Tenet Health Corp.
NYSE: THC
Recommendation: BUY

Company Data

Price	$88.90
Market Cap	$688.7M
P/E	23.92x
EV/EBITDA	14.70x
Price Target	$116.71
Upside	33.40%

Investment Thesis

We recommend a buy on Tenet Health Corp (THC) with a target price of $116.71 and an implied upside of 33.40%. Tenet Health Corp is a diversified healthcare service company that is headquartered in Dallas, Texas.

We recommend a buy on Tenet Healthcare Corporation (NYSE: THC); strong expansionary acquisitions with low leverage commitments, strategic repositioning within the industry, and experienced leadership with a focus on Conifer Health Solutions create a unique opportunity to buy. Additional upside may be realized as Medicare spending increases, THC continues refinancing initiatives, and urbanization trends positively impact ambulatory surgery centers. Through subsidiaries, joint ventures, and partnerships THC is looking to expand its current network of hospitals as well as healthcare facilities and services.

Business Overview

THC operates 60 acute care hospitals and over 530 other healthcare facilities, including surgical hospitals, urgent care centers and imaging centers. Its three main revenue segments are Hospital Operations (55.4% of adjusted EBITDA), Ambulatory Care (34.3%), and Conifer (10.3%). Net patient services revenue in Hospital Operations and Ambulatory Care segments are attributable to managed care payers. Revenue is recognized on an admissions basis for THC's hospitals and related outpatient facilities. Tenet's ability to negotiate favorable managed care contracts with health maintenance and preferred provider organizations and other third-party payers drive revenue within Hospital Operations and Ambulatory Care.

Industry Overview

The healthcare industry is currently valued at $3.0Tn with a 1.4% annual growth rate from 2022-2026. The industry operates within multiple subsegments, with ambulatory healthcare services and hospital industries making up 40.6% and 42.7% of the industry respectively. Drivers of the industry include the increasing number of people with private health insurance and increase in federal funding's for Medicare and Medicaid. The three largest markets within the hospital segment are inpatient care (45.7% of industry revenue), outpatient care (18.1%), and emergency room visits (36.2%). The geriatric population is integral to satisfy the demand for hospital and ambulatory care services. The growing population of people over the age of 65 in the United States drives demand as well as the Medicare based revenue within the overarching healthcare industry.

Strong Expansionary Acquisitions with Low Leverage Commitments

Tenet Healthcare will perform well through its history of deliberate acquisitions and divestitures while also maintaining its commitment to low leverage that will contribute to long success. THC's history of acquisitions begins with its acquisition of USPI which its 94.5% stake provides ownership interests in 308 ambulatory surgery centers, 40 Care Spot Urgent Care Centers, 24 imaging centers and 24 surgical hospitals in 31 states. THC also acquired Aloha Cardiology PC in April of 2019 which gave THC cardiology care center exposure in Arizona. Despite numerous acquisitions, THC has remained committed to maintaining its sub 5x leverage ratio within all its endeavors. THC is currently at a Net Debt and Medicare/EBITDA multiple of 3.13x which upholds to its sub 5x goal. They have also refinanced its debt obligations twice in the last year which has produced annual cash interest savings of $33Mn and $12Mn respectively. They have also generated more free cash flow from these financing activities. In the past quarter there has been $413Mn generated in free cash flow as compared to -$53Mn in Q1 '20 and -$182Mn in Q1 '19. As previously stated, the divestiture of THC's urgent care centers provided $80Mn in Q2 '21. Within these transactions THC has maintained low liabilities while also freeing up capital for future acquisitions. Based on historical we can see that its Net Debt/EBITDA multiple historically has been in the range of 6-8x roughly between 2014-2019. As most of the increase in acquisitions have been within the most recent few years it is important to note that the multiple has declined from 6.2x in 2019 to 3.2x in 2021. Within the industry where we see consolidation, and M&A activity playing important roles within growing market share, Tenet Health's dominant acquisitional nature proves its ability to maintain a competitive advantage in the market. THC's strategic purchases allow them to increase its top line growth by expanding its market footprint and with its declining leverage ratios alongside increased acquisition activity, THC is well positioned to continue acquisitions to grow and perform well in the future.

Strategic Repositioning within the Industry

Tenet Healthcare has remained well positioned within the Hospital and Ambulatory industries with its strong market presence and we expect THC to improve its favorable industry positioning through repositioning themselves to adhere to the movement towards ambulatory surgeries instead of hospital surgeries that will position them for top and bottom-line growth. Within the Hospital market we are focusing on Tenet's plan to continue operations here but limit expansions and due the market's maturity which poses little opportunity for revenue growth. The industry comprises $968.6Bn in revenue, however the revenue growth is stagnant. The annual growth rate from 2016-2021 was at -1.7% and is only projected to be at a growth rate of 2.5% from 2021-2026 despite facing a 2.9% decline in 2021 alone. Aware of the exposure to the matured market with little growth opportunity, THC has entered a definitive agreement to sell out of its urgent care centers in its hospital segment to increase cash flow to focus on the ambulatory care segment. Based on the growing ambulatory care market we can see THC positioning themselves well to continue revenue growth within this operating segment due to its strategic investments of ambulatory surgery centers (ASC). First in the ambulatory care industry it is low for capital intensity, globalization, and market concentration, and is expected to grow at an annual rate of 4% by 2025 as it is driven by cost conscious patients, who are seeking inexpensive alternatives to hospital-based surgeries, as ASC performed surgeries can allow patients to save up to 61% on its procedures. THC is the market leader within ambulatory care comprising 4.7% of market share and generated $1.4Bn in the industry's revenue in 2020. The revenue growth and positioning from THC comes from its growing joint venture in 2015 taking a majority 50.1% of UPSI to operate its ASCs. In 2021 it has increased to a 95% stake with 333 ASCs under operation. Tenet Health's plans to focus on the expansion of its ambulatory care is important to show the parallels between both larger industries and its operating segments within THC to illustrate why they are shifting its focus from hospital to ambulatory operations. Looking at the industry we can see that the Hospital industry has significantly smaller margins and less year over year growth whereas in the Ambulatory segment the margins are exponentially larger with attractive year over year marginal growth. To analyze THC's effect, we see the same relationship between the metrics. As the Ambulatory segment is a more profitable industry, we can see the transition to focusing on the ambulatory segment which will create top line growth and attractive margins.

Experienced Leadership with Focus on Conifer Health Solutions

Tenet Healthcare's CEO Saum Sutaria has a background in healthcare and private equity practices working at McKinsey in 2019 and previously held an associate clinical faculty appointment at University of California San Francisco. His expertise is going to guide management in utilizing a strategy that focuses on a deleveraging commitment which will be possible through the strength that its Conifer business is currently giving both top-line and operating margins. Tenet Healthcare recently backed out of its plan of a tax-free spinoff of Conifer Health Solutions. THC expects Conifer to build a robust pipeline and keep track of both operational and financial progress it has been making y/y. During fiscal year 2022 revenue growth for Conifer is projected to be in the mid to high single digits. High growth rates will aid in the guidance of Conifer, expected to contribute ~10% of total revenue by 2023, where in FY 2021 it made up ~6.3%. EBITDA margins have increased by 1,000+ bps from the Conifer segment since 2017 with a FY 2022 outlook of 17.3-18.0%. Management is focusing on shareholder value through this plan to exit out of the spinoff of Conifer, as it currently provides services to 650 THC and Non-THC hospitals nationwide. Conifer is currently in an agreement with Catholic Health Initiatives (CHI) that expires on December 31, 2032, and allows it control of patient access, revenue integrity, accounts receivable management, and patient financial services within CHI's facilities. Conifer also focuses on revenue cycle management services which is set to grow alongside the global healthcare revenue cycle management outsourcing market which is projected to increase to $23 billion by 2023.

Comparable Company Analysis

Within our analysis we tiered our comparable companies into 3 buckets, first being similar product lines, next market cap, and last operating margin growth profile. Given THC's relative value to peers, we see THC is the most attractive peer through its commitments to low leverage and marginal growth. We expect once THC captures more share in ambulatory markets, we could see EV/EBITDA multiple expansion and Operating Margin growth, bringing it closer in line with to comps. THC consistently is middle of the pack for ROIC and FCF, as well as a lower P/E ratio. We believe the metrics analyzed for THC are tremendous relative to peers and show room for unrealized gains alongside our materialized thesis. As analyzed in our thesis its metrics historically have improved and we see this catering towards multiple expansion and margin growth.

Catalysts

1. Increases in Medicare Spending
2. Refinancing Initiatives
3. Urbanization Trends

Risks

1. Collective Bargaining and Union Activity
2. Fissured Workplace
3. Mandated Staffing Ratios
4. Medicaid Spending Fluctuations

Valuation

Using a Discounted Cash Flow model and an EV/EBITDA multiple of 7.7x for the base case, we found an implied upside of 33.48% and a targeted share price of $116.78. For the bear case, we found an implied upside of 14.19% and a targeted share price of $99.90. For the bull case, we found an implied upside of 37.49% and a targeted share price of $120.29. To arrive at our different outputs, we carefully considered revenue and EBIT growth as well as multiple expansion. We attributed this growth largely to expectations within the ambulatory care sector, improvements in operating efficiency, and management guidance. We believe that the company's growth, cash flow generation, consistent delevering, and shift away from the hospital segment have yet to fully be realized in the valuation. That being, we were still conservative with our revenue and growth assumptions to account for potential risks or delays in Tenet's long term business plan.