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THC - Tenet Healthcare Corp Corporate Call to Discuss Conifer Strategic Review Process and Tax-Free Spin-Off of the Business

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PRESENTATION

Operator

Good day, and welcome to the Tenet Healthcare call to discuss the company's intention to spin off Conifer. Today's conference is being recorded. At this time, I would like to turn the conference over to Brendan Strong, Vice President of Investor Relations. Please go ahead, sir.

Brendan Twohig Strong - *Tenet Healthcare Corporation - VP of IR*

Good morning. The slides referred to in today's call are posted on the company's website. Please note the cautionary statement on forward-looking information included in the slides. In addition, please note that certain statements made during our discussion today constitute forward-looking statements. These statements relate to future events, including, but not limited to, statements with respect to our business outlook and forecasts, our future earnings and financial position and future corporate actions. These forward-looking statements represent management's current expectations based on currently available information as to the outcome and timing of future events, but by their nature, address matters that are uncertain. Actual results and plans could differ materially from those expressed in any forward-looking statement. For more information, please refer to the risk factors discussed in Tenet's most recent Form 10-K and subsequent SEC filings. Tenet assumes no obligation to update any forward-looking statements or other information that speak as of the respective dates, and you're cautioned not to put undue reliance on these forward-looking statements.

I'll now turn the call over to Ron Rittenmeyer, Tenet's Executive Chairman and Chief Executive Officer.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Thanks, Brendan, and good morning. I appreciate everybody joining us today on such short notice.

As you saw in the press release that we issued this morning, we have completed our strategic review of Conifer. And following a thoughtful and detailed process, the Board and I have decided that the best path forward for Conifer is to execute a tax-free spin-off to the shareholders of Conifer by the end of the second quarter of 2021. During this call, I will discuss the breadth and depth of the strategic alternatives that we explored as well as outline the key next steps that we're taking to prepare Conifer to be an independent publicly traded company.

So before discussing the Conifer spin-off in more detail, I want to take a moment to provide a brief overview of our results for the quarter. We expect adjusted EBITDA will be comfortably within our outlook range for the quarter and consensus -- and consistent with consensus estimates. Volume growth strengthened in our hospital business, with admissions and adjusted admissions both up for the quarter. USPI continues to deliver favorable volume growth, and Conifer delivered another strong quarter. We will have greater detail available in our upcoming earnings call on August 6. And I wanted to reaffirm our adjusted EBITDA outlook for both Q2 and the full year before I move into the Conifer discussion. Our call today is really about Conifer, so I'm not going to answer any other specific questions on Q2 until our call on August 6.

So moving forward on Slide 2, we've listed at a higher level the process starting with our announcement in December 2017, a few months after I was named CEO, of a strategic review for Conifer. You should recall at that time and throughout this process, I was clear that we would sell the business if we receive a valid all-cash offer that represented a fair value for the businesses, including improvements made during the process and a contract that clearly supported the main mission of collecting all of Tenet's cash as well as provisions that were commercially acceptable.

So for context, at that point, there was clearly some uncertainty in general regarding Tenet. We were making several significant leadership changes. We have announced but not yet completed a $1 billion divestiture program. And there were questions how we were going to fund the continued buy up of USPI.

Fast forwarding to today, we are very much in a different position as a company. The leadership changes across the entire enterprise have created a new and invigorated sense of urgency and accountability. This includes changes at the Board level, with 6 of our 11 directors having joined since October 2017, changes in senior management team including our new COO, and numerous changes throughout our corporate ranks and hospital leadership teams. We have completed our divestiture program, executed and completed our buy up of USPI, focused on top line growth and continuing to grow same facility -- same facility revenue in both our Hospital and Ambulatory businesses. And we further expanded USPI through additional acquisitions. We are more than halfway through an aggressive cost-reduction initiative that remains on track to remove about $450 million of annual run rate expenses from our cost structure by the end of the year.

And regardless of the structure of this strategic review process and the uncertainty that it created relative to the team and in general, the company, Conifer has produced financial results which are dramatically improved over prior years. And we believe Conifer will continue to make forward strides that will be impactful and sustainable.

As a company, we're on a path for adjusted EPS in 2019 to be roughly triple that what we reported in 2017. We continue to make progress towards lowering our ratio of debt to adjusted EBITDA primarily through EBITDA growth, with a 4.7% EBITDA growth in 2018 and another 4% to 7% growth contemplated in our outlook for 2019. And we remain focused on margin expansion, with a roughly 200 basis points of margin expansion from 2017 to 2019. While we are far from declaring victory, it is clear that the company has reset and is in a much stronger financial position than it was just a few years ago.

So moving to the Conifer decision and referring to Slide 3, we wanted to take a moment to place the Conifer effort for the last 18 months into context. We kicked off and undertook an exhaustive review of different options, all with the goal of delivering value for our shareholders. As part of the process, we evaluated many different alternatives. And we primarily focused on 2 structures: an all-cash sale of Conifer, which was the #1 focus when we started; and merging Conifer with another company, then spinning out the combined company via a tax-free spin to Tenet shareholders. That was the transactional structure we deeply explored during the exclusive negotiations that we announced in February.

Slide 4 provides a pictorial outline and the initial sales process that we have conducted. One of the driving reasons we started this strategic review was because shareholders approached us and said, "We believe there could be some buyers for Conifer that would be willing to pay a high multiple for the business, possibly in the mid- to high teens." Our Board and I were very willing to listen to these ideas and thought it was worth exploring. We undertook the process with a clear intent, and we continued to state that in our communications to pursue a sale if we were able to negotiate an appropriate price for Conifer. In many discussions with our shareholders and other stakeholders, it was openly shared by this constituency that this was the right framework for our decision.

As you can see, this was, by any measure, an extensive process. We engaged Goldman Sachs to run the process. And we spoke with a total of 74 potential buyers, including 16 strategic buyers and 58 financial buyers. Out of the group, 9 submitted preliminary nonbinding bids for Conifer, and 3 of these initial bids were high enough for us to continue moving through the process.

A point that is critically important is that the preliminary bids were based on a business plan that we have provided to the buyers that projected Conifer would deliver $308 million of EBITDA in 2018. As I'm sure you'll recall, when we first announce our intention to pursue a sale of Conifer in 2017, we said that we expect Conifer would deliver $270 million to $280 million of EBITDA in 2018.

Month by month, we continued to identify and promptly execute opportunities to improve Conifer's cost and service structure. And we reflected this through our bankers to the bidders as we recognized changes, including details on how it was achieved as well as in the increased EBITDA outlook for Conifer that we provided in conjunction with our fourth quarter, first quarter and second quarter earnings releases last year.

Ultimately, we ended up delivering $357 million of EBITDA at Conifer in 2018, an increase of $82 million from what we projected at the start of the year. Conifer delivered nearly as much EBITDA growth in 2018 in absolute dollars as they did in the prior 3 years combined. These are exceptional and most importantly, sustainable results. Conifer will continue to grow in 2019, and this was achieved despite the natural uncertainty of a strategic process coupled with the potential negative impact of hospital divestitures.

So looking at Slide 5, our expectation was the bid was needed to recognize and reflect these sustainable improvements, which were easily verified in due diligence. It was clear that Conifer was making great progress in enhancing its performance. It was also clear that this was something that bidders did not want to pay for since they have Conifer's enhanced performance and synergies that they would achieve after an acquisition.

Our job is to maximize value for our shareholders, not their shareholders nor the bidders. So we rightfully require that we be paid for the performance improvements. However, the bids simply did not reflect those changes. Our perspective was, and we openly stated and discussed it with potential bidders, that we had identified the savings, we were achieving the results as our performance showed, and felt it was appropriate to be paid for that performance. We also identified a clear path to offshoring, but offshoring was not included by the bidders in determining the values.

Additionally, the terms that the buyers proposed for a long-term contract between Tenet and Conifer were, in our view, unrealistic. In general, some, if not most of the potential bidders, expected a 10-year contract or longer, which frankly we had no issue with. However, they also wanted above-rate market escalators. The buyers didn't want to be held accountable for collecting 100% of our cash, which is critically important to us and something that I discussed numerously. There were several different iterations, but not ensured that we would have a proper and effective recourse if cash collections fell short.

Additionally, many expected unrealistic guarantees. For example, we did not sell a hospital -- if we did sell a hospital, they expected us to guarantee the buyer would use Conifer; or if not, we would continue to pay the buyer for that sold asset's RCM as if we still owned it for the duration of the contract. That's not how outsourcing works. It is the outsourcers' responsibility, and in turn their risk, to sell their service to the new buyer or to find new business to replace what could be lost.

Finally, some of the bids provided an equity component versus an all-cash sale. We did not want to accept the transfer of the risk in this type of transaction nor the potential lack of liquidity of someone else's equity.

In the end, the parties conducted varied degrees of due diligence on Conifer and submitted their offers. We felt these offers were not adequate, especially considering the improved financial performance at Conifer. And as I said on several occasions, I strongly believe there was a view among some and maybe all of the buyers that we had to sell Conifer, that we were a forced seller, that we had to sell Conifer to delever the company. And as I've said throughout the process, Conifer is not a strategic part of Tenet but is a very valuable asset. And our shareholders deserve the right place for it if we sold it. And we continue to believe Conifer is a very valuable asset, and we also continue to believe there is room to further improve it going forward.

On Slide 6, while the outright sale of Conifer at the right price was our first choice, we decided it was also appropriate to invest the time and effort to ensure we had explored all alternatives valued creation. We determined there may well be another alternative worth exploring that might yield an acceptable value. This included the idea of combining Conifer with a third party and then spinning this new entity in a tax-free spin to our shareholders. There were several potential benefits from a transaction like this that we have outlined.

We believe the merger/spin transaction could have been structured in a way that would have been tax-free to both shareholders and Tenet. That's why a straight spin of Conifer is expected to be tax-free to both shareholders and Tenet.

The tax implications of a sale versus the spin were critically -- a critically important part for the decision process, so it's worth taking a second to discuss this. As you know, we have a federal net operating loss carryforward. The size of the NOL is approximately $1 billion as of December 31, 2018, meaning that we could offset $1 billion of taxable income for federal tax income purposes. If we were to sell Conifer, this would trigger a taxable gain. And even at a low valuation combined with our very low tax base at Conifer would have used up most or all of the NOL.

Tenet is at the point where we are generating taxable income, and we expect to use the NOL over the next few years without a sale of Conifer. Using the NOL to offset a proportion of the taxable gain on Conifer sale is not free. In addition, we remain open to making additional changes in our hospital portfolio, which also could result in taxable gains. We concluded that it's much better to explore options for Conifer that would be tax-free to shareholders, including a merger/spin or a straight spin that would preserve our NOL for other purposes, including enhancing our cash flow over the next few years as we continue to work to improve performance.

Looking at Slide 6, we stated the most significant potential benefits of our merger/spin. There was a way to structure that transaction, so that shareholders would benefit from owning a separate company focused on revenue cycle management and other business process outsourcing services while providing an appropriate amount of leverage on the new Conifer by using a debt-for-debt exchange at the time of the spin, which we expected to be tax-free to Tenet, thus reducing the debt level at RemainCo. We're mindful of how a merger/spin would impact both the leverage profile for RemainCo and SpinCo and have been thoughtful of this in order to provide a balance.

Finally, our expectation was there would be both revenue and cost synergies and possibly some management synergies by combining Conifer with another company. A merger/spin would allow Tenet's shareholders to participate in this upside if they chose to be taking their ownership interest in the new Conifer post-spin.

Clearly, these were some great reasons to be excited about the prospect of a merger/spin, which is why we spent several months in exclusive negotiations and due diligence. As we proceeded with our diligence on the merger partner and further evaluated these opportunities and negotiated the relative valuation between Conifer and a partner that we are looking at, we did ultimately conclude that this just simply was not the right transaction. So at that point, we concluded that to unlock the value created by Conifer, the most effective action was a tax-free spin to the Conifer shareholders. It was the most logical and effective step forward.

Slide 7 outlines our view of the strategic rationale for the tax-free spin to shareholders. As I mentioned, when we started the process, Conifer was a valuable business with strong margin and great free cash flow. The service that Conifer provides is incredibly important to Tenet and its customers. However, unlike USPI, we don't believe Conifer is a strategic part of our health care delivery platform or frankly any hospital system. The revenue cycle management and value-based care services that Conifer provides can easily be done on an outsourced basis. Therefore, separating Conifer from Tenet allows us to retain the great services that Conifer provides to all of our hospitals, while recognizing the different financial profile, capital needs and growth trajectory for Conifer. Having separate management teams and a board entirely focused on Conifer's service offerings could help the company further improve execution and accountability. Each company will be able to independently pursue what is best for its growth, its customers, its employees and ultimately, its shareholders.

Over the long run, our view is that separating Conifer should translate into improved shareholder value as a result of the benefits of the separation that I have just outlined, combined with giving the markets an opportunity to value these distinct businesses separately. There is still a lot of work that we need to do for Conifer to be fully prepared for an independent company status, which we outlined on Slide 8. We believe this work will take up to 2 years, so we're targeting a spin-off by the end of the second quarter of 2021. We know as many of you do, there is a long list of material things that have to get done to set up the mechanics and regulatory aspects of this spin. We need to recruit a new independent board with skills and perspectives to help shape Conifer's future growth and strategy. We will need an IRS ruling or legal opinion that it will be a tax-free transaction for U.S. federal income tax purposes for our shareholders and Tenet. And as with any spin, the SEC will need to declare the Form 10 effective. We will need new independent auditors and a variety of separation points regarding policies, et cetera.

We have a new and exciting partner with Dignity -- with the Dignity-CHI merger that we need to ensure is included in these discussions. And while all of these take time, there are also several important business milestones that we need to achieve before Conifer is ready to be a stand-alone company.

Start with we want to position Conifer as a growing company, which is adding new customers and delivering profitable and positive revenue growth coupled with a robust sales pipeline. Following today's announcement, Conifer will have an opportunity to develop and execute on a new sales and marketing plan, highlighting the benefits of its future independence and improved competitive position. Simultaneously, we are restructuring the commercial part of the business and rebuilding the sales team at Conifer. And we are in the midst of an active effort to recruit a new commercial sales office -- officer. All of these actions should translate into stronger revenue growth.

The second set of significant action is the management team that will carry Conifer forward. As we announced this morning, Steve Mooney, Conifer's CEO, has stepped down. And we've named Conifer COO, Kyle Burtnett, as the interim CEO effective today. The company and myself want to thank Steve for his years of commitment and oversight to create a valuable and viable company in Conifer, and we view him as an alumnus of Tenet. Kyle has delivered a consistent and exceptional set of performance metrics since being placed in that role in 2017. He has a long and distinguished career at Tenet, USPI and now Conifer.

While we're very pleased with his performance, we're also launching a national search for a permanent CEO. Kyle understands and agrees he'll be one of the candidates that we'd consider as we look at the right person to lead Conifer as an independent publicly traded company. And we will ensure this is done objectively and with the appropriate emphasis on a long-term quality candidate. Likewise, we need to give Conifer's future CEO sufficient time with the business and potentially making additional changes to position the company for future success.

We also believe it will be helpful to materially complete our offshoring efforts so that the market could really understand the go-forward financial profile for Conifer. While this may be an ongoing project, we do see the next 18 months as a critical transition period. Our intense focus on improving Conifer's financial performance while maintaining or enhancing operating performance for customers, including Tenet, will position Conifer well for its future success. And this work will take us a bit of time.

As I discussed on several occasions, we also need to finalize the contract between our hospitals and Conifer on terms that make sense for both sides on a go-forward basis with appropriate incentives and penalties. It's critically important that Conifer continue to do a great job collecting our cash. And the part -- the only part for Tenet is that the right contractual terms in place. As part of a new agreement, we expect to adjust both the scope and services for how it will provide for our hospitals and the rate that hospitals pay to Conifer for this service, and we're finalizing those details.

We're also still working through additional cost-reduction opportunities. I do believe Conifer continues to have meaningful opportunities to further improve its cost structure. Much of it should be in place by 2020, so we should be able to better articulate the impact and explain the benefit from offshoring in further detail on our fourth quarter earnings call in the coming February.

And then finally, we do intend to spin off Conifer with an appropriate capital structure, which we expect to include the same debt-for-debt exchange we talked about in the merger/spin.

This is an exciting day for us and it is a very big day for Conifer. When we spin off Conifer, we believe this investment in time and change will ensure it is well positioned for success as an independent company. And we believe our health care delivery platform will also be positioned for growth and further success.

So with those prepared comments, operator, we're now prepared for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll take our first question from Ralph Giacobbe with Citi.

Ralph Giacobbe - *Citigroup Inc, Research Division - Director*

I guess one, just hoping you could flesh out a little more thoughts on the -- I know it ranges around how much debt will shift to Conifer and capital structure of Tenet sort of post the spin. Just want to clarify the comments sort of that debt-for-debt exchange.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Well, there's not much -- I mean Ralph, I appreciate your question and I understand why you're asking it, but remember, we have 2 years. At the same time, we've got to realize that we are clearly, as you've seen, we -- the trajectory of Tenet hospitals in that part of the business, USPI, I think is very positive. If you look back in the last several quarters, we've hit our EBITDA. We've even hit consensus or beat consensus 6 out of 7. The one we missed was due to selling our practice and the value-based contract issue in California. So when I look at just performance, I'd say that we hit 7 out of 7. Comfortably, EPS has hit all 7.

So from a performance standpoint, we are clearly focused on debt at Tenet, first on performance, which I've always said. Asset sales, we haven't talked much about that because I do not want to publicly start talking about what assets we may or may not dispose of, but clearly, it's a very clear topic. We are actively involved and looking at those things. There are still areas that we think we would be better if we trimmed off certain pieces. So we're going to continue to be aggressive about that. So then once that's done, that will all have an impact on debt, obviously, and the profile of Tenet.

And then you kind of slip forward to 2 years from now when we spin it out, I think that decision and the debt exchange will be made as we get closer to that because we'll have a clearer view and a clearer feel. But there's no way I'm going to -- we plan to load up Conifer and cause that to have a capital structure problem on the way out. We want it to be successful. So it's a balancing act, and it's kind of hard to see theoretically with all these actions in place. All I can do is tell you that, based on our trajectory, I believe that we will do the things we've said. And then separately, based on the debt-for-debt exchange, we will do an appropriate capital structure. So I know that it's not the exact numbers you want me to fill out, but that's the best way I can go when I look forward without it being more than theoretical. Dan, do you have any follow-ups to that?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Ralph, listen, we've talked about we're very focused on reducing our leverage, which is primarily through earnings growth. But the -- as Ron mentioned, when we get to the point of the spin-off, we will look at what makes sense from a capital structure perspective in terms of the amount of debt on the Conifer organization. And then essentially what would happen at that point would be there would be a reduction in debt on the Tenet side.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

You mean a tender-for-tender thing.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Correct.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I hope that's helpful.

Ralph Giacobbe - *Citigroup Inc, Research Division - Director*

Okay. And then -- yes, yes, that's fine. I understand. At some level, wait and see. But I just want to be clear, I guess on my follow-up on the Conifer EBITDA. So your guidance for the midpoint of this year I think is around $375 million. Would that amount simply come out of the total Tenet EBITDA base? Or are there other considerations overhead, stranded costs where we need to make sort of other consideration as opposed to sort of that simple math when the time comes?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Ralph, it's Dan. You're right. The midpoint is $375 million for this year. Certainly, as we move forward, we expect Conifer's earnings to grow. And in terms of -- at the time of the spin-off, obviously, depending on the Conifer's earnings level at that point as well as we did want to point out that we will be looking at entering into a new contract with Conifer, and so depending on the ultimate pricing on that particular contract. But I think, directionally, you should be thinking of it like that, whatever Conifer's EBITDA is, that's what...

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I don't -- I'm not concerned about the Conifer contract issue being a big issue because it will be fairly consistent. There'll be -- obviously, we've said we're going to relook at some of the scope of things. But let's assume that this moves past and comes through and won't affect the number in the end result.

To your question about costs, yes, there'll be costs that will come out of Tenet. I mean there are things that, as an enterprise, you do. Some of that will go over Conifer. But my impression or my expectation -- really not impression, my expectation is that over the next period of time, Conifer will step over all that. I don't see us moving large cost blocks over to Conifer because Conifer will have to do some things for a public company structure. But I expect them to be able to step over that with other improvements.

Equally, I expect Tenet to reduce its costs and continue to reduce its costs. And whatever cost that Tenet eliminates should not be a one-for-one change for Conifer. I mean simplistically, you could say that would happen, but I do not expect that will happen. We've already started to look at that. And so Tenet will get some. I think it's a little early to be specific about that. But rest assured that we do not plan to see large cost shifts back and forth. So...

Operator

We'll take our next question from Pito Chickering with Deutsche Bank.

Philip Chickering - *Deutsche Bank AG, Research Division - Research Analyst*

As we think about the spin-off, you mentioned some pushbacks from potential buyers, including contract length and cash collection provisions. Can you tell us how long the contracts will be on the Conifer -- when they spin out? Will you have escalators in place on those contracts? And would cash collection provision terms be different from other rev cycle management companies you've unloaded?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Well, it's a good question. I would just say that I can't totally answer that. Look, the contract for Conifer and Tenet, it's already structured out, I think, 99%, albeit it's not a lot different than what we're doing today. The goal is 100% cash collection. If you don't collect 100% cash, then you have a potential penalty. If you collect over 100%, meaning that you've been more aggressive, you've found other opportunities, you should get rewarded for that. It's pretty much how we manage the company today. And so fundamentally, it's not a big change.

Length of time, look, 10 years is fine. I think it could be longer. But typical of these -- typical outsourcing contracts mean 10 years is a reasonable time.

Escalators are important, but at the same time, companies need to -- outsourcing companies need to not have built-in price increases. They have to provide services that make you want to give them a price increase or provide you new services. The real issue for outsourcing is to have some type of incentives to improve. And when you have that incentive, you get your pricing increase based on efficiency.

Not a lot different than what we get from managed care in many respects. There has to be efficiencies built into the system. They have to look for cost improvements on an ongoing basis. That's where they should benefit. They have to look for new technology to automate and figure out ways to cut out steps in the process. I believe that building in standard escalators at times is not necessarily the most positive way to incentivize someone's performance.

So this will not be a contract that will be out of, I think, out of market. If anything, I think it will be very much market. And -- but I can't compare it to everybody else's contract because those kind of terms are not necessarily publicly available. But it will not be a contract that's unreasonable or out of commercial standard. So...

Brendan Twohig Strong - *Tenet Healthcare Corporation - VP of IR*

Pico, was there anything else? Sounds like means we're moving on. Shelby?

Operator

Yes, sir. We'll take our next question from A.J. Rice with Crédit Suisse.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

First of all, I just want to explore a little bit more. Obviously, you've got a partner in Conifer in Dignity. They own about 24% of it, I believe, still. Can you just tell us how involved they have been in this decision-making process? Or do you now go to them and present this to them? And within the terms of their relationship with Conifer, do they have the ability now? Is there a change of control that allows them either to put the equity to you or to Conifer? Or is there any provision for them to restructure their contracts as a result of the change in control type of provision?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

So let me answer this a couple of ways. One is there are no provisions for them to do any of that. So the contract is the contract. But they've been involved. Saum is sitting here with me. He's just recently spoken with them, correct? I mean they're totally up to date. The new Common Spirit, which is obviously the combination, senior level, we've met with directly. And they're very, very comfortable with where we are. Saum, do you have any other...

Saumya Sutaria - *Tenet Healthcare Corporation - COO*

I think the management team at Common Spirit is very supportive of this.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

So I see no change in any of that.

Albert J. William Rice - *Crédit Suisse AG, Research Division - Research Analyst*

So would the intention be then for them to just retain the 24%. So you'd spin yours out to your shareholders and they would retain their stake. Or what would happen to their stake?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

A.J., it's Dan. Well, ultimately, we can't predict how they'll ultimately view their investments on a long-term basis. But the plan is that at the time of spin, they would get the appropriate interest in the new organization.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

The same as any shareholder. And whether or not they keep that stake or sell it, I mean we have no control over that. They'll still be contractually engaged with Conifer as a customer.

Philip Chickering - *Deutsche Bank AG, Research Division - Research Analyst*

Okay, and then my other question was related to -- so you're going to go out and bring in -- do a national search for a new CEO of Conifer. Just things like negotiating with contracts with you all and other sort of strategic decisions, can they move forward before you get a new CEO? Or you sort of bring in the new CEO and then you finalize those types of things.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

We're running the business. We will -- we're going to move forward. I mean we've got 2 years. We're going to have -- we're able to move forward on all of those things. As we hire a CEO, they will certainly engage with us on all of them. But for now for next 2 years, we still own and operate it, so the majority of it, along with Common Spirit. So from my perspective, we're not going to stop doing what we're doing. And -- but new CEO, obviously, will join the company with full awareness of where we are, what we're doing. And we'll look for their insight as well. But conceptually, I don't see it changing the pace or anything we're doing.

Operator

We'll take our next question from John Ranson with Raymond James.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

Just curious on Conifer, the cost cuts, what should we think about in 2020 as sort of a starting-out point when you fully load the cost cuts? Is there some additional wraparound cost cuts that will go into EBITDA as we think about modeling next year?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

John, it's Dan. Absolutely, one of these -- there will be incremental cost efficiencies realized in next year, and we think beyond in terms of cost actions that we have already have targeted and begun to execute on.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

I'm sorry, I meant the $80 million. Is that fully realized this year? Is there a piece that will go into next year? I didn't ask the question right. I'm sorry.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes, John, yes. There will be piece realized into next year. Yes, if you recall, the $250 million cost reduction initiatives are -- we will fully realize that by the end of this year. And then the incremental $200 million, taking us up to $450 million, we realize about $50 million this year, and then the remaining $150 million, we capture next year. And Conifer's part of that.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Right. Conifer's part of the whole...

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

Yes. Approximately how much of that is Conifer?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

We haven't specifically said the exact dollar amount, but it's a fair amount of that money.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

It just isn't fair, [sell C3], and they didn't give me a number.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Well, here's how you think about it. So as we look... yes, I know. And if you look at our breakdown of our savings that we have on our walk forward and in the slides, I'd use about the same proportion.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

Okay. See, I mean I knew I'd get an answer out of you, Dan. I'd said that you'd answered it. The other question I had, a more broad, strategic question. If you look at the competitive landscape in revenue cycle, some of your competitors have layered in, let's say, incremental capabilities beyond just kind of a revenue outsource. Conifer hasn't grown a lot. And you guys have said, well, when you've got an asset held for sale, it's hard to grow it. But I'm just kind of interested longer term, what strategic capabilities do you think Conifer needs to compete and win and grow versus what it has today?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Saum?

Saumya Sutaria - *Tenet Healthcare Corporation - COO*

Yes, this is Saum. So it's a good question. And I think one of the important things that we would reiterate, it is very hard to grow when there's uncertainty about the future of Conifer, both from an ownership and structure standpoint. We think this clarity will help.

Look, the second thing is Conifer has been an evolving business over the last few years in terms if its capabilities across the revenue cycle, including greater automation, standardization of workflow and also dealing with the complexities in today's environment from a payer reimbursement and payer dispute denials environment over that period of time. So there are a number of incremental technologies that have been built into Conifer's platform that make it today a very different performance entity as reflected in the results of our customers, including Tenet, than what it was even a few years ago.

So as we have talked about the cost savings and the EBITDA improvement that Conifer has achieved through efficiencies as a strong part of the narrative, we've spent less time talking about all the advancements we've made in the actual business and capabilities that Conifer can deliver to its customers. With this announcement, we will be much more focused on that go-to-market story, being at the forefront of what we discussed and let the results speaks for themselves.

Look, the second thing I would say is that the marketplace for revenue cycle outsourcing and including value-based payment changes that create additional opportunity in the revenue cycle, we believe is still a strong and growing market. The addition of other services, IT services and other things that you're seeing in the market may actually add too much complexity in a single outsourcing relationship versus the discipline and focus of excellent revenue management and value-based care payment management, which we believe we can offer.

So I don't think it's clear that the market has declared that broad-based, back-office capability outsourcing in a single entity is necessarily better than a focused technology and automated revenue cycle and value-based care business, which really is important to collecting, as Ron continues to repeat, 100% of our and our customers' and future customers' cash. So I don't have a prediction about how that's going to go, but I will tell you that we believe there's a lot of runway in the marketplace to continue to improve and expand our offering in the revenue cycle.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

And I would just add to that. If you think broader, the spin-out provides an opportunity for the platform to be expanded separately. When it's no longer part of Tenet, it could be viewed differently. And I think our marketing engine here, at least at Conifer, has never really ignited and gone after what the platform can provide and the strategic stuff it can provide, even beyond that. But it needs to provide it as a separate offering, not necessarily to Saum's point, overcomplicating the revenue cycle piece.

John Wilson Ransom - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Director of Healthcare Research*

And just -- the last follow-up for me, kind of going back to capital structure is you guys are just all in on fixed rate debt. And I know it's great you don't have covenants and that sort of thing. But as you think about your capital structure, why in the world would you at least take, say a ton of EBITDA and put it into a floating rate bank line? And just have more flexibility if you sell assets, have new leverage, have more flexibility to pay down debt at par versus having to wait until a bond matures or whatnot? It just seems like you're -- all this focus on cost cuts, the obvious ones to me is your capital structure, which largely remains, of many company I cover, the most fixed-rate, bond-centric capital structure I've ever seen.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

We don't disagree with that statement, David.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes, John. Certainly, we will be looking at that as we move forward and make sure it makes -- whatever ultimate capital structure we put in place, that it makes sense given the interest rate environment.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

And I'll say Tenet as well as Conifer, that's right. We agree.

Operator

We'll take our next question from Justin Lake with Wolfe Research.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Just a bunch of follow-ups to stuff that's already been asked. First on CHI, can you remind us what the remaining term of that contract is? And when does it end?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

2032, Justin. It's Dan.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Okay. So effectively, don't expect them to have to sign some kind of further contract extension here.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes, this has no impact whatsoever on their contracts with Conifer.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Okay. And in terms of CHI EBITDA, should we just think about that as being in the ballpark of the 24% ownership that they have? Is it about 1/4 of EBITDA contribution to the company?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

We don't break that out. I don't...

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

No. We -- you mean in terms of the CHI share of -- that drives Conifer EBITDA's or their EBITDA?

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Yes. I'm talking about it.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes. What we talk about publicly, Justin, is between Tenet and CHI, it represent roughly 75% of revenue. And so in terms of the earnings, that would be directionally in the ballpark as well. But again, there is no change whatsoever in the contract as a result of the plan to spin Conifer.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Got it. And then just in terms of the question that was asked before by Ralph on leverage. I totally understand you guys are thinking this through. But let's just say you get to the 5x I think you're kind of targeting. Should we think about this entity having similar leverage when it spins out to the overall company? Or should we expect it to have anything meaningfully below or above?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I'm going to bump that because again, based on what I said earlier, we're going to look at all that and provide a range. But I'm not going to -- I mean we are not going to over-leverage the spin. That would not be in the best interest of Tenet or any of the shareholders. And that's about as far as I really want to go with that description for you.

Justin Lake - *Wolfe Research, LLC - MD & Senior Healthcare Services Analyst*

Well, totally understand. Just at what point do you think you will be able to communicate that along this process? When do you think you'll be sharing that with shareholders?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Certainly not before I'm into the second year. I got to get through this -- we have 2 years to go. This is not a conversation until sometime after the first year that we do this. And I'd say 6 months before we maybe get to the spin, if you're going to push me on the dates, that's the earliest that we start I think publicly talking about. I mean you just got to realize that you're asking me to commit to things over the next 2 years that at this stage, I think, we need time to look at our asset sales and the other stuff we talked about doing. And it's just inappropriate to sit here and theoretically come up with numbers, et cetera, that -- and scenarios that we're working on. So I can't commit to that until I think later in the process. So...

Operator

We'll take our next question from Josh Raskin with Nephron Research.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

As you guys sort of thought about this process, and I understand that a lot can change over a 24-month period. But as you evaluated some of the bids that you didn't think were particularly reasonable and reflective of the value, and sort of juxtapose that with this tax-free spin from a valuation perspective, I understand you mentioned kind of a mid- to high teens multiple that had been put to you by stakeholders or shareholders, et cetera. Is that a base? Is that where you were framing your reference in terms of where you think this will trade in the market? Or do you have different views than what was sort of put to you in terms of that idea?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Well, clearly, we'd like it to certainly trade at upper teens. But I don't think I can answer that question at this point, other than we certainly believe it will trade very, very well. We believe it will be a strong company in the market. And we think it will have a good offering, both in terms of its cost structure as well as what we believe we're doing for its growth structure. So without having specifics today because I don't -- as we put this together, we obviously posted in our own process, looked at what we think is reasonable, and together with Goldman and others, did scenario planning around that. So we wouldn't be doing this if we did not believe this was not going to be a very successful move for our shareholders as well as for the company. So I can only tell you that you understood where we were headed. The numbers that were -- I said earlier from our stakeholders were interesting numbers. But the reality is, this will be a market decision. And I believe that this thing should provide a very, very strong, exciting company when it spins out. And I think it will also be good for Tenet and overall shareholders. So I don't know how else to really answer that at this point, because I can't quote a specific multiple. I did at one time in terms of what I thought, and it was not a good idea.

Joshua Richard Raskin - *Nephron Research LLC - Research Analyst*

Maybe I didn't ask the question well. So as you think about those bids that came in, I guess more specifically, where they in that range of valuations and the terms were just unreasonable. And you thought, hey, we can spin this 2 years from now with more acceptable terms, better outcome? Or were those bids just not reflective of that mid- to high-teens valuation that you know was...

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I would say it was all of the above. I would say it's all of the above. We were not -- the bids, as I said in my prepared remarks, did not reflect the improvements at Conifer. So if you look at the $86 million, it did not reflect in our opinion substantially those improvements, did not reflect the future plans on offshoring. They just didn't. And the reality is we saw them reflective more of the earlier numbers. So they weren't at the level we thought were appropriate. You got to understand the mix of equity versus cash. We didn't want equity, so we discounted that. So it's very hard to do an apples-to-apples comparison, other than to say that we made a decision today based on what we think is the best return for our shareholders and the best outcome for Conifer and Tenet and our minority investor in terms of Common Spirit. So we made a decision based on that. That's the only way I can really answer that.

Operator

We'll take our next question from Kevin Fischbeck with Bank of America.

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

You mentioned that part of the, I guess, opportunity over the next 2 years as you bring it together is to somehow bring kind of this -- announce a sort of new partner. But with Dignity and CHI coming together, you mentioned that there was some sort of opportunity in that combination that you felt would be more obvious, I guess, in 2 years? Can you explain a little bit more what you meant by that?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I don't really recall saying that. I saw that as a -- I mean there's always opportunities, but I don't see -- I don't believe we said anything exactly that way. I don't have any knowledge of what Common Spirit is going to do from a contractual standpoint. They're -- they obviously have an agreement with us until 2032, and we expect to execute that flawlessly for them. But beyond that, I don't think that I can today identify any specific opportunities beyond that with them. Clearly, if there is one, we'll be standing in line and, hopefully, our performance will make us more attractive than anybody else. But at this stage, I think that's a -- that would be a hope, but I don't have specifics beyond that. Is that -- Dan, did I miss anything here?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

I think it's -- clearly, it's -- we will look for opportunities to expand our relationship with Common Spirit. But as we outlined, the process to ultimately get the company to be public, it's not as if it's contingent on some specific incremental business with Common Spirit.

Kevin Mark Fischbeck - *BofA Merrill Lynch, Research Division - MD in Equity Research*

Okay. And then I guess you mentioned also that being a separate publicly traded -- or separate company would potentially help in the sales process. Are you seeing actually that, that is a barrier now, that being owned by Tenet has in fact been a explicit issue with some customers? I just wanted to understand kind of how much better that sales -- go to sales strategy might be as a stand-alone company.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

I don't think it's really a barrier, but realistically as a company, Conifer is not a stand-alone business. it doesn't get 110% of our attention. It's a division. It is -- it can be very well be a stand-alone division, a stand-alone company. I think as such, it will have more freedom and more ability to move on its own and to build the team and resources accordingly. So I always believe when you have divisions, you really always need to evaluate whether it will be a stronger stand-alone company or stronger as part of your company. I think it was nurtured and brought through the process very effectively by Tenet, but there is a point where it's got to go and do its own thing. And I think it is the right thing to do or we wouldn't be doing it. Otherwise, we would have just kept it. But I think realistically, it is the right decision from a value standpoint.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

And Kevin, the other thing I think is that now that there is clear visibility as to the future of Conifer, that will resolve maybe uncertainty in potential customers' minds.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Yes, and we'll certainly sell it that way. Saum, do you have any other...

Saumya Sutaria - *Tenet Healthcare Corporation - COO*

I think it will always remain the case that Conifer's ability to operate, and the diversity of markets it does across Tenet and all the other customers that it serves, will probably -- and with the performance expectations that clients have, will always remain a differentiating capability versus the rest of the revenue cycle outsourcing industry. Because we serve the broadest range of markets with the most diverse array of health system payers in this space and across multiple clients. So the capability is incredibly portable across the country for any client that chooses to use Conifer with the expectations that Tenet and others would have around performance. So it's a unique feature, whether or not it's owned by Tenet or not.

Operator

We'll take our next question from Gary Taylor with JPMorgan.

Gary Paul Taylor - *JP Morgan Chase & Co, Research Division - Analyst*

Just 2 questions, one just sort of going back a little bit to, I think, what Josh was asking. When we look at the public traded comps, I think one trades around 6 and one trades 7.6x 2020 EBITDA. And it's sort of in the middle of that. It's not obvious from the publicly traded comps that there is immediate value creation from the spin. So what gives you confidence that this would trade in a way, superior to the way consolidated Tenet is trading?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Gary, it's Dan. When we look at the business, we are optimistic that when the company spins out, that it will trade at a value-accretive nature to Tenet's overall trade multiple. That's our belief. And as we continue to improve and grow the business, we believe that we'll be able to convince investors that it should trade -- Conifer as a stand-alone company should trade at a higher multiple.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

And Conifer -- it's Ron. Conifer, we have really established I think superior cost bases in Conifer. And we will do more of that as we complete the offshoring steps and some other things. So the companies, the business that we now bring on as well as the existing business, such as Tenet, will therefore be more efficiently brought on, more efficiently operated than in the past.

We will continue to, over the next few years, tighten the overhead component of independent Conifer, Conifer as we have the whole company. You saw our remarks about the second quarter. We are continuing to run this company, I think, overall with a much stronger effort to reduce the things that do not generate a return and tighten up spending in areas that do not add value.

So when this spins out, I think it will be spinning out as a relatively well-built, very tightly operated company, which in many cases when divisions are spun out, do not have that. It will have -- the process is pretty well buttoned up. And we'll hit the street with expectations to continue to grow and be able to be competitive in the marketplace because it will be able to price competitively given its overall cost structure will be incredibly tighter, I think, than most.

That is the same process that, when we talk about Tenet's improvement, that we're doing on that side. It's one thing to increase value -- to increase volumes, which we are doing through just operating better and providing the type of things that the communities need in terms of the hospital business. And we're doing that in a much more thoughtful way, a much better way, a much more efficient way. And that allows us to operate better and actually provide more. So from the standpoint of the company, I'm comfortable that we should be able to operate at a level and have a multiple that reflects that. Obviously, that will be determined by the market.

So I -- yes, what's the confidence? The confidence is in the belief that we will have that type of setup. So that's the best I can give it. So...

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes. I mean I think when you have very high-margin business, strong cash flow-generating business and a business that has -- its CapEx needs on an annual basis are relatively light. So we think that all will contribute to a valuation that will be strong.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

And we'll continue to improve the technology basis and the centers of excellence within it. So...

Gary Paul Taylor - *JP Morgan Chase & Co, Research Division - Analyst*

My one follow-up, I know you talked about this. You've talked about this before, but just an updated thought. I mean given consolidated Tenet's leverage profile, I mean, what do you say to shareholders and credit holders who'd say moving $250 million-ish of free cash flow or spinning that out materially harms legacy Tenet financial profile?

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Gary, it's Dan. We don't believe it's going to materially harm Tenet. We're obviously very, very focused on delevering and improving free cash flow generation, and we will demonstrate that over the next several years. And so we wouldn't be doing this if we thought it was going to materially harm Tenet.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

And we just spent a lot of time on this. And again, I go back to trajectory of the company is very positive, and I think the performance has been positive. So I -- we would not do this if we thought it would materially harm the company. The Board wouldn't do it. I wouldn't do it. The management wouldn't do it. So...

Operator

We'll now take our last question from Matthew Gillmor with Baird.

Matthew Dale Gillmor - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

I just had one follow-up, and it's on Conifer's cost structure. Conifer's margins are higher than the targets of the closest public comp. And it sounds like that's not driven by pricing or terms with Tenet in that contract. So can you give us some sense to why Conifer has a better cost structure? And just sort of help us understand the sustainability and then the upside to that cost structure?

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Well, the upside, I think, continues to be how you restructure it and what type of overhead you put against it. I don't want to sound glib, but I mean I think it's because we are really trying to run it the most efficiently way possible. We remove things that are not additive. So I don't know, Dan, do you have...

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Yes. I mean I think, when we -- listen, we've been very focused on improving the...

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

Overhead.

Daniel J. Cancelmi - *Tenet Healthcare Corporation - CFO & Executive VP*

Operating cost structure over the past 1.5 years. Kyle came on board and improved an already efficient cost structure, but realized a lot of efficiencies very quickly, quicker than we had originally anticipated. So certainly, that obviously helps from a margin perspective. And listen, Conifer has been doing a very good job for not only Tenet but Common Spirit and others, and again leveraging its platform, which drives margin enhancement.

Brendan Twohig Strong - *Tenet Healthcare Corporation - VP of IR*

All right. Thanks a lot of, everybody, for joining us today. We look forward to speaking with you again on August 6 when we put out our second quarter earnings results. Thank you.

Ronald A. Rittenmeyer - *Tenet Healthcare Corporation - Executive Chairman & CEO*

With that, operator, I guess we'll end the conference. Correct, Brendan?

Brendan Twohig Strong - *Tenet Healthcare Corporation - VP of IR*

Correct.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.
