

LifePoint Assets Could Go into REIT Following Merger

July 23, 2018

LifePoint Health's plan to merge with RCCH HealthCare Partners was a rising tide that lifted the boats of other for-profit hospital chains on Monday, serving as a reminder of private equity's interest in hospitals.

For-profit rural hospital operators LifePoint and RCCH, both based in Brentwood, Tenn., would have combined \$8 billion in revenue, 84 hospitals, physician practices, outpatient centers and post-acute providers in 30 states. The two companies signed a definitive agreement to merge and plan to close the deal, which would entail LifePoint transforming from a public company into a private one, within several months.

Private equity firm Apollo Global Management owns RCCH. It will pay LifePoint's shareholders \$65 per share in cash once the deal is complete, resulting in a \$5.6 billion purchase price, including \$2.9 billion in net debt and minority interest.

LifePoint's current chairman and CEO, William Carpenter III, will continue in those roles for the post-merger company, which will retain LifePoint's name.

"LifePoint and RCCH are aligned in our missions and commitment to ensuring that non-urban communities across the country have access to quality care, close to home," Carpenter wrote in a statement. "Together, we can extend this shared focus while generating new opportunities for growth and partnerships that will help us navigate the changing healthcare industry dynamics."

Martin Rash, chairman and CEO of RCCH, said in a news release that the opportunity to join with LifePoint marks a significant milestone in RCCH's history. The company was formed through the merger of RegionalCare Hospital Partners and Capella Healthcare in 2016. Its owner, Apollo, entered the hospital business when it bought RegionalCare in 2015.

Some analysts believe Apollo will pursue a real estate investment trust structure with some of LifePoint's assets, especially given its history of doing so with a portion of RCCH's hospital portfolio.

Ana Gupte, a senior analyst and managing director of healthcare services with Leerink Partners, said Apollo was "quite successful" in converting some of RCCH's assets into a REIT owned by Medical Properties Trust. RCCH's management also has become comfortable with REIT operations, and some executives have experience at other for-profit hospital chains like Community Health Systems.

"They're quite seasoned on integrated rural healthcare providers, and I think they must be relatively familiar with the LifePoint business, so I think it's a doable endeavor," Gupte said.

Other examples of hospitals becoming part of REITs include Capella Healthcare, which in July 2015 sold its hospital real estate to Medical Properties Trust for \$900 million. Ardent Medical Services and Steward Health Care have also converted a portfolio of their hospitals into REITs, Gupte said.

"With the REIT option, I think there is an opportunity to turn around the assets," Gupte said, noting that rural hospitals have faced challenges as they try to grow their volumes and expand margins.

Matt Caine, a managing director at SOLIC Capital, said such a move would improve Apollo's liquidity immediately and could provide enough cash to get back a meaningful portion, if not all, of its equity investment. Then there's the added benefit of the long-term payment stream that would come back to the REIT in the form of rent for the underlying real estate. The only drawback would be the higher cost of financing such an operation.

"I would expect Apollo to pursue that," Caine said.

Frank Morgan, an analyst with RBC Capital Markets, said he hopes Apollo doesn't plan to shift LifePoint's assets to a REIT. That's because he thinks the marketplace is more receptive to hospitals owning assets.

"I don't think there is anything wrong with leasing some of your assets, but over the long run, it's probably a better strategy to focus on increasing your ownership, not decreasing it," he said.

LifePoint's share price was up 35% on the merger news Monday afternoon. Fellow for-profit hospital chain Community Health Systems was up 14% at close. Tenet Healthcare Corp. was up 8%. That's likely because the LifePoint-RCCH deal could inspire private equity interest in those chains.

"That's what the market is pointing to, that there could be someone else to follow suit," Caine said. "You could make the argument that on a valuation basis, those two are sort of the next in line for an attractive pop relative to the value of their underlying assets."

The possible deterrent to private equity's interest in Tenet and CHS is the high leverage on their balance sheets, Caine said.

Gupte highlighted Tenet specifically as a company to watch, as it is also seeing significant activism among its investors.

"There is the possibility there could be some private equity interest," she said.

Gupte wrote in a report that the deal will likely receive antitrust clearance with minimal divestitures, although some may be necessary in Arizona and Tennessee, where both companies have hospitals. **Caine said it would only be between one and three hospitals and isn't likely to deter Apollo.**

In 2016, Apollo was reportedly considering buying CHS' assets.

Under the agreement, which must be approved by regulatory agencies and LifePoint's shareholders, LifePoint may solicit alternative acquisition offers within a 30-day period. Financing for the deal is being provided by Barclays, Citigroup, RBC Capital Markets and Credit Suisse, according to a news release. Goldman Sachs is acting as financial adviser to LifePoint and MTS Health Partners is providing financial advising to RCCH.

The purchase price represents a roughly 36% premium to LifePoint's closing share price on July 20, the last trading day prior to the announcement. LifePoint's share price had spiked 40% that day on the unconfirmed report by Reuters that the company may be acquired by Apollo.

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