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Questioning Perrigo's Growth

Are Perrigo shares a bargain, even though the stock is off 57% over the past year?

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Perrigo and Valeant have much in common besides Papa. That should give pause to Perrigo bulls, who claim the stock, down 57% in the past year, to $92.39, is a bargain. We beg to differ here, as well.

Perrigo also presents flattering "adjusted" non-GAAP profit figures that exclude regular costs of operation, says New Constructs' Trainer. And it has also employed price increases to push up results.

Lately, Perrigo has grown by acquisition, using debt to do deals. The company spends only 3% to 4% of sales on R&D, well below the industry's average of 15%. Perrigo is domiciled in Dublin, so taxes are lower than they might be if it were U.S.-based.

Perrigo regularly touts its double-digit revenue increases, but plays down the distinction between growth that was purchased and the much slower organic growth underlying 70% of sales. The company sells nonprescription products in the U.S. and Europe.

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Perrigo's shares have fallen since Mylan (MYL) abandoned a hostile takeover attempt last fall. Perrigo executives received millions in bonuses, while the company's market capitalization fell by about $12 billion, Trainer says. Shares traded at $140 to $160 before the Mylan approach. At today's price, bulls say they are cheap.

A closer look at sales growth suggests otherwise. In fiscal 2015, ended in June, revenue rose 13%, to $4.6 billion. However, the majority of that increase—$400 million—came from Omega Pharma Invest, a European over-the-counter drug firm whose results weren't included in the year-earlier period. Excluding Omega, which Perrigo bought on March 30, 2015, for $4.4 billion, sales growth was about 4%.

Perrigo has just switched to a calendar year, and the Omega boost is even bigger. In calendar 2015, revenue grew 28%, to $5.35 billion, but if $1 billion in Omega sales—not included in calendar 2014—is removed, underlying revenue growth was 4% again. The mostly U.S.-focused OTC division, half of sales, grew 1% last year.

Bulls point to Perrigo's price/earnings ratio of 11 times calendar-2016 guidance of $8.20 to $8.60 in EPS. But that ignores the company's recent guidance reduction from the $9.50-to-$9.80 range, due to pricing pressures in its prescription-drugs business, which accounts for 20% of sales. As with Valeant, big price increases are a thing of the past.

Perrigo says "adjusted" calendar 2015 EPS rose 21%, to $7.59 from $6.21, in 2014. That leaves out standard operating expenses, Trainer notes, such as acquisition-related amortization and inventory step-up expenses, and an intangible-asset impairment charge for Omega.

GAAP results give a "vastly different" view, he adds, with 2015 swinging to a loss of 23 cents from net income of $2.57 in 2014. Debt has ballooned to $5 billion from less than $1 billion in 2011. While Perrigo's sales have climbed 64% since then, the cost of sales has risen 61%—and operating costs, more than 110%—in the same period.

Perrigo's fundamentals aren't great, either. In an April 26 report, Goldman Sachs analyst Jami Rubin forecast prescription-business pricing pressures, lower expectations for Omega (hence the asset write-down), and fewer new-product launches. Rubin, who rates Perrigo a Sell, writes that it "doesn't deserve to trade at the premium it has historically for high sustainable growth, which has not materialized."

The company declined to make new CEO John Hendrickson available for comment, citing its May 12 first-quarter report. The year-ago first quarter was the last with no Omega sales, so headline comparisons could look good again. Without another sizable acquisition relatively soon, however, the growth game may be up for Perrigo. The stock isn't cheap, and once the Omega deal is lapped, that could become more obvious.

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