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Tenet Healthcare Corp. (NYSE: THC)

Tenet's Immune System Committed To Purging Inefficient Hospitals

We recommend an overweight position on THC's 4 ⅝ 1st Lien notes due 2024. THC's top-line has diminished in recent years due to hospital divestitures and industry-wide admissions headwinds. While these divestitures are hurting the top-line, the company is committed to pruning their hospital portfolio, strategically divesting inefficient hospitals in undesirable markets. Combined with a cost reduction initiative employed in the beginning of 2018, their overall hospital portfolio efficiency should increase. This places them in an attractive space to pivot with the industry-wide shift from inpatient to outpatient operations, which has significantly higher EBITDA margins. THC has increased its stake in USPI to facilitate this transition and should continue to invest FCF to increase this high margin segments contribution to the overall revenue mix. Furthermore, revenue decrease should be stabilized by growth in the Conifer segment, which THC has expressed interest in growing unless the right opportunity to sell, merge, or spinoff arises. Management has reiterated a commitment to deleveraging to the 5.0x range by the end of 2019, which, coupled with EBITDA growth, should contribute to an appreciating credit profile and respective tightening of bonds. Overall, we expect THC's 24's to tighten ~30 bps, representing a return of 6.86% FYE'19.

Security Information

Bond Maturity: 7/15/2024
Rating: Ba3 / BB-
Coupon: 4 ⅝
Price: $95 ⅜
YTW: 5.57%
Spread: 278 bps
Rank: 1st Lien Note
Call Date: 7/15/2020
Call Price: $102.313
LTM EBITDA: $2,554 million
Debt/EBITDA: 6.04x
EBITDA/Interest: 2.03x

Source: Bloomberg (12/3/18), MFIF Analysis

Figure 1: Capitalization Table

Tenet Healthcare Corp.								
LTM EBITDA as of 11/5/2018	2,554.0							
Outstanding Debt Metrics & Leverage								
Type of Debt	Rate%	Maturity	Debt Out. ($MM)	Debt / Adj. EBITDA	Price	Yield	Call Date	Call Price
Asset Backed Revolver (L+125)	3.648%	12/4/2020	0.0		100.000			
Letter Of Credit (L+150)	4.251%	3/7/2021	96.0		100.000			
1st Lien Notes	4.750%	6/1/2020	500.0		100.016	4.66%		
1st Lien Notes	6.000%	10/1/2020	1,800.0		101.984	4.79%		
1st Lien Notes	4.500%	4/1/2021	850.0		98.995	4.91%		
1st Lien Notes	4.375%	10/1/2021	1,050.0		98.797	4.79%		
1st Lien Notes	**4.625%**	**7/15/2024**	**1,870.0**		**95.374**	**5.57%**	**7/15/2020**	**102.313**
Total 1st Lien (Ba3 / BB-)			**6,070.0**	**2.38x**				
2nd Lien Notes	7.500%	1/1/2022	750.0		104.018	3.40%	1/7/2019	103.750
2nd Lien Notes	7.500%	1/1/2022	750.0		104.113	1.37%	1/4/2019	103.750
2nd Lien Notes	**5.125%**	**5/1/2025**	**1,410.0**		**95.602**	**5.94%**	**5/1/2020**	**102.563**
Total 2nd Lien (Ba3 / B-)			**2,910.0**	**3.52x**				
Senior Notes	5.500%	3/1/2019	498.0		100.312	3.91%		
Senior Notes	6.750%	2/1/2020	300.0		101.938	4.91%		
Senior Notes	8.125%	4/1/2022	2,799.4		104.018	6.73%		
Senior Notes	6.750%	6/15/2023	1,898.3		98.201	7.20%		
Senior Notes	7.000%	8/1/2025	500.0		97.533	7.46%	8/1/2020	103.500
Senior Notes	6.875%	11/15/2031	429.5		88.394	8.32%		
Total Senior Unsecured (Caa1 / CCC+)			**6,433.9**	**6.04x**				
Total Debt			**15,413.9**					
Market Capitalization			2,543.0					
Less: Cash			500.0					
Enterprise Value			**17,456.8**	**6.84x**				

*****Source: Company Filings, MFIF Analysis, Bloomberg (12/3/18)*

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Hospital Segment – Pruning Portfolio to Cure Inefficiencies
Tenet has embarked on a mission to improve their fundamental business structure by divesting costly hospitals and redeploying capital to improve hospitals in desirable markets. In 2017, General Hospital revenue accounted for ~86% of total revenue. Due to a combination of the industry-wide headwind of admissions and divestitures of inefficient hospitals, Tenet aims to decrease this share in the revenue mix. In Q3'18, 14/21 markets had positive adjusted admissions, indicating that the markets that didn't perform well had a large impact on decreased overall admissions. Admissions have been suffering as Americans seek cheaper treatment from pharmacies and outpatient clinics. Detroit remains a significant headwind for admissions, lowering adjusted admissions 70bps. To combat this, Tenet has developed targeted advertisements for specific neighborhoods in Detroit to promote long term organic growth. THC plans to continue restructuring its portfolio to shed underperforming assets and redeploy capital with a focus on expanding outpatient facilities and paying down debt. They recently divested a hospital in Philadelphia, sold out of 75% of a joint venture in Dallas, and expressed interest in selling all 4 hospitals in Chicago.

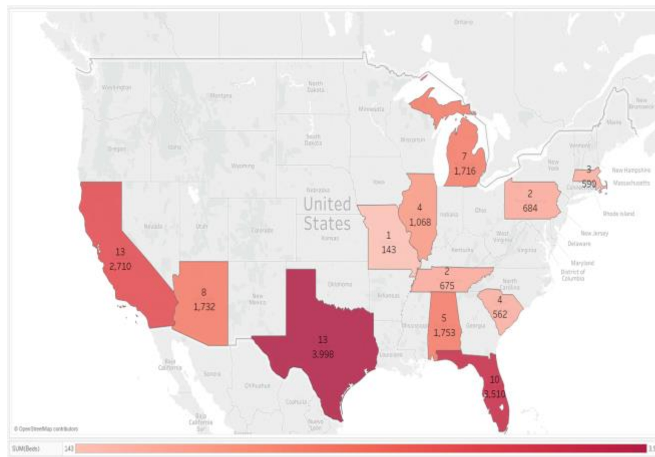
Cost Saving Initiatives - The Shift to Outpatient via USPI
Throughout the industry, hospitals have been suffering from weak admission numbers. From a hospitals perspective, outpatient facilities are relatively profitable as ambulatory margins (30% - 40%) are much greater than hospital margins (7% - 13%). In 2018, Tenet spent $500 million to increase their stake in USPI to 95% ownership. USPI is now the largest ambulatory surgery provider in the US with 400 facilities across the US. THC also opened 11 new outpatient centers in attractive markets in 2017 and 30 more in 2018, alongside acquiring 8 outpatient businesses. Besides their focus on pivoting from inpatient to outpatient, Tenet has complemented their goal of cost cutting by reducing their operational costs by ~$290 million in 2018. This is due to the shedding of costly hospitals and a higher nurse retention rate, which lowers wage expenses and in turn, improves EBITDA margins.

Management - Glenview Capitals Tough Pill to Swallow
Over the past 2 years, Tenet has had a majority overhaul of C-Level executives and board members. Within this management restructuring, 7/10 board positions have changed within the past 1.5 years, exhibiting extremely high board member turnover. In March of 2017, the CEO, Trevor Fetter, was forced by Glenview Capital, the largest shareholder (~18%), to step down after the company's poor equity performance. At this time, management implemented a poison pill to protect the company and minority shareholders against a hostile takeover by Glenview Capital. This poison pill allowed holders of more than 4.9% equity to purchase additional shares at a 50% discount, effectively diluting shares outstanding and making it more difficult for Glenview Capital to take a controlling stake in the company. This new management also consistently committed to deleveraging from ~6.5x to 5.0x by 2019 and has deleveraged half a turn in 2018 by paying down debt and improving EBITDA margins through cost cutting initiatives and divestitures of inefficient hospitals.

Risks to Thesis

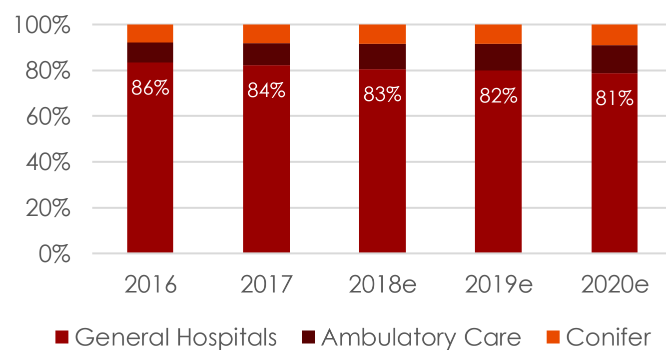
- In the event that the admissions headwind heightens, THCs hospital segment remains vulnerable as it contributes ~80% to overall revenue
- In the event of an economic downturn, employed individuals lose their managed care which is a reliable source of payment
- Large maturity walls approaching in 2020 ($2.6 bn), 2021 ($1.9 bn), and 2022 ($3.6 bn)

Figure 2: THC Hospital and Licensed Bed Network



**Source: Company Filings, MFIF Analysis*

Figure 3: Revenue Mix ($mm)



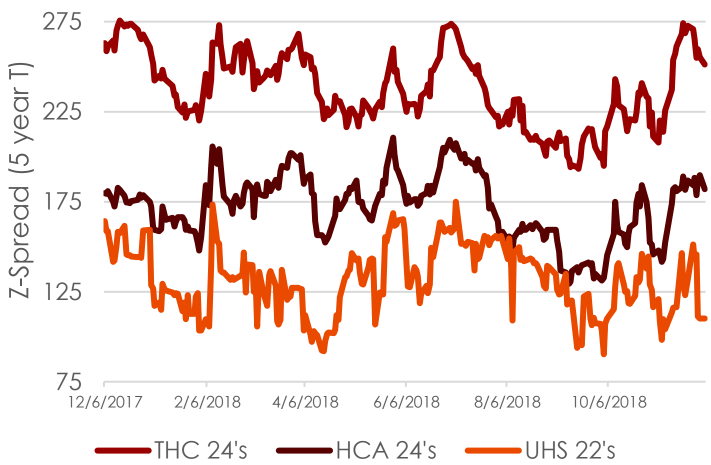
**Source: Company Filing, MFIF Analysis*

Figure 4: Top Security Holders

Security Holders (4 ⅝ 24's)		Equity Holders	
BlackRock	5.66%	**Glenview Capital**	**17.46%**
Franklin Res.	4.82%	BlackRock	15.32%
Capital Group	4.81%	Vanguard	10.25%
Fidelity	4.56%	Harris Associates	7.31%
JP Morgan	4.04%	Davidson Kempner	3.83%
Prudential	3.07%	Partner Fund Mgmt.	3.29%
Allianz	2.11%	JP Morgan	3.14%
Principal Financial	1.99%	State Street	3.02%
Teachers Ins.	1.87%	Dimensional Fund	2.32%
Northwestern Mut.	1.76%	Nantahala Capital	2.06%

**Source: Bloomberg Terminals (12/6/18)*

Figure 5: Relative Valuation



**All notes are 1st Lien*
**Source: Bloomberg (12/3/18)*

Relative Valuation

Currently, THC's 24s are trading ~70 bps wider than HCA's 24's. HCA is the largest urban hospital company in the industry. HCA is comparable with respect to business model, however it is almost 3x the size in terms of number of hospitals, admissions, and it is 4x in EV. THC is trading ~140 bps wide to UHS's 22's, which is comparable in terms of size, however UHS operates as a rural hospital company. As a whole, the hospital industry has experienced turbulent spreads movements in the past year. THC and HCA's spreads tend to move in tandem as they are both urban hospitals, while UHS is not as correlated to the urban hospitals. Looking forward, we expect THC's 24's to tighten ~30 bps to HCA and UHS by 2019 and ~55 bps by 2020 as their leverage decreases to ~5x and EBITDA margins improve from the sale of inefficient hospitals, a pivot towards outpatient operations, and general cost saving initiatives.

Pairs Trade

We believe that there is an opportunity to boost returns within the capital structure by buying the 4 ⅝ 1st lien notes due 2024 and shorting the 5 ⅛ 2nd lien notes due 2025. By buying the 1st lien notes, we forgo 40 bps of yield in exchange for 1.1x turn less of leverage and 1 year less of duration risk. The 2nd lien notes seem to be trading too tight given these metrics and therefore, we recommend a short position as we believe the 2nd lien notes will widen relative to the 1st lien notes.

Pairs Trade	1st Lien	2nd Lien
Coupon	4.625%	5.125%
Price	95.374	95.602
YTW	5.57%	5.94%
Spread	278 bps	304 bps
Leverage	2.38x	3.52x

Conifer

Conifer Health Solutions is a subsidiary of Tenet that manages their revenue cycles and handles patient communications. Conifer adds financial value by increasing revenue collection and reducing revenue leakage. At the beginning of 2018, there was significant pressure externally to sell Conifer. In August 2018, THC equity fell 15% after the company revealed that they are still in the process of the sale, indicating that investors believe the sale of Conifer would be advantageous for THC. However, in Q3'18 earnings call, the interim CEO expressed that he is hesitant to sell Conifer unless the right conditions are met and that Tenet is down to a select few bidders still considering the deal. In the event Conifer is not bought, Tenet is exploring strategic alternatives such as a merger or spin-off to simplify their business model.

Downside Risk

As the hospital segment comprises ~80% of total revenue, Tenet is exposed to further admissions headwinds. Furthermore, if the market were to enter an economic downturn, the hospital industry as a whole would be vulnerable to a declining portion of managed care in the payer mix, which is the most reliable source of revenue collection. However, Tenet's Conifer business effectively hedges some of this threat as they reduce revenue leakage across the payer mix. If these events do transpire, we expect the industry as a whole to widen.

Figure 6: Investment Horizon (24's) and ROI

Horizon	Adj. EBITDA	Debt/ EBTIDA	Spread	Return on Investment
2019e	$2,589	5.47x	248 bps	6.86%
2020e	$2,673	5.11x	223 bps	6.40%

**Source: MFIF Analysis*

Figure 7: Competitor Comparison

FYE 2018e ($mm)	THC	HCA	UHS	CYH
# of Hospitals	68	179	326	125
Admissions	683,745	1,936,613	765,212	738,036
Licensed Beds	18,302	46,738	29,278	20,850
EV	$17,456	$83,319	$16,475	$14,374
Adj. EBITDA	$2,474	$8,769	$1,770	$1,135
EBITDA Margin	13.5%	18.77%	16.6%	8.2%
FCF	$3,264	$4,671	$620	$47
Debt/EBITDA	5.94x	4.04x	2.35x	63.52x
EBITDA/Interest	2.72x	4.84x	11.90x	-1.08x
P/E	19.75x	16.01	15.66x	-
Market Cap	$2,540	$49,090	$12,440	$553
Dividend Yield	-	0.99%	0.30%	-
Credit Rating	Ba3 / BB-	Ba1 / BBB-	Ba1 / BBB-	Caa1 / B-
YTW	5.57%	4.81%	4.19%	8.15%
Spread	278 bps	203 bps	141 bps	538 bps

**Source: MFIF Analysis, Bloomberg (12/3/18)*

Tenet Healthcare Corp.

Summary Model | December 6, 2018

All Dollar Values in Millions (USD)

	2016	2017	1Q18e	2Q18e	3Q18e	4Q18e	2018e	2019e	2020e
General Hospitals	$16,891	$ 16,260	$ 3,947	$ 3,733	$ 3,762	$ 3,789	$15,231	$15,219	$14,877
% Growth	-0.2%	*-3.7%*	*-4.1%*	*-8.6%*	*-2.7%*	*-9.7%*	*-6.3%*	*-0.1%*	*-2.2%*
Ambulatory Care	$ 1,797	$ 1,940	$ 498	$ 531	$ 502	$ 583	$ 2,114	$ 2,232	$ 2,356
% Growth	*87.4%*	*8.0%*	*9.5%*	*12.5%*	*7.3%*	*7.0%*	*9.0%*	*5.6%*	*5.6%*
Conifer	$ 1,571	$ 1,597	$ 404	$ 386	$ 371	$ 414	$ 1,575	$ 1,630	$ 1,688
% Growth	*11.2%*	*1.7%*	*0.5%*	*-3.5%*	*-7.5%*	*5.0%*	*-1.4%*	*3.5%*	*3.5%*
Total Revenue	**$19,608**	**$ 19,179**	**$ 4,699**	**$ 4,506**	**$ 4,489**	**$ 4,635**	**$18,329**	**$18,476**	**$18,316**
% Growth	*5.1%*	*-2.2%*	*-2.4%*	*-6.2%*	*-2.1%*	*-6.9%*	*-4.4%*	*0.8%*	*-0.9%*
Salaries & Wages	$ (9,356)	$ (9,274)	$ (2,227)	$ (2,135)	$ (2,180)	$ (2,213)	$ (8,755)	$ (8,694)	$ (8,612)
Supplies	$ (3,124)	$ (3,085)	$ (774)	$ (748)	$ (726)	$ (750)	$ (2,998)	$ (3,024)	$ (2,947)
Other Operating Expenses	$ (4,891)	$ (4,570)	$ (1,138)	$ (1,124)	$ (1,094)	$ (1,045)	$ (4,401)	$ (4,456)	$ (4,371)
Depreciation & Amortization	$ (850)	$ (870)	$ (204)	$ (194)	$ (204)	$ (211)	$ (813)	$ (844)	$ (844)
Other Expenses	$ (181)	$ (267)	$ 83	$ 4	$ (54)	$ (54)	$ (21)	$ (95)	$ (36)
Operating Income	$ 1,206	$ 1,113	$ 439	$ 309	$ 231	$ 362	$ 1,341	$ 1,362	$ 1,505
Interest Expense	$ (979)	$ (1,028)	$ (255)	$ (254)	$ (249)	$ (230)	$ (909)	$ (877)	$ (846)
Income Tax (Expense)	$ (67)	$ (219)	$ (70)	$ (44)	$ (6)	$ (8)	$ (128)	$ (33)	$ (33)
Other Non-Operating Expense	$ -	$ (164)	$ (1)	$ (1)	$ -	$ -	$ (2)	$ -	$ -
Net Income	**$ 160**	**$ (298)**	**$ 113**	**$ 10**	**$ (24)**	**$ 124**	**$ 302**	**$ 453**	**$ 627**
EBITDA Reconciliation									
Net Income	$ 160	$ (298)	$ 113	$ 10	$ (24)	$ 124	$ 302	$ 453	$ 627
(+) Income Taxes	$ 67	$ 219	$ 70	$ 44	$ 6	$ 8	$ 128	$ 33	$ 33
(+) Interest Expense	$ 979	$ 1,028	$ 255	$ 254	$ 249	$ 230	$ 909	$ 877	$ 846
(+) Depreciation & Amortization	$ 850	$ 870	$ 204	$ 194	$ 204	$ 211	$ 813	$ 844	$ 844
EBITDA	$ 2,056	$ 1,819	$ 642	$ 502	$ 435	$ 573	$ 2,152	$ 2,207	$ 2,350
(+) Non-recurring Expenses	$ 234	$ 550	$ 48	$ 30	$ 71	$ 133	$ 321	$ 382	$ 323
LTM Adj. EBITDA	**$ 2,290**	**$ 2,369**	**$ 690**	**$ 532**	**$ 506**	**$ 707**	**$ 2,474**	**$ 2,589**	**$ 2,673**
% Growth	*2.7%*	*3.4%*	*33.7%*	*-3.1%*	*10.7%*	*-14.3%*	*4.4%*	*4.7%*	*3.2%*
EBITDA Margin	*11.7%*	*12.4%*	*14.7%*	*11.8%*	*11.3%*	*15.2%*	*13.5%*	*14.0%*	*14.6%*
Free Cash Flow									
LTM Adj. EBITDA	$ 2,290	$ 2,369	$ 690	$ 532	$ 506	$ 707	$ 2,474	$ 2,589	$ 2,673
(+) Income Taxes	$ (67)	$ (219)	$ (70)	$ (44)	$ (6)	$ (8)	$ (128)	$ (33)	$ (33)
(+) Interest Expense	$ (979)	$ (1,028)	$ (255)	$ (254)	$ (249)	$ (230)	$ (909)	$ (877)	$ (846)
(+) Net Working Capital	$ 2,785	$ 3,155	$ 578	$ 622	$ 648	$ 670	$ 2,518	$ 2,613	$ 2,616
(-) CapEx	$ (992)	$ (757)	$ (159)	$ (198)	$ (144)	$ (189)	$ (690)	$ (757)	$ (757)
Free Cash Flow	$ 3,037	$ 3,520	$ 784	$ 658	$ 755	$ 950	$ 3,264	$ 3,536	$ 3,653
Balance Sheet									
Total Debt	$15,255	$ 14,937	$ 14,889	$14,867	$14,850	$14,693	$14,693	$14,170	$13,670
Cash Balance	$ 1,076	$ 762	$ 877	$ 921	$ 553	$ 881	$ 1,643	$ 1,875	$ 1,983
Credit Metrics									
Debt/EBITDA	6.66x	6.31x	5.39x	6.99x	7.34x	5.20x	5.94x	5.47x	5.11x
Net Debt/EBITDA	6.19x	5.98x	5.08x	6.55x	7.06x	4.89x	5.28x	4.75x	4.37x
EBITDA/Interest	2.34x	2.30x	2.71x	2.09x	2.03x	3.08x	2.72x	2.95x	3.16x
FCF/Debt	19.9%	23.6%	21.1%	17.7%	20.3%	25.9%	22.2%	25.0%	26.7%