The Wall Street Journal
March 4, 2011

A Windfall for HCA Investors
By GREGORY ZUCKERMAN

Bain Capital,Kohlberg Kravis Roberts & Co., Bank of America Corp. and the brother of former Senate Majority Leader William Frist are each in line to make nearly $3 billion from $1.2 billion investments in the 2006 leveraged buyout of hospital chain HCA Holdings Inc.

The gain—about 250% over five years that were trying for the economy and health-care companies—would amount to one of the largest ever from a private-equity deal.

The profits show the original attraction of $20 billion-plus "megadeals," which enjoyed a heyday during the credit boom last decade. Investing at such scale, with high leverage, can yield huge results should a company's value increase moderately, as was the case with HCA. Ironically, the windfall could grow further under President Obama's health-care overhaul, a plan that Sen. Frist's fellow Republicans have fought though Sen. Frist himself in the past supported.

The HCA deal grew from frustration of HCA executives, whose shares continued to stagnate despite healthy cash flows, share buybacks and increased dividends. HCA already had been taken private—and public—back in the late 1980s. This time, it was a more audacious undertaking, involving a half-dozen banks and the same number of equity investors. Just months before its July 2006 announcement, HCA had lowered its performance projections for the year, underscoring the dangers of the deal.

Company co-founder Thomas F. Frist Jr., older brother of Sen. Frist, contributed $950 million, including $885 million existing HCA shares and $65 million of additional cash. He received a nearly 19% stake in the newly private company. About 1,400 HCA executives also received equity. Sen. Frist, who was Republican majority leader at the time, didn't play a role.

Leveraged Profits: The HCA Story

Private-equity investors put in $4.9 billion to fund the $33 billion purchase of the country's largest hospital operator, HCA Holdings. When the company goes public next week, they will have earned cash and paper gains of about $12 billion. How did they do it?

HCA
Hospital Corporation of America℠

Fall 2006	2007-2010	2010	March 2011
Tapped credit markets at their boom-time best. Put down just over 15% of the $33 billion. Borrowed the rest.	Cut costs and improved cash flow from 5% annual growth to 7%.	Used improving cash flows to issue more than $4 billion of dividends to the owners while any future gains are nearly all profit. Obama health plan improves prospects, as it stands to reduce costs for uninsured patients.	Plans to take HCA public, selling 18% of shares to new shareholders.

Both Bain and KKR each agreed to kick in nearly $1.2 billion for nearly 25% of the company, as did the private-equity unit of Merrill Lynch, now a part of Bank of America Corp. Citigroup Inc. and another unit of Bank of America bought smaller pieces of the buyout, which at the time was the largest in history. (New Dodd-Frank law rules curtail banks from making such investments now.)

Some dismissed the purchase, which awarded HCA shareholders a 30% premium, as overpriced. The economy soon slumped, representing another obstacle.

But the deal shows how powerful leverage can be when it works in your favor. The investors ended up putting in about $4.9 billion, with $28 billion of debt financing from banks and bond investors. Just as an individual purchasing a home with a 15% down payment can profit with even a small rise in the home's value, the investors were in line to score if they could boost the company's value even a bit.

Private-equity firms are hesitant to speak to the importance of leverage in their deals, preferring to focus on ways they improve businesses. There was some of that at HCA. It reduced purchasing at its 164 hospitals, and is doing a better job integrating back-office and other operations. HCA's earnings before interest, taxes and amortization have climbed about 35% since going private, or an annual growth of about 7% a year, up from 5% growth before the buyout.

But with so much leverage in place, the profits began to pile up. Over the past year, HCA's owners paid themselves about $4.3 billion in dividends, nearly the entire amount of the original investment.

The deal shows how powerful leverage can be. Above, the Spotsylvania Regional Medical Center in Fredericksburg, Va., part of HCA.

Public investors also grew more optimistic about hospital shares, anticipating that the Obama health plan will keep a lid on hospitals' costs for uninsured patients. That helped set the stage for the initial public offering, expected next week.

Bain and KKR will divest some of their stakes via the IPO, which will sell off about 18% of company shares to the public. The firms each should pocket roughly $445 million in the sale, on top of the roughly $1 billion each earned in dividends. Their remaining shares—at the IPO "midpoint" price—should carry a value of about $2.5 billion.

All told, the firms are each in line to score total paper and actual profits of about $3 billion from their original $1.2 billion investments.

The Frist family, meanwhile, could sell about $40 million of shares in the IPO, and will be left with a stake valued at about $2.3 billion. The family already received a dividend check of about $800 million.

The investors still have to sell their remaining shares, making the ultimate return on their investment contingent on the performance of HCA after the slated IPO. The company still is dealing with $26 billion of debt. But health-care overhaul, assuming it goes forward as currently envisioned, eventually could be a boost.

Lower Medicare reimbursements, due to the overhaul plan, have crimped earnings lately. By 2014, more Americans will have access to insurance, so the percentage of HCA's revenue coming from uninsured patients who may never pay their bills—currently about 13%—likely will drop, boosting the company's bottom line.