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Tenet Healthcare Corp. (THC)

Q2 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Please standby. We're about to begin. Good day everyone and welcome to the Second Quarter 2015 Tenet Healthcare Earnings Conference Call. My name is Dana and I'll be your operator for today's call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session.

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.

I will now turn the call over to Trevor Fetter, Tenet's Chairman and CEO. Mr. Fetter, please go ahead, sir.

Trevor Fetter

President, Chief Executive Officer & Director

Great. Thank you, operator, and good morning everyone. As you saw in the press release we issued yesterday, we delivered another strong quarter with improvements in our top and bottom line results. Slide two in our presentation provides an overview of the financial highlights. We achieved adjusted EBITDA of $568 million which is a 23% increase over the prior year. We also completed our transactions with United Surgical Partners International and Aspen Healthcare in mid June, which added $16 million of EBITDA in the quarter.

Even after excluding that additional benefit, adjusted EBITDA was slightly above the top end of our guidance. Inpatient volumes were relatively strong on a historical basis with growth of 1.7% over the second quarter of last year making it one of our top ten volume quarters over the past decade. I'll note this is the first time we've faced a tougher comparison since we started reporting very strong volume growth in the second quarter of last year.

Before I share details on the strategic accomplishments for the quarter, I'd like to comment briefly on the new financial profile of Tenet and how you should think about our company going forward. With USPI and Aspen now part of our operations, we added a new Ambulatory Care segment, which you will see in our financial reporting.

We're also providing some additional disclosures in our guidance to account for the various portfolio activities we announced this year. While we still have more work to do on our portfolio, we hope this gives you a better understanding of what the new Tenet looks like.

As you know, we've been taking steps to improve our acute care portfolio for some time. This includes forming strategic partnerships with other regional healthcare providers. Our goals here are to achieve market leadership position and build the scale needed to be successful as the delivery system shifts toward more value-based care delivery and reimbursement. As you'll see on slide four and five, we announced several transactions in the last few months that reflect this strategy.

In June, we signed a definitive agreement to form a joint-venture with Baptist s in Birmingham, Alabama. The new joint-venture will combine our Brookwood Medical Center with Baptist's hospitals. Brookwood is a great facility on its own and we believe it will be even better positioned as part of a larger regional system.

In July, we signed a definitive agreement to form a joint-venture with Dignity Health and Ascension Health to operate the Carondelet Health Network in Tucson, Arizona. Tucson will be a new market for us, although we already have a meaningful presence in the state with six hospitals, two short-stay surgical hospitals and 12 surgery centers in the Phoenix area. Carondelet is also an extension of our partnership with Dignity Health in which we have co-managed and accountable care organization in the Arizona since early 2014.

In both the Baptist and Carondelet joint-ventures, Tenet will be the majority partner with management responsibility for the facilities, physicians and other related businesses that will be part of each network. In mid-July, we completed an agreement to lease and operate the Hi-Desert Medical Center in Joshua Tree, California. Hi-Desert is a small community hospital which has historically referred some of its more complex cases to one of our two hospitals in the nearby Coachella Valley. We already operate Desert Regional Medical Center in Palm Springs and JFK Memorial in Indio, which were only about 20 miles from Hi-Desert. With Hi-Desert in our portfolio, we will now run three of the four hospitals in the Greater Palm Springs area solidifying our number one position in that market.

We're also seeking to divest hospitals or exit markets where we don't believe we can achieve the scale needed to be the most efficient local healthcare provider.

Slide six includes the summary of these activities. In June, we announced a definitive agreement to sell of Saint Louis University Hospital. We are also pleased with the level of interest we received from bidders for our hospitals in Atlanta and North Carolina. We're far along in the process and we remain on-track to complete these divestures by the end of the year or early next year.

Turning to our new Ambulatory Care segment, pro forma same-facility system-wide cases increased 6.8%, including the results of USPI and Aspen in both periods. While Tenet's earnings benefited from only two weeks of contributions from USPI, we're pleased to report that USPI delivered solid results for the quarter in line with our expectations.

We remain very bullish about the strategy of combining with USPI, and continue to believe that we are well-positioned to benefit from consumers migrating to lower cost, more convenient care setting.

As a reminder, USPI gives us an immediate number one position with scale in the fast growing ambulatory surgery sector as high-quality assets and an exceptional team, and enhances our long-term earnings potential.

Growing by partnering with and serving the vast not-for-profit sector is a key component of Tenet's strategy. We are pleased with all of USPI's 50 not-for-profit health system partners continue to be our partners today. We look forward to expanding these relationships through acquisitions and development opportunity, and we also believe USPI remains very well positioned to add new health system partners. For example, Dignity and Ascension are both very important partners of USPI, and we're pleased to deepen our relationship with these two outstanding organizations through the Carondelet transaction, I mentioned earlier.

Likewise, in March, we announced the new joint venture with Baylor Scott & White Health that brings together five hospitals in the Dallas area. Baylor Scott & White is one of USPI's most significant and long-standing partners. The USPI's relationship with Baylor continues to grow through new opportunities, including its recent joint purchase in June of a new surgical hospital in an area north of Dallas.

USPI also recently expanded its partnerships with key partners Dignity Health and Memorial Hermann. Conifer continues to perform well within an active pipeline of new business. Dartmouth-Hitchcock Health in Northern New England recently selected Conifer to manage the revenue cycle business for its hospitals and affiliated physicians.

Dartmouth-Hitchcock is a large and prestigious client that serves a patient population of 1.2 million and provides access to more than 1,000 primary care doctors and specialists in almost every area of medicine. The organization was especially interested in Conifer, because of its expertise in physician billing services, which we gained through our acquisition of SPi Healthcare last year. Having both hospital and physician billing capabilities in-house further differentiates Conifer as health systems increasingly look for one partner to manage these services.

Conifer's growth is also being driven by its proven capabilities and years of experienced in value based care. Health systems are continually engaging Conifer to craft risk stratification programs and manage population health. A notable recent example is the Yale New Haven Health System in Connecticut. We're currently handling value based care arrangements for more than 5.4 million lives, which represents growth of 15% over last year.

For the second year in a row, Conifer received recognition as the top ranked provider of financial and consulting services to accountable care organizations in a leading industry survey conducted by Black Book. This is another strong endorsement of Conifer's expertise in establishing and managing risk based payment models, as healthcare continues to shift from volume to value, having these capabilities within Tenet is especially beneficial.

In summary, we had another solid quarter that beat our expectations. We took a number of important steps to continue building a stronger and more diversified portfolio to become a more capital efficient operation, that's more closely aligned with healthcare today and leverage our interconnected businesses to enhance Tenet's value proposition over the long-term. We remain focused on aggressive implementation of our strategy to create sustainable value for our shareholders and improve the care delivery system for our patients and customers.

And with that, let me turn it over to Dan Cancelmi for more specifics on our performance and our outlook. Dan?

Daniel J. Cancelmi
Chief Financial Officer

Thank you, Trevor and good morning and everyone. There are several points that I would like to make today. Our volume growth was strong in the quarter and in line with our expectations. EBITDA exceeded the high-end of our guidance even after we exclude the earnings of USPI and Aspen. Our new segment disclosures offer greater visibility into the performance of each of our businesses. We are updating guidance for 2015 and providing you for modeling purposes with the baseline pro forma view of 2015. To give you a sense of our portfolio on a going forward basis once all of our announced M&A activities are completed. And finally, we expect to generate approximately $1 billion in net cash proceeds from our previously disclosed portfolio activities.

Adjusted EBITDA was $568 million in the quarter which included $16 million from USPI and Aspen for the last two weeks in June. Excluding these earnings, we delivered EBITDA of $552 million which exceeded our guidance of $500 million to $550 million. We generated EBITDA growth of a $108 million or 23% compared to last year. This performance was driven by a combination of same hospital volume growth and pricing, the recognition of $45 million California Provider Fee revenues and 36% EBITDA growth by Conifer. These growth drivers will partially offset by a $25 million decline in health IT incentives.

Moving to slide seven, we made a number of changes to our financial disclosures to provide you with an enhanced view our financial performance. The biggest change is that we now have a third segment that we refer to as our Ambulatory Care segment, which contains the results of our new USPI joint venture and Aspen. Our Hospital segment now excludes the financial results and associated case volumes performed at the legacy Tenet surgery and imaging centers that we contributed to the USPI joint venture.

For example in previous quarters, there outpatient surgeries performed within our free-standing centers were reported in our adjusted admissions and outpatient surgery metrics of our hospital segment. These are now reported as cases in our Ambulatory segment. There were no changes in how we report Conifer's results and we will continue to report the business as a separate segment.

Slide eight, provides a helpful summary of the main drivers of our equity and earnings of unconsolidated affiliates. Historically, we had a small amount of equity earnings which we reported in the revenue line. Since equity earnings are now more material, we are presenting them separately on our income statement just below the revenue line.

As you can see on slide nine, our hospital volume trends remained very healthy in the quarter. We grew same-hospital admissions 1.7% and adjusted admissions increased 2.3%. Both were in line with our expectations.

As you think about our volumes this quarter, it is important to keep in mind that we started reporting much stronger growth rates in the second quarter of last year. We generated same-hospital patient revenue growth of 6.9%, and a 4.5% increase in patient revenue per adjusted admission. These results were driven by our volume growth in the quarter, improved commercial rates, and the additional California Provider Fee revenue.

From a cost perspective, our teams have done a great job generating the $100 million to $200 million of annual Vanguard Synergies that we outlined, when we announced the acquisition two years ago. We expect to exit the year on a $200 million annual run rate.

Slide 10 contains additional details on our uncompensated care expense as a percentage of adjusted revenue which was 10.9% in the quarter, down from 12.2% last year. This was primarily due to the decline in our uninsured volumes as a result of benefits we are realizing from newly insured patients.

Conifer has played a role in driving our uncompensated care expense lower by helping uninsured patients qualify for Medicaid. In the quarter, we qualified 96% of the people that we identified as being eligible for coverage, which is an exceptional result. This is up from 94% in the second quarter of last year.

Turning to slide 11, our Ambulatory segment's pro forma case growth was very strong. Revenue per case in the quarter was softer than historical trends primarily due to the Aspen's recent investments to grow same-day cases. These cases have lower acuity and generate lower revenue per case. For anyone not familiar with USPI's historical financial reporting, the system wide growth shown on the slide includes the cases performed at consolidated and unconsolidated centers. This provides a better overview of volume performance across the entire portfolio.

On slide 12, you'll see that our Ambulatory segment generated $115 million of EBITDA on a pro forma basis, representing a year-over-year increase of 4.5%.

Conifer delivered another quarter of outstanding year-over-year growth, with EBITDA increasing 36% to $60 million. This continues a trend of impressive growth in recent years.

Slide 13 provides the historical details. Conifer is on track to meet or slightly exceed $260 million of EBITDA in 2015, with the back half of the year averaging about $60 million per quarter, with slightly more EBITDA in the fourth quarter than the third quarter. We expect Conifer to see some earnings pressure in the third quarter from ICD-10 rollout activities and new client integrations that also has upside potential in the fourth quarter from client incentive opportunities.

As Trevor mentioned, in June, we announced that Conifer won a contract to serve Dartmouth-Hitchcock. We often breakeven and sometimes have start-up losses during the first 12 months to 18 months of a new contract. So, you will start to see the revenue from this contract in the third quarter, but you should not expect to see any significant benefit on the EBITDA line this year.

Our cash flow was very strong in the quarter. And we are raising our 2015 adjusted free cash flow guidance by $75 million to $225 million to $425 million. Adjusted net cash provided by operating activities was $467 million in the quarter, up from $318 million in the second quarter of last year. After subtracting capital expenditures, we generated $292 million of adjusted free cash flow in the quarter.

We are also announcing today our decision to consolidate our three current group purchasing organizations down to one. As part of our performance excellence program, we are continuously pursuing opportunities to be more efficient. Over the past year, we conducted an exhaustive evaluation of our GPO contracts and are excited to announce that we have decided to work, exclusively with HealthTrust Purchasing Group, starting in the first quarter of 2016.

As part of this change, we are moving our purchasing functions completely in-house. This will improve alignment and enhance our sight over our spend. We look forward to partnering with HPG to drive increased savings with our supply chain.

Turning to guidance, slide 14 provides our updated outlook for 2015, as well as a pro forma view of 2015, as if all of our previously disclosed M&A activity had been completed by January 1 of this year.

In the third quarter, we expect to generate adjusted EBITDA of $550 million to $600 million. Our new Carondelet joint venture in Tucson and the sale of St. Louis University Hospital are targeted for completion late in the third quarter. However, given the anticipated timing, I would not expect either of these transactions to significantly impact our third quarter results. The larger impact of our M&A activities will start to be seen in the fourth quarter.

For the full year 2015, we raised our adjusted EBITDA guidance by $175 million and increased our adjusted free cash flow guidance by $75 million. Our outlook include assumptions regarding estimated completion dates for the transactions we listed in our press release. When thinking about our guidance for the year, we started with our original EBITDA guidance of $2.05 billion to $2.15 billion which we continue to believe is the fair way to think about our outlook for the year prior to the impact form M&A.

Next we add about $225 million to $235 million of EBITDA from acquisition primarily USPI and Aspen. Then we subtract roughly $50 million to $60 million in divestitures which mostly impacts the fourth quarter. The net impact is a $175 million increase in our guidance. While we're not commenting today on 2016, we are presenting a pro-forma view of 2015 to give you a sense of for what Tenet looks like going forward once all of the previously disclosed M&A transactions are completed.

On this pro-forma basis, we would have expected to generate adjusted EBITDA of $2.25 billion to $2.35 billion in 2015. At the midpoint of the range, our pro-forma EBITDA margins for 2015 would have been 13.1% up 110 basis points from the guidance we provided earlier this year. When thinking about this pro-forma guidance, we also started with our original EBITDA guidance of $2.05 billion to $2.15 billion. We then added $400 million to $450 million from acquisitions.

Again this is primarily driven by USPI and Aspen although Hi-Desert, Birmingham and Carondelet have a larger impact on a full-year basis. We then subtracted roughly $200 million to $250 million of EBITDA related to divestitures. With all the acquisitions and divestitures that we have been discussing, another question that we frequently receive is what are the estimated net cash proceeds from all of these transactions.

Slide 15 provides a high level summary of which transactions will be sources and uses of cash. We expect to generate net cash proceeds of about $1 billion from all these transactions. This does exclude what we pay to acquire interest in USPI and Aspen.

In summary, we produced strong results in the quarter. We drove volume growth, achieved favorable pricing increases and exceeded our EBITDA expectations for the quarter. We significantly advanced our strategies and are positioning Tenet to be a higher margin, more capital efficient, stronger free cash flow generating company, which you are starting to see in our higher pro forma margin and with our increase in free cash flow guidance for the year.

I'll now ask the operator to assemble the queue for our Q&A session. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And we'll take our first question today from A.J. Rice with UBS.

A.J. Rice
UBS Securities LLC
Q

Thanks. Hello, everybody. Congratulations in getting all these deals done.

Trevor Fetter
President, Chief Executive Officer & Director
A

Good morning.

A.J. Rice
UBS Securities LLC
Q

I'll first of all maybe just quickly ask about USPI and Aspen, I guess is together with that. Can you give us a little bit of flavor now that you have those under your tent, what is the growth mandate that they have? What's the availability of growth capital for them? What does the pipeline look like, a little flavor for that if possible?

Trevor Fetter
President, Chief Executive Officer & Director
A

Yeah. Good. Thank you, A.J. We are – we're joined by Bill Wilcox and Jason Cagle this morning, and I'm just going to ask them to address a bit about their strategy and what the pipeline looks like, what the organic growth looks like, and kind of address some of your questions there.

William H. Wilcox
Chief Executive Officer & Director, United Surgical Partners International, Inc.
A

Okay. Great. Good morning, A.J. The pipeline that we have is still quite robust both in terms of ASCs and the surgical hospitals, and also the interest and demand from our health system partner is current and we believe future. So that continues to be quite strong and as you know the ambulatory surgery center market is very – is not consolidated at all and there is a lot of opportunities out there.

In terms of capital spend, it will very probably allow year-to-year. This year so far it's been very good year for us, last year similarly the year before that it was little quieter so it'll be – it will vary from quarter-to-quarter and year-to-year, but overall, we think there are going to be lots of opportunity for deploying capital. In terms of the growth rates, if we've been really pleased with our same store growth as well as our growth including acquisitions, and we think that we'll continue to have strong growth from a case perspective and reasonable growth from a net revenue per case perspective, which gives us a nice overall revenue growth.

A.J. Rice
UBS Securities LLC
Q

Okay. Great. And maybe just one follow-up on the proceeds that you got coming in the $1 billion or so by around year-end. What – have you got some priorities for what you're going to do with that cash?

Daniel J. Cancelmi
Chief Financial Officer
A

Good morning, A.J. This is Dan. We certainly – one of the areas where we could possibly allocate that capital is to – we have some long-term debt, $750 million that we can call it a fairly reasonable price that it has a higher interest rate. So that's certainly one area that we are looking at in terms of allocating those proceeds toward.

A.J. Rice
UBS Securities LLC
Q

Okay, great. Thanks a lot.

Operator: And I'll take our next question from Whit Mayo with Robert W. Baird.

Whit Mayo
Robert W. Baird & Co., Inc. (Broker)
Q

Hey, thanks. Good morning. I guess first question just on USPI, just was looking for an update on conversations with the hospital partners. Just curious if anyone has indicated any desire to put ownership back to you guys or just may be qualitatively what's been the reaction from those hospital partners?

William H. Wilcox
Chief Executive Officer & Director, United Surgical Partners International, Inc.
A

Hi, Whit. This is Bill Wilcox again. We've been really pleased with the conversations we've had with each of our health system partners, obviously one of the first things we did when we contemplated this merger a year ago is go and talk to all of the key players, and then over the course of the past year we've talked to everyone of our health system partners. And as Trevor said, we went into this negotiation with 50 health system partners and we came out of it with 50 health system partners. We've recently expanded that relationship with some of our key ones, Dignity, Memorial Hermann that Trevor pointed out. We also just last week closed another deal with Ascension. So the reaction has been overall favorable, and I think there's going to be enhanced capability on our part with Tenet behind us and with some of the non-surgical ambulatory approaches that we are now going to be taking.

Whit Mayo
Robert W. Baird & Co., Inc. (Broker)
Q

That's helpful. And maybe for Keith, just looking at Conifer. Is there an opportunity to bring Conifer closer to some of these joint ventures that you're working on right now or is that not in the plan? And any comments you can make on savings as you transition to HPG would be great.

Keith B. Pitts
Vice Chairman

A

Well, I'll take the first piece on Conifer with the joint ventures. We have – in several of the joint ventures, we have great opportunity to bring Conifer in. We will, for example, Carondelet will – Conifer will take over Carondelet, which is over $0.5 billion in their patient service revenue sometime in the first six months after closing. So, that's a prime example.

The other thing is, on some of our divestitures we are having conversations and Conifer will remain, for example, in a few of these already we've actually confirmed will remain and have a contract, for example in St. Louis. And so, that will become a non – that will be consistent revenue, but now non-Tenet revenue for Conifer and we've had that in the conversation with some of the other divestiture potential partners as well.

So, not only do we have the opportunity to move Conifer into the joint ventures, but we also have the opportunity to have Conifer remain as a service provider in some of the divestitures as well.

Trevor Fetter
President, Chief Executive Officer & Director

A

And I would just add – Whit, this is Trevor that as you would imagine, there's a lot of conversations between Conifer and USPI coordinating the relationships through the various channels that go both ways. Dan, do you want to speak to the part of Whit's question relating to the supply chain?

Daniel J. Cancelmi
Chief Financial Officer

A

Sure. Good morning, Whit. Yes, certainly we – over the past year, we've been conducting a very thorough evaluation and assessment of our group purchasing organizations that we've been utilizing over the past several years, and we concluded after looking at this, and looking at all the various alternatives that made the most sense to consolidate to a single GPO, we think it's going to provide numerous operational, clinical, financial benefits. By consolidating the spend, we're going to be able to achieve lower unit cost and increased efficiencies in our supply chain. So we're really excited about the partnership with HPG.

Whit Mayo
Robert W. Baird & Co., Inc. (Broker)

Q

Okay. Thanks. Nice job.

Operator: And we'll take our next question from Dana Nentin with Deutsche Bank.

Dana Nentin
Deutsche Bank Securities, Inc.

Q

Great. Thanks for taking the question. And I guess first just one quick follow-up on USPI. How are you thinking about synergies for USPI this year and how that plays out?

Daniel J. Cancelmi
Chief Financial Officer

A

Good morning, Dana. This is Dan. So when we – as we've mentioned, when we announced the transaction – we think that there are significant synergies out there and we've targeted $50 million of synergies that we feel very comfortable with, and as we've continued to integrate and work with Bill and Jason and their teams, we feel more confident in that. And yeah that will – those synergies will be realized over two year or three year period, and we feel very good where we are at from a synergy capture perspective.

Dana Nentin
Deutsche Bank Securities, Inc.

Q

Okay, great. And then just one quick question on reform. Is there any color you could provide on incremental benefit in Q2, and then it looks like the exchange admissions and outpatients were up nicely. Any comments you could provide on the mix there between exchange and Medicaid expansion benefit?

Daniel J. Cancelmi
Chief Financial Officer

A

Yeah, so Dana this is Dan again. In the quarter – let me parse out our volume. We believe that roughly 40% of our volume growth related to business that we're generating and capturing, from individuals, who now have coverage under an exchange product or Medicaid coverage. As I mentioned in my remarks, Conifer has done a great job, qualifying individuals for Medicaid coverage and providing outreach efforts to individuals, also looking at exchange offering. So, we couldn't be more pleased with our success there.

We did continue to grow our exchange volume sequentially, which is nice to see. And as we've mentioned quite a number of times on previous calls, we're very well positioned from a contracting perspective, almost all of our hospitals have contracts with the most affordable plans. And so we feel that's a big reason why we're capturing a large amount of that business.

Dana Nentin
Deutsche Bank Securities, Inc.

Q

Okay, great. Thanks a lot.

Operator: And we'll take our next question from Andrew Schenker with Morgan Stanley.

Andrew Schenker
Morgan Stanley & Co. LLC

Q

Hey, good morning. So just want to dig a little deeper into the guidance for this year and the annual guidance here. There's obviously a lot of moving parts. But it seems to me that the USPI and Aspen numbers or the acquired numbers seem a little light, especially relevant to the size of the outsource, I just mean by that right, if you annualize 1H or annualize the $16 million you got for two weeks, that gets you to about for $115 million at the low end.

And then obviously all the deals are coming in, which should be all consolidated. So you'd assume that would ultimately flow through the EBITDA line. So, is there potential upside to some of those numbers? Then on the flipside, the sales there for Baylor Scott & White JV, some of that earnings comes back through the income and unconsolidated line I assume so, I mean, how should we think about all those moving parts on total EBITDA line, it sounds like those were very profitable hospitals in reality. So just trying to understand all those moving parts as they come together in the guidance. Thank you.

Daniel J. Cancelmi
Chief Financial Officer

A

Andrew, this is Dan, let me address that. So, in terms – let me address USPI real quick. Their results in the quarter were in line with where we expected them to be and I believe that's the same case with Bill and Jason and their team. So, USPI had a very good quarter and the results this year are tracking in line with where we thought the business would be.

Let me try to give a broader review of the guidance. We've raised our guidance a $175 million for 2015, we – as I mentioned in my remarks, we added in terms of when you think about the second half, we added about $225 million to $235 million of earnings. USPI is the biggest component of that along with Aspen. Then we have divestitures that will be occurring in the second half of the year, but they're predominantly occurring in the fourth quarter and so when you take the $225 million to $235 million and you back out the divestitures and the timing it varies with each transaction by month, but we're going to – we backed out about $50 million to $60 million of earnings in the quarter, and that's how you get this net increase of $175 million. So we feel really good about the guidance for the back half of the year.

Real quick, let me explain the guidance for the full year on a pro forma basis. You take our $2.1 billion midpoint when you started the year out and then you add in acquisitions of $400 million to $450 million, again, USPI and Aspen, biggest components there, okay.

Now let me say one thing there. That is 2015, it does not include all the growth that we're going to generate from the pipeline that Bill just mentioned, in the future. It also does not include the improvements that we're going to make in our Tucson facilities, in the Birmingham facilities. So, we're not providing guidance for 2016. What we're doing here is trying to provide a baseline for 2015, before assuming these transactions had occurred at the beginning of the year, and it does not include the future growth prospects that we're going to generate.

Andrew Schenker
Morgan Stanley & Co. LLC

Q

Okay. I think that makes sense. And then just a second part just on NCI, I think in the slide you suggested $41 million for the Ambulatory Surgical segment, during the quarter. And then I think last quarter you were about $33 million, which I assume is majority Conifer's. Are both of those reasonable run rates for those two divisions, acknowledging that as you grow those divisions, that number should grow as well? And then I assume there's an additional contribution, as you close the other acquisitions, you had highlighted, as well which could increase that number for next year, is that really, anyway to size what that contribution might be for the fourth quarter I guess when a lot of those deals will close?

Daniel J. Cancelmi
Chief Financial Officer

A

Andrew it's Dan here. Let me address that. Yeah, one thing let me point out that the lion's share, the majority of that non-controlling interests, a large portion that is non-cash. So in terms of the Welsh Carson's ownership, there's no cash distributions there, the Catholic Health initiatives ownership in Conifer is non-cash as well. In terms of the run rate, keep in mind in our second quarter numbers it only included two weeks for USPI. So we have obviously a full quarter in there in Q3 and Q4, and so you'll see growth in that NCI's number just to the fact that you have full quarters for USPI in the back half of the year.

Andrew Schenker
Morgan Stanley & Co. LLC

Q

Thank you.

Operator: And we'll take our next question from Sheryl Skolnick with MS USA.

Sheryl R. Skolnick
Mizuho Securities USA, Inc.

Q

Good morning, thank you. So, really busy you guys and great job on all the way around and thank you for the clarity on the guidance, much appreciated and currently being reflected in your stock price. I do want to focus my questions on that guidance though.

You said basically the right way that you think to think about this is to take the unchanged original guide and then apply various changes to that. So can you speak to a minute on basically the unchanged baseline of $2.05 to $2.15 with the midpoint of $2.1 billion of EBITDA as a fair way to look at the business. You obviously did somewhat better than your high-end of guidance in this quarter on EBITDA. And it looks like and the sense I'm getting is that you're very pleased with the operations and prospects for the underlying business separate and apart from whether or not assets are coming out of that business.

So can you speak to that part of the guidance for a little bit? Give us a sense of – I know you took down the top end of adjusted admissions growth in the updated outlook. But give us a sense of where you think you are in that range, are we closer to the top end, closer to the middle, given the strength and performance that we've already seen and the strong execution you've had?

Daniel J. Cancelmi
Chief Financial Officer

A

Good morning, Sheryl. This is Dan. Let me address that. So certainly, we are pleased with the performance in the first half of the year, solid volume growth, good mix, acuity was up in the second quarter generating nice pricing growth as well in the quarter, in addition to our contract negotiations also contributing to that. And we had pretty good cost control. Again although we can always do better there. We're going to capture additional efficiencies down the road. So after a really good start for the year, when we look out to the second half of the year, we do still think the original range is still a fair way to think about it, but you know based on our results so far this year, certainly you know comfortable with the midpoint, if you had to think about it, you know the upper half of that range was likely where we would be. So, you know we feel good. We're half way through the year, that's why we put a range out there. You certainly, when you assess through the back half of the year, we feel good, but you know that's why we're – we're at right now, and certainly looking to drive further growth.

Sheryl R. Skolnick
Mizuho Securities USA, Inc.

Q

Right, got it. And that's kind of what I thought you would say, so that's very helpful. If we can talk to the $1 billion net of cash proceeds, and you know anticipating that you actually get that. Can you think – can you help us think through how you might deploy that. Is it prudent to actually pay down some debt here or you know given that EBITDA is going up, you're naturally deleveraging or are there other better uses for that meaning keeping [indiscernible] (41:12) and Conifer and other parts of you business particularly busy?

Trevor Fetter
President, Chief Executive Officer & Director

A

So, obviously, we haven't committed 100% to the specific action that we will take, but certainly the higher rate debt that's out there $750 million, it certainly near the top of the list and we'll assess our capital allocation needs based on the timing on the transactions close. But certainly we have higher rate that are out there that we can now call it at more affordable price. And so that certainly one of the items we're going to be focusing on when we think about how we'll ultimately use the proceeds.

Sheryl R. Skolnick
Mizuho Securities USA, Inc.

Q

Great, okay. Thank you very much.

Operator: And we'll take our next question from Gary Lieberman with Wells Fargo.

Gary Lieberman
Wells Fargo Securities LLC

Q

Good morning. Thanks for taking the question. Lots of consolidation in the managed care space. Can you talk about, how you think you're positioned from a market share perspective going into that and if there is any risk to pricing and if you're seeing anything from that?

Trevor Fetter
President, Chief Executive Officer & Director

A

Yeah, Gary, it's Trevor. We're – a big part of our strategy here is to improve our positioning constantly, and that's part of why we are making the portfolio move that we are and engaging in the partnership strategies that we are and changing the overall nature of our business in the way, we are. With respect to managed care industry, these are very large companies to begin with. We have important relationships with all of them. It's also important just like, we always like to remind people that 80% of the hospital industry is not for profit local hospitals.

The biggest payers that we typically deal with are not the big companies that you know, but the state based Blue Cross plans most of which are not for profit and while consolidation among buyers always tends to put pressure on suppliers is kind of strategy 101. We feel like we're very well-positioned. First of all we have very important relationships with all of these companies. We have very senior level relationships with them. We have a highly automated, very efficient revenue cycle with them that we are generally a better value for them than other providers that they deal with in our markets. And we believe that we'll be just fine as we go through this.

The – it is interesting to watch and they – consolidation in that sector seems to be happening very quickly, but I think, I'm very comfortable with how we're positioned. We're a low cost, high value provider that has very strong relationships with them and that should put us in a very favorable position to deal with whatever effects of this consolidation there maybe.

Gary Lieberman
Wells Fargo Securities LLC

Q

Thanks. And any increase in the pace of conversations or the number of conversations on innovative payment models with any of the payers?

Trevor Fetter
President, Chief Executive Officer & Director

A

Well, it is a constant topic. We're probably doing more innovative payment models than other organizations of our similar size. I think this really is something that originated with Vanguard although there was a lot of it at Tenet as well, but Vanguard was pretty aggressive in setting out ACOs, building pilots, and you name it.

And together with that experience that we gained in our local markets, plus the positive experience we'd have in Tenet, plus the historic position we had in California where sort of the original value based care models in capitated arrangements 20 plus years ago, plus the skills we have within Conifer value based care, which I can't under emphasize or overemphasize, where we've got 5.4 million lives in value-based care arrangements already.

We've got a lot of expertise, a lot of experience some positive, some negative, you learn from both, and I think, we're very well positioned for these kinds of arrangements with payers. It's very market specific, so we are not trying to drive the whole country in that direction, but where it make sense for us, where we can gain competitive advantage, we do it.

Gary Lieberman
Wells Fargo Securities LLC

Q

Great. Thanks a lot.

Operator: And we'll go next to Matt Borsch with Goldman Sachs.

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Yes, hi. Good morning. I wanted to just ask, if you could comment on your perspective on the mergers and consolidations that are occurring or are proposed in the managed care industry. How you think those may affect the landscape for you, and any other comments you can provide on your perspective?

Trevor Fetter
President, Chief Executive Officer & Director

A

Matt, I hate to say this, but that was the just the question that was asked by Gary and the answer that I just gave.

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Oh, I'm sorry and I missed that, I apologize.

Trevor Fetter
President, Chief Executive Officer & Director

A

I know it's a very busy...

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Yeah.

Trevor Fetter
President, Chief Executive Officer & Director

A

Well, I know, it's a very busy morning and there are many calls taking place all at the same time. So you're completely forgiven...

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Sure.

Trevor Fetter
President, Chief Executive Officer & Director

A

...for doing that, but that the short story is – we are sort of uniquely well-positioned to deal...

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Okay.

Trevor Fetter
President, Chief Executive Officer & Director

A

...with that consolidation.

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Got it. Got it. Okay, I'll catch up on that. And can you comment on maybe this one too, but can you comment on pricing, well you did pretty well relative to our model, and I'm wondering, what if you can spike out some additional factors that might have contributed to that?

Trevor Fetter
President, Chief Executive Officer & Director

A

That has not yet been asked or answered, so I'm going to ask Dan Cancelmi to cover that.

Daniel J. Cancelmi
Chief Financial Officer

A

Hey, Matt, how are you. Good morning.

Matthew Richard Borsch
Goldman Sachs & Co.

Q

Good.

Daniel J. Cancelmi
Chief Financial Officer

A

Couple of the things, certainly the – our mix of business was a contributing factor. Our – we continue to realize favorable pricing increases in contract negotiations, so that's obviously a factor as well.

Acuity was up in the quarter and we also – there is an element of that 4.5% growth that relates to the fact that we had $45 million of California Provider Fee revenues this quarter. We did not have any in the second quarter last year. That $45 million was in our guidance, but there was no revenues in the last year's second quarter. The program had not been approved at that point in time. So that had a little over 1% impact on the metric, but it's still about 3.3%.

Matthew Richard Borsch
Goldman Sachs & Co.
Q

And maybe if I just on a different question on volumes, within your surgery volumes, any specialties you can spike out that you're noticing up or down at this point in the year versus last year?

Trevor Fetter
President, Chief Executive Officer & Director
A

Actually, since we now have the Ambulatory segment and surgeries taking place in the hospital and both results were very good, I'd like to start with Britt Reynolds speak about surgical trends in the inpatient setting and then Bill Wilcox...

Matthew Richard Borsch
Goldman Sachs & Co.
Q

Sure.

Trevor Fetter
President, Chief Executive Officer & Director
A

...on the outpatient setting.

Britt T. Reynolds
President-Hospital Operations
A

Thank you Matt. Very good quarter for us on the inpatient surgery side with a percent surgery – inpatient surgery growth, so we're really pleased on the service line of focus and execution. Specifically, we saw a good growth in ortho, joint and spine arenas. Also, as Dan alluded to earlier, high acuity, high CMI, good quality of patient volumes. We also saw neurosurgical, bariatrics, oncological surgery, cardiac surgery and trauma. So we saw – I mean just the tail I think of this quarter from a inpatient utilization standpoint was a really nice year-over-year trend in inpatient surgery and a nice sequential building from Q1 to Q2 on inpatient high acuity, just to be succinct.

William H. Wilcox
Chief Executive Officer & Director, United Surgical Partners International, Inc.
A

And this is Bill Wilcox, added from our perspective, we did have a very solid quarter and the answer is very similar to what Britt just gave and probably know that over half of our business is musculoskeletal and that was the part that grew nicely. Also with Aspen, we had a very strong outpatient surgical case growth over the UK. So it was a welcomed robust quarter for us all the way around.

Matthew Richard Borsch
Goldman Sachs & Co.
Q

All right. Thank you.

Operator: And we'll take our next question from Kevin Fischbeck with Bank of America Merrill Lynch.

Kevin Mark Fischbeck
Bank of America Merrill Lynch
Q

Okay. Thanks. A couple, hopefully quick questions. So, the $1 billion of net proceeds from deals, is that from the balance sheet as it is today or are there already deals in that calculation?

Daniel J. Cancelmi
Chief Financial Officer
A

Kevin, This is Dan. Good morning. The $1 billion relates to the transactions. We outlined them in our press release as well as in the slide. And it's the sale of our Atlanta Hospitals, North Carolina facilities at St. Louis University and it's net of the investments we'll make in the Tucson joint venture with Dignity and Ascension, as well as Baptist, Birmingham as well as [indiscernible] (51:15) that we previously talked about.

William H. Wilcox
Chief Executive Officer & Director, United Surgical Partners International, Inc.
A

Yeah. It's a harsh way to keep track of the timing so none of these have really closed yet. It is more incremental.

Kevin Mark Fischbeck
Bank of America Merrill Lynch
Q

Okay. All right. So that's all incremental, okay.

William H. Wilcox
Chief Executive Officer & Director, United Surgical Partners International, Inc.
A

That's correct.

Kevin Mark Fischbeck
Bank of America Merrill Lynch
Q

And then, when we think about that your, I know you're not commenting on 2016, but you made the point about 2015 pro forma and what it doesn't include, it doesn't include the Tucson investments and it doesn't include Birmingham growth or USPI growth. I guess, it also doesn't include obviously the HPG savings, are there any other kind of the big moving pieces that we should think about that you pro forma something into the base 2015, but aren't included when we think about 2016 and the growth from there?

Daniel J. Cancelmi
Chief Financial Officer
A

And Kevin, this is Dan. Let me, just clarify just a couple of things. The pro forma 2015 does include Tucson, but it doesn't include the growth that we're going to generate down the road, and same thing holds true with Birmingham. Those are the baseline. What we included in this pro forma view was baseline 2015 results for those facilities. And so, as I mentioned, it doesn't necessarily fairly include the upside in the future from those facilities as well as, as I've mentioned Aspen and USPI down the road.

Kevin Mark Fischbeck
Bank of America Merrill Lynch
Q

Okay. And then, I guess HPG, no other big moving parts.

Daniel J. Cancelmi
Chief Financial Officer

A

That's right. HPG as I mentioned in my remarks that new relationship will go into effect in the first quarter of the next year and we'll certainly be providing more insight down the road on that.

Kevin Mark Fischbeck
Bank of America Merrill Lynch

Q

Okay. Real quick, are you getting an equity ownership in that as part of the deal?

Daniel J. Cancelmi
Chief Financial Officer

A

Yes.

Kevin Mark Fischbeck
Bank of America Merrill Lynch

Q

HPG?

Daniel J. Cancelmi
Chief Financial Officer

A

Yes.

Kevin Mark Fischbeck
Bank of America Merrill Lynch

Q

Okay. Great. Thanks.

Operator: And we'll go next to Sara James with Wedbush Securities.

Sarah James
Wedbush Securities, Inc.

Q

Thank you. I appreciate all the color on the net cash proceeds, the potential uses. So, are you still thinking debt leverage in the 5%s range that you've talked about in the past it's been your goal. And we were estimating – even if you did go ahead and pay down the full $750 million of high interest rate debt, you'll kind of be at the high end or just above that. So, how should we think about your appetite go forward given your current leverage for acquisitions versus JVs?

Daniel J. Cancelmi
Chief Financial Officer

A

Good morning, Sarah. This is Dan. Certainly, we have been driving down our leverage subsequent to the Vanguard acquisition. And as we've mentioned, when we announced the USPI and Aspen transaction, it was essentially neutral, a 0.1 impact on the leverage ratio.

So, in terms of where we're at now, it's roughly – it's a 5.7%. We're going to continue to drive that down through improved performance as we grow our business. And when we think about down the road in terms of a specific target, we certainly want to get it lower than where it's right at now, but we'll certainly be evaluating the opportunities and how we invest capital, but certainly the goal is to reduce that.

Sarah James
Wedbush Securities, Inc.

Q

And last question here is, I'm just trying to get an idea of the scale of the cross-selling opportunity and I apologize if this is a little basic. But as we think about the opportunity of signing up some of USPIs not for profit partners with Conifer, what is the range of potential revenue per partner or if maybe that range is too wide, how can we think about the opportunity as a group across all 50 partners?

Trevor Fetter
President, Chief Executive Officer & Director

A

So, we're running out of time, I'm just going to have Steve Mooney to – our CEO of Conifer, could you just comment briefly on how the channel works? We're not going to give any specific estimates about what it could be worth?

Stephen M. Mooney
President & Chief Executive Officer, Conifer Health Solutions LLC

A

You know, so the channel is obviously very important to us. I mean, we are doing a lot of work for not for profits out there currently today. USPI with their 50 plus relationships, clearly opens up the door. Most of our services we offer today whether it's around the revenue side of our hospitals, [indiscernible] (55:44) care work, is really based on kind of high levels of strategic work of the hospitals and trust with the organizations, and clearly USPI has built high levels of trust with the organizations they work with. So we are going to obviously leverage those as much as we possibly can and have those conservations open those doors.

But exactly where that will lead, we don't know at this point. We need obviously just opening up the conservations now. We think over the course of the next obviously several quarters we'll have a better perspective on kind of how these things are going. Some of them currently today, we cross actually work on right now. USPI's relationships with some organizations that we also do work with as well, [indiscernible] (56:19) how we leverage basically even greater than we are today. It was in organization for both sides, and also how can we also bring in some of the work the USPI is doing in some relationships that we have at Conifer as well. So, just thinking about that from a customer base as well as the enterprise of Tenet, and how they look at their relationships from a JV perspective and working all sources of USPI, Conifer and the Tenet hospital organizations.

Operator: And that does conclude our question-and-answer session. Gentlemen, I'll turn the call back to you for any additional or closing remarks.

Trevor Fetter
President, Chief Executive Officer & Director

Well, we know there is another call beginning within a couple of minutes, so we'll let everybody go. We look forward to seeing you over the course of the next few months at conferences or other events and then we'll have our earnings call in November. Thanks.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. Thank you for your participating. You may now disconnect.