Yield Health Care index. That index lost 1.5% yesterday to see its yield push past the 5.95% mark. The index spread is now 417bps, 8bps less than the recent highs seen just after Hillary Clinton announced that she was looking to crack down on what she viewed as price gouging within the industry.

High Yield Healthcare Bonds



Source: Markit

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