



Top Picks

THC (THC) Unsecureds

We rate THC's unsecured bonds Buy. We believe existing yield on the unsecureds compensate investors for the risks in the story. At an offer price of 96, the 6.75% unsecured bonds of 2023 trade at a YTW of 7.66%. Given these bonds are non-callable, if THC refinanced this tranche 1.5 years prior to maturity the yield-to-most-likely (YTML) would be 9.21%. We believe if THC sold Conifer that it could be deleveraging (0.25x-0.5x based on our math using a range of assumptions around run rate EBITDA less MI in the hands of another owner, TEV/EBITDA multiple, taxes associated with a hypothetical sale, NOL usage, etc.). We would expect proceeds would largely go to reduce leverage and that any dividend in connection with such a deal would not be significantly leveraging. That said, we acknowledge even a \$250-\$500 mm dividend would be large relative to the size of THC's existing market cap (but only a 0.1x-0.2x impact to leverage). And we believe covenants would allow this.

We believe there are also other ways THC could boost its share price that would also benefit the credit profile. We believe if THC undertook more significant asset sales that could yield 1x or so of deleveraging (which hypothetically would take our 2018 net leverage estimate from 5.9x to 4.9x before the sale of Conifer), the equity multiple could potentially improve given it would be a less leveraged company. And we would expect bonds to respond favorably to the lower leverage. And although possible, we believe the spin/sale of USPI such that it left the residual hospital box significantly more leveraged is a low probability.

We broadly believe THC has a solid hospital footprint with strong local market share. And despite volume and mix pressures felt by many in the hospital space over recent quarters, we prefer THC's position as an urban hospital operator relative to the rural model despite the potential for additional competitive pressure from recent hospital and non-hospital combinations in the marketplace. We further believe USPI helps diversify the company away from hospital and Medicare revenue, and into a higher growth businesses. Although it does have remaining amounts to pay WCAS for its USPI stake (approximately \$550-650 mm over the 2018-2019 time frame), we believe THC can use asset sale proceeds to satisfy a large portion of this.

The risks to our Buy rating on the 1st lien bonds and unsecured bonds come from several areas. Bonds could underperform if THC misses operationally, if it does not consummate incremental asset sales, and/or if it undertook a transaction that shifted value from bondholders to equity holders. Upside risks to our Hold rating on the 2nd lien include significant operational outperformance.