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Community Health Systems is ailing

by Ernest SIM

In the wake of President-elect Donald Trump's victory in the recent US elections, the Affordable Care Act (ACA), widely known as ObamaCare, has come under the spotlight. Trump's campaign centered on the repealment and replacement of the ACA. With his victory, an impact on publicly-listed hospital firms seems imminent, given that these hospital chains benefited from higher earnings because of the mandatory insurance act. Already, Trump has displayed determination in tackling the ACA as he prepares to set foot into the Oval Office.

The RMI-CRI 1-year Probability of Default (PD) for four out of five of the publicly-listed hospital chains in the US exhibits a general upward trend during the past 14 months (see Figure 1). In particular, the PD for Community Health Systems Inc. (CHS), the second-largest publicly traded hospital chain, rose significantly during the last month. Tenet Healthcare Corp., the third-largest publicly traded hospital chain, also displays a relatively high PD across the same period amongst hospital firms, albeit at a much lower PD level when compared to CHS.

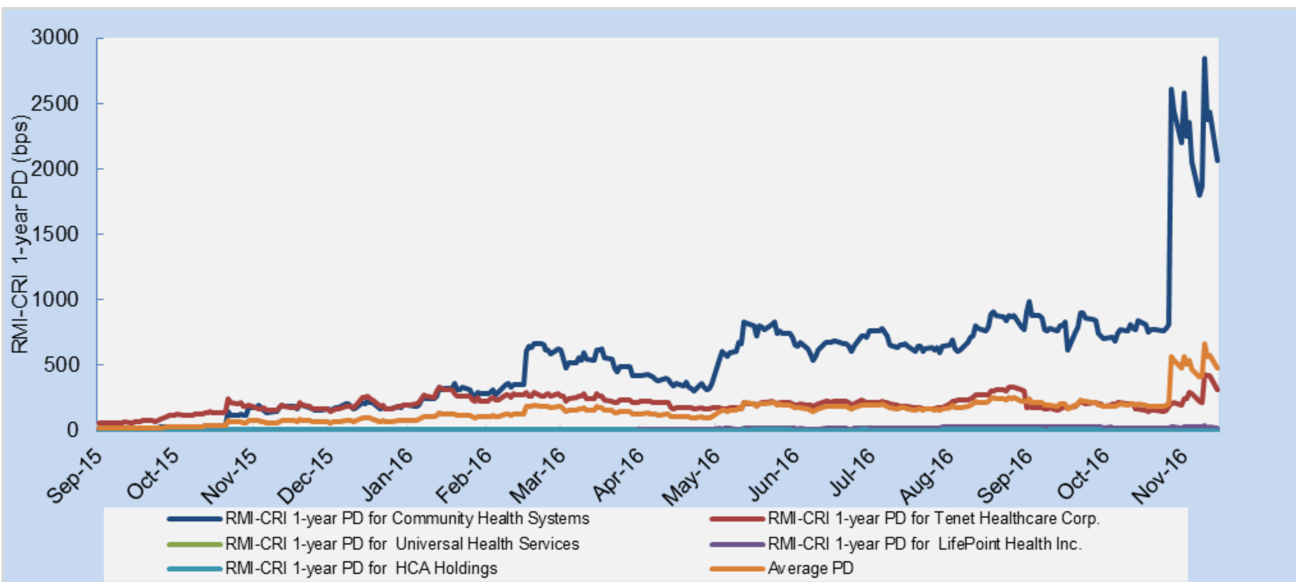

Figure 1: RMI-CRI 1-year PD for hospital management companies. *Source: RMI-CRI*

Recent quarters saw CHS' financial results revealing signs of a weakening credit profile. CHS's debt has shot up, with total debt to equity skyrocketing from 348.54x in Q3 2015 to 617.82x in Q3 2016 and total debt to trailing 12 month EBITDA rising from 5.96x in Q3 2015 to 44.03x in Q3 2016 (See Table 1). Furthermore, the cash ratio and current ratio dipped from a year ago while the quick ratio fell quarter-on-quarter from 1.33x in Q2 2016 to 1.23x in Q3 2016 (See Table 1).

Unlike CHS, Tenet Healthcare has lower leverage and higher liquidity than CHS (see Table 1). Tenet Healthcare's total debt to equity ratio has decreased from 546.44x in Q3 2015 to 417.83x in Q3 2016 while total debt to trailing 12 months EBITDA had decreased from 7.74x in Q3 2015 to 6.90x in Q3 2016 (See Table 1).

Besides the growing pile of debt, CHS has had to contend with downward spiraling profits. While shrinking same hospital admissions resulted in CHS's earnings being adversely impacted (see left panel of figure 2), hospitals under Health Management Associates (HMA) Inc., a hospital chain that was acquired by CHS, continue to experience lower revenue growth as compared to other CHS hospitals, contributing to the drag on overall topline growth. Consequently, CHS's profit has been plummeting with the hospital chain reporting a fall in adjusted net income margin from 0.21% in Q2 2016 to -0.87% in Q3 2016.

In contrast, Tenet Healthcare's bottom line has outperformed CHS in recent quarters. Tenet Healthcare's Q3 2016 adjusted net income margin and operating margin, which were lower than figures reported by CHS in Q3 2015, is higher than CHS. In addition, Tenet Healthcare's adjusted net income margin for Q3 2016, despite decreasing from the previous quarter, at 0.32%, registers a profit; CHS reported a loss at -0.87% for Q3 2016 (See Table 1).

Quarter	Community Health Systems Inc.					Tenet Healthcare Corp.				
	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016
Adjusted net income margin (%)	1.39	-0.60	0.57	0.21	-0.87	1.04	-0.83	-0.41	0.75	0.32
Operating margin (%)	7.24	3.04	5.88	-29.96	3.33	6.12	6.27	6.88	5.48	6.87
Total debt to trailing 12 months EBITDA (X)	4.96	6.79	7.02	26.67	44.03	7.74	7.83	7.58	7.12	6.9
Total debt to equity (X)	348.5	364.7	361.2	602.9	617.8	546.4	450.1	439.1	423.1	417.8
Current ratio (X)	1.76	1.68	1.72	1.77	1.69	1.54	1.20	1.20	1.13	1.13
Quick ratio (X)	1.23	1.24	1.28	1.33	1.23	0.73	0.71	0.83	0.77	0.76

Table 1: Financial data for Community Health Systems Inc. and Tenet Healthcare Corp. *Source: Bloomberg*

While both CHS and Tenet Healthcare experienced a dive in market capitalization, CHS had a more drastic plunge – a fall from a market cap of USD 6bn in September 1, 2015 to just above USD 0.6bn in November 14, 2016, a 90% decrease in market cap (see right panel of Figure 2). In comparison, Tenet Healthcare's market cap tumbled from USD 4.7bn to USD 1.6bn, a 65% decline.

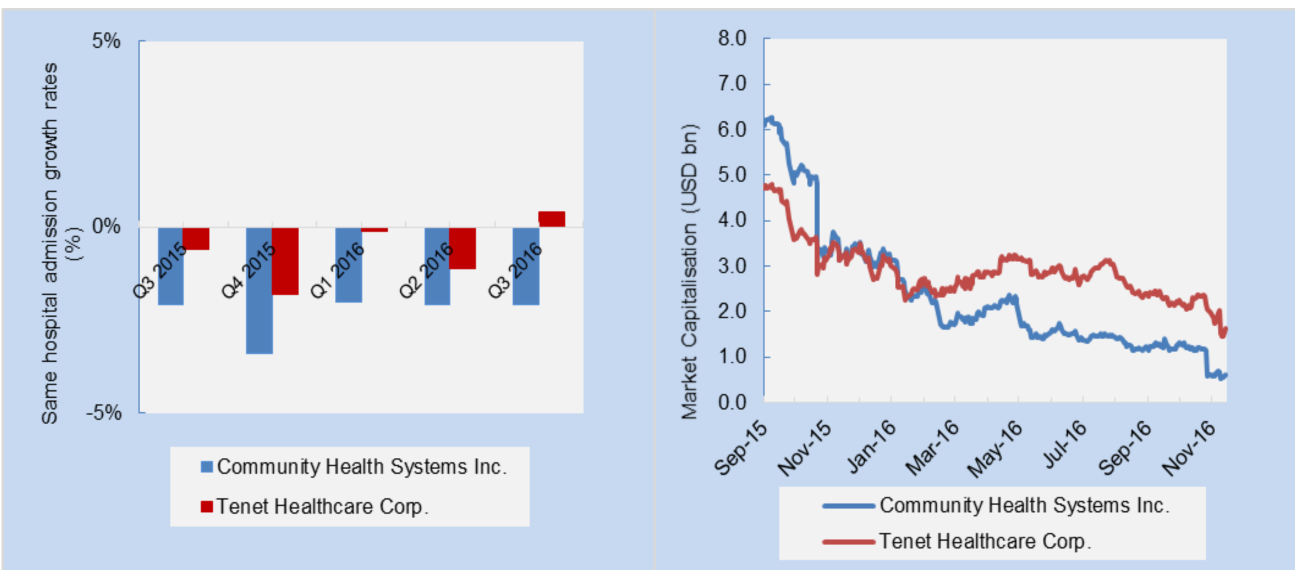

Figure 2: Same hospital admission growth rate (in %) (left panel) and market capitalization of Community Health Systems Inc. and Tenet Healthcare Corp. *Source: Bloomberg*

In light of the deterioration of its financial health, CHS has tried to address various segments, raising EBITDA margins and improving its financial standing. On August 2015, CHS proposed the spin-off of 38 hospitals and its subsidiary Quorum Health Resources, establishing a separate entity, known as Quorum Health, targeted towards rural cities with CHS maintaining its focus on markets with heavier population. However, over the past few months, CHS has turned towards heavy divestment as an urgent measure to pare back on debt. CHS has sold four of its rural hospitals, a majority interest in its Home Health Division and has sold Rockwood Health System for USD 435mn with proceeds from the sale of these assets used to fund debt.

Looking ahead, gauging by the relatively weaker credit profile of CHS, repealment or replacement of the ACA could deal a heavy blow to the debilitated CHS. Still, while CHS seems to be in worse shape as compared to Tenet Healthcare, both CHS and Tenet healthcare's future margins as well as the US healthcare industry depends on the outcome of the ACA. Although the full brunt of the impact on publicly-listed hospital chains and the wider healthcare industry will take time to unfold, the financial markets have already reacted negatively, with hospital and insurance firms' stock prices plunging due to the uncertainty of the ACA under the Trump's administration.

Credit News

Lackluster US earnings drag down global dividends

Nov 21. Global dividend payouts have fallen sharply as subdued earnings add to concerns over the election of Donald Trump, Brexit, and China's economy. The plunge in the third quarter is the weakest performance in more than a year. Underlying dividend growth, which excludes special dividends, has also been slowing as profits have disappointed. Since the US is the largest contributor to dividends, it dragged down the global dividend payouts. (FT)

UK's Hammond says budget options constrained by high debt

Nov 20. Britain's first budget plan since the Brexit vote will not include a big new spending push because of high public debt level. However, it will still provide some support for the economy and struggling families. Britain's economy has so far defied the expectation of an immediate recession after the Brexit vote, hence reducing the urgency of a major fiscal stimulus. However, most economists expect a sharp slowdown in 2017, pushing up unemployment when inflation is likely to rise. Earlier on Sunday, the Treasury announced GBP 1.3bn in new spending on roads as part of the plans to increase Britain's weak productivity growth. (Reuters)

MAS introduces Asian Bond Grant to help raise international capital

Nov 17. The MAS announced on Nov 17 that it will be introducing an Asian Bond Grant next year to make it more attractive for Asian issuers to raise international capital in Singapore. Qualified issuers for the grant will be able to offset up to 50% one-time issuance costs, such as international legal fees, arranger fees and credit rating fees. An MAS official stated that this initiative aims to strengthen Asia's bond markets, and to allow issuers in the region to raise the needed long-term capital for sustainable growth to fully reap the fruits of favorable macro trends. In addition, MAS is considering ways to nurture a healthy and sustainable credit rating culture in Singapore's bond market. (Channel NewsAsia)

Asia's hedge funds suffer highest withdrawals in 4 years in October

Nov 16. The global hedge fund industry has faced an investor backlash this year amid underperforming returns and high fees. Asia's hedge funds had the highest investor withdrawals in October in more than four years as the industry is struggling with disappointing returns. Hedge funds investing in Asia ex. Japan witnessed a net outflow of USD 2.1bn, or 1.3% of total assets, compared with 0.7% in Europe and 0.2% in North America. Investors allocating to Asia are the most cautious because the hedge fund industry in the region is relatively young and funds investing in Chinese equity market this year have suffered heavy losses. (Straits Times)

Trouble brewing in commercial real estate

Nov 15. Defaults are increasing in a key corner of the commercial real estate debt market just as borrowing costs are set to jump, raising the possibility of a slowdown of the USD 11tn US commercial property sector in 2017. As a matter of fact, the financial crisis-era regulation makes some commercial real-estate borrowing more expensive and complicated. The interest rates have increased since the election of Donald Trump and seem to sustain the rising trend from recent historic lows. The worries raised fresh concerns for the commercial property market as it enters its eighth year of expansion. (WSJ)

Insurer AIG in mortgage lending push (FT)

Bis Industries debt tipped to trade (AFR)

Revenue and profits tumble at Taiwan's top two carriers (JOC)

Regulatory Updates

FSB urges countries to complete banking reforms

Nov 18. The Financial Stability Board (FSB), a global body of central bankers and regulators, has urged countries to complete a contentious banking reform package, known as Basel III. The reforms were expected to be finalized by the end of the year but European banks complained that the overhaul would hit them disproportionately. Banks believe the overhaul will lead to higher capital requirements, requiring banks to do another round of capital-raising. Donald Trump's victory also raises questions as to what the US position towards financial regulation will be. (FT)

US watchdog hits out at Fed over bank stress tests

Nov 16. America's congressional watchdog has criticized the Federal Reserve over its handling of the annual bank stress tests, in a landmark report that may pave the way towards gentler treatment of banks operating in the world's largest economy. The stress tests have limited banks' distribution of capital through dividends and buybacks, while prompting them to spend billions of dollars on improving risk monitoring. Although the system is established for preventing repeating the crisis in 2008, banks complained that the Fed has given itself too much freedom to tweak the dials each year, penalizing certain activities and has steered banks toward a narrow field in which competition is high and profits are low, without efforts to justify their decisions. (FT)

Fund managers braced for tougher fee rules (FT)

Bankers predict Trump will not reshape regulatory agenda (FT)

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