

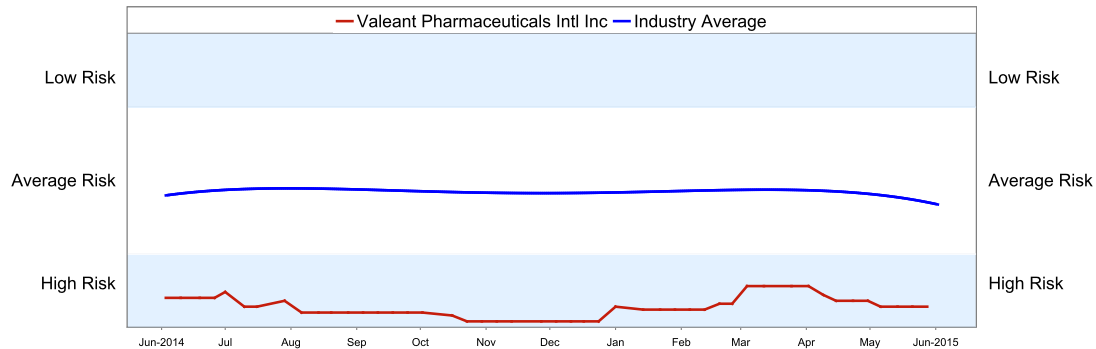
ESG Flag - High Risk

ESG Analysis

Sector: Healthcare  
 Industry: Pharmaceuticals - Diversified  
 Market Cap: USD 80,964.2mm

Last Data Update: May 28, 2015  
 Last ESG Flag Change: Jan 1, 2015

Valeant Pharmaceuticals Intl Inc (NYSE:VRX)



ESG Analysis

Valeant Pharmaceuticals International has a recent history of significant restatements, special charges, and write-offs, and has disclosed material weaknesses in its internal controls. In September 2014, Valeant disclosed an audit by the US Internal Revenue Service covering tax years 2011 and 2012 and by the Canada Revenue Agency covering tax years 2010 and 2011. The structure of the company’s board also raises some concerns. The roles of Chairman and CEO have not been split, which may compromise the board’s independence from current management interests. While Valeant has appointed an independent lead director as a counterbalance to the CEO’s influence, he is overboarded, serving on a total of four MSCI-rated boards. In addition, the company has not adopted a full majority director election standard and multiple related party transactions involving the family members of Valeant executives raise concerns regarding potential self-dealing or abuse. Ownership at Valeant is led by principal shareholder Ruane, Cunniff & Goldfarb, who owns 10.25% of the company’s outstanding shares.

ESG RATING ANALYSIS

This company was first assigned an ESG rating on 2/24/2012. A complete history of its rating as of the first week of each month is shown in the chart above, and also compared against the average rating for its sector and industry. You can hover over the indicators on each charted line to show the letter grade rating and percentile rank as of that date. Our current global ESG rating for Valeant Pharmaceuticals International is an overall D. This rating falls into the lower ranges for all the companies we rate, indicating the presence of significant concerns in one or more areas and the need for further review and study.

Please note that ratings changes in the first part of the year reflect, in part, changes due to MSCI’s annual ratings methodology updates and universe expansion.

Valeant Pharmaceuticals International has reported one or more restatements or special charges, suggesting the need for closer scrutiny of the company’s financial standing.

HIGHEST IMPACT KEYMETRICS

The following flagged KeyMetrics indicate the most important factors driving our current ESG rating for Valeant Pharmaceuticals International:

- Related Party Transactions
- Overboarded Non-Exec Directors
- Overboarded Audit Committee Members
- Severance Vesting
- Asset-Liability Valuation

ESG Flags	VRX	INDUSTRY
ESG Overall	High Risk	Average Risk
Governance	High Risk	Average Risk
Environmental	Average Risk	Average Risk
Social	High Risk	Average Risk
Industry: Pharmaceuticals - Diversified		
Based on data last updated on May 28, 2015		

- Low Risk - Top 25%
- Average Risk - Middle 50%
- High Risk - Bottom 25%

Industry flags show the average ESG risk level for all rated companies in a given industry peer group, for each ESG component, based on the Thomson Reuters Business Classification (TRBC) system.

The industry average line in the Risk Level History chart also tracks the average overall ESG Risk Level over time for that same TRBC industry group.



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- Internal Controls
- Restatements or Special Charges

Our ESG concerns at Valeant Pharmaceuticals International are focused primarily on the company's social impacts.

#### SOCIAL IMPACTS

Valeant Pharmaceuticals International has been designated High Social Impact on the basis of its primary operating industry. Social impacts, policies and practices at this company are under continual review and monitoring, based on a combination of news reports, legal and regulatory filings, and the company's own reporting commitments. A red flag in our Sustainability Board Oversight KeyMetric for this company indicates that the board has not formally acknowledged its responsibility in overseeing the company's social impacts. Ideally the company would have established links between its incentive pay policies for company executives and the effective management of its social and environmental impacts, but this is not the case. It does not currently report on its sustainability policies and practices via the Global Reporting Initiative, a commonly used and highly effective standard for such reporting, nor has it become a voluntary signatory of the UN Global Compact, yet another commonly employed global standard for achieving and maintaining more effective sustainability practices. In the area of workplace safety this company has not yet implemented OHSAS 18001 as its occupational health and safety management system, nor does it actively disclose its workplace safety record in its annual report or other reporting vehicle.

#### CORPORATE GOVERNANCE ACCOUNTING AND FINANCIAL REPORTING

The Valeant Pharmaceuticals International board of directors includes a fully independent audit committee, and at least one member of that committee meets our standards for financial expertise. The company's independent auditor is PricewaterhouseCoopers LLP (US). For the most recently reported fiscal year, Valeant Pharmaceuticals International paid a total of \$16,251,000 in audit and other related fees. This figure includes \$12,565,000 in basic audit fees. We note that the company has experienced significant and noteworthy accounting events, as further detailed below under <u>Material ESG Events</u>. Specifically,:

- The company has disclosed material weaknesses in its internal controls in the past two years.
- The company has a history of significant restatements, special charges, and/or write-offs in the past two years.

#### THE BOARD

The Valeant Pharmaceuticals International board's policies and practices do not raise significant concerns at this time regarding its ability to properly oversee management and represent shareholder interests, but shareholders should note the issues discussed below.

The Valeant Pharmaceuticals International board currently has an independent majority, which enables it to more effectively fulfill its critical function of overseeing management on behalf of shareholders. The board includes at least one executive director in addition to the CEO, characteristic of 34.4% of companies in this market. Multiple inside directors may provide a too-strong management voice within the boardroom.

Multiple related party transactions and other potential conflicts of interest involving the company's board or senior managers should be reviewed in greater depth, as such practices, even when limited to current market rates, raise concerns regarding potential self-dealing or abuse. We note that related party transactions are relatively rare in this market, with only 12.2% of companies in Canada flagged on this issue.

The company has not adopted a full majority director election standard, greatly limiting the ability of company shareholders to hold members of the board accountable in uncontested elections. Majority voting has become prevalent among companies in GMI's Canadian universe, with only 72.1% flagged for lacking this practice.

Director overboarding may be a problem for this board, with at least one non-executive director sitting on too many boards. GMI considers a non-executive director to be



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overboarded when they sit on more than four public boards. For CEOs and other executive directors the limit is three boards. EXECUTIVE PAY

Executive pay practices at Valeant Pharmaceuticals International raise a number of concerns as enumerated below.

The Valeant Pharmaceuticals International board includes an independent compensation committee, considered best practice for oversight of executive compensation.

The following flagged KeyMetrics raise concerns regarding the board's ability to implement and maintain effective incentives for the company's CEO and other top executives:

- Unvested equity awards partially or fully accelerate upon the CEO's termination, characteristic of 66.8% of companies in the home market. Accelerated equity vesting allows executives to realize pay opportunities without necessarily having earned them through strong performance.
- The company has not disclosed specific, quantifiable performance target objectives for the CEO. While a majority (92.4%) of companies in the home market have not disclosed these targets, disclosure of performance metrics is essential for investors to assess the rigor of incentive programs.

Finally, additional concerns related to the company's pay practices are enumerated below:

- A decline has occurred in the CEO's equity holdings in the company over last year. Diminished executive exposure to company stock may work to reduce the alignment between the CEO's interests and those of shareholders.

**OWNERSHIP & CONTROL**

While no significant concerns are raised by the company's corporate governance practices, shareholders should be aware of the potential risk factors enumerated below.

Limits on shareholder rights and management-controlled takeover defense mechanisms currently in place at Valeant Pharmaceuticals International include:

- The board's unilateral ability to amend the company's bylaws without shareholder approval
- Constituency provisions that may be invoked to deter tender offers regarded as hostile by current management
- Fair price provisions that fail to insure that all shareholders are treated fairly
- Limits on the right of shareholders to take action by written consent
- The absence of confidential voting policies

**ENVIRONMENTAL IMPACTS**

Valeant Pharmaceuticals International has not been designated High Environmental Impact, primarily because of the limited environmental exposure inherent in its primary operating industry. While effective environmental oversight and reporting should still be considered important standards for all companies, and high environmental impact events will still be flagged for this company should they occur, we do not believe that the absence of such policies and practices will have a material impact on its investment returns, and do not incorporate such omissions in our ratings for this reason. While not as important to our rating as the company's actual impact ratios, a company's disclosure practice is also an important measure of its overall environmental integrity. In this case the company has been flagged for disclosure weaknesses relative to peers in all areas, based on data provided by Trucost.

On August 15, 2014, it was reported that a recently disclosed audit of US tax returns for Valeant, the Canadian pharmaceutical group pursuing a \$53bn hostile takeover of Allergan, was part of a two-year inquiry by the Internal Revenue Service, according to people familiar with the situation.

On July 3, 2014, it was reported that Bausch & Lomb (a subsidiary of Valeant Pharmaceuticals) had recalled at least 850,000 tubes of an eye-care ointment because some tubes contained tiny crystal particles that could injure the cornea.

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In November 2013, Valeant Pharmaceuticals posted a third-quarter net loss of \$973.2 million, or \$2.92 per share, compared with a profit of \$7.6 million, or 2 cents per share, a year earlier. The loss included a restructuring charge of \$305 million primarily related to the acquisition of Bausch & Lomb and an impairment charge of \$645 million.

On October 28, 2013, it was reported that Valeant Pharmaceuticals, Inc. had agreed to pay \$142.5 million to settle all outstanding disputes with Anacor Pharmaceuticals. The payment included a \$100 million award of damages to Anacor related to a contractual dispute with Dow Pharmaceutical Science, Inc., a Valeant subsidiary.

In its 2012 10-K, Valeant indicated that it remained the subject of SEC investigations concerning past accounting practices.

On February 29, 2012, it was reported that AstraZeneca, Sanofi and Actavis were served with indictments relating to the Serbian bribery investigation, while Roche, Merck KGaA, and a unit of Valeant Pharmaceuticals were also charged.

On October 7, 2008, Valeant Pharmaceuticals International continued its cooperation with the U.S. Securities and Exchange Commission's Formal Order of Investigation on events and circumstances surrounding trading of the Company's common stock. The Company has also been subject to the investigation on its first pivotal Phase 3 trial for taribavirin and statements made on the public release of data and matters regarding its stock option grants since Jan. 1, 2000. In September 2006, the Company's board of directors established a Special Committee to review its historical stock option practices and related accounting, and informed the SEC of these efforts. The investigation also covers the Company's restatement of certain historical financial statements announced in March 2008.

On September 12, 2006, Valeant Pharmaceuticals International disclosed that federal regulators had launched an inquiry into stock trades that were made in the spring 2006 when the company released results of a drug trial. In a statement, Valeant said the Securities and Exchange Commission had also asked for information about Valeant's efforts to recover controversial bonuses paid to company founder and former Chief Executive Milan Panic. He was ousted in 2002 amid allegations that he was mismanaging the company.