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Tenet Limps Toward Another Round of Cuts

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Tenet (THC Quote - Cramer on THC - Stock Picks) could soon undergo a major amputation.

The ailing hospital chain may cut its hospital base by nearly one-third in an effort to save itself. *Modern Healthcare*, a trade publication that raised the possibility on Monday, said Tenet could announce the asset sales -- in three core markets -- as early as next month.

If the rumors prove true, Tenet will emerge from the operation 40% smaller than it was just over a year ago. The company has already shed 14 hospitals since it came under attack for aggressive business practices that inflated profits in the past. The next round of asset sales is expected to include twice as many hospitals in Tenet strongholds such as California, Florida and Texas.

At least one bond analyst instantly smelled desperation.

"I think it would just confirm that their cash flow is rapidly deteriorating," said Argus analyst Bill Eddleman, who recommends selling Tenet bonds. "They'll get a lump sum of cash, but then the cash flow off those hospitals is gone. ... The chances of a bankruptcy for this company further increase the more hospitals they sell off."

The market took a dim view of the news as well. Tenet's stock -- which set a 52-week high after an analyst upgrade last week -- fell for the fourth straight session, tumbling 2.6% to $16.56 on Tuesday.

Nevertheless, some analysts chose to look on the bright side. Robert Mains of Advest says he sees "more good than bad" in Tenet's rumored plans. And even Prudential's David Shove, who's been bearish on Tenet for months, pointed to asset sales as a possible cure for the company.

After Tenet announced a new probe of its facilities in El Paso last week, Shove suggested that the company might simply exit regions -- particularly in Texas and California -- where it has come under particularly heavy fire.

"This action would be the proverbial 'two birds with one stone' -- knock out legal risk and purge underperforming assets," Shove wrote.

But Jeff Villwock, a managing partner at Caymus, sees no easy solution for Tenet's problems.

"When they sell the asset, they have to keep the liability," he pointed out. "The liability side doesn't change. ... They're going to be required to pay back the government."

Villwock calculates that Tenet owes nearly $2 billion -- at least -- to the federal government alone. The company also faces a number of patient lawsuits that could cost it $1 billion or more.

And raising cash, even through asset sales, may not be easy. Villwock points out that Tenet owns a number of underperforming hospitals -- in markets like California, Texas and Philadelphia -- that nobody may want. Tenet's California hospitals are struggling to pay higher labor costs without help from the outlier payments that made them profitable in the past. Meanwhile, the Texas facilities are treating a huge number of uninsured patients who are worsening the company's bad debt load. And the Philadelphia facilities -- including one that Tenet is fighting to close -- have been a drain on the company for years.

"If they're selling junk, who's going to buy all these things? Villwock asked. "And if they do [find a buyer], how much can they get? ... The answers are, 'I don't know,' and 'Not much.'"

Of course, Tenet could choose to sell its attractive assets. But Villwock says the company would essentially be selling its future in the process. Like Eddleman, Villwock believes that Tenet is starting to behave like a company that's in dire straights.

"This is a movement by a management team that knows they're running out of cash," he said simply.

Goldman Sachs analyst Andrew Bhak also smelled trouble. He said the asset sales, if carried out, signal one of two things -- neither of them necessarily good. Either the company is reversing its prior growth strategy, he wrote, or it is scrambling to prepare for ongoing financial challenges. And he, too, believes that Tenet may struggle to find buyers for its underperforming assets.

If Tenet does succeed -- and manages to shed 30 of its hospitals -- it would lose its ranking as the second-largest for-profit hospital chain in the country. **Community Health Systems** (CYH Quote - Cramer on CYH - Stock Picks), which currently ranks as No. 3, would move behind front-runner **HCA** (HCA Quote - Cramer on HCA - Stock Picks).

Lehman Brothers analyst Adam Feinstein believes that Tenet is simply "repositioning itself as a more focused company." Feinstein, who triggered last week's rally by upping Tenet to neutral, has predicted that Tenet will start to recover later this year and post earnings of up to $1.30 -- more than double current estimates -- in 2005.

Still, even Feinstein warns of serious risks at the company. He believes there is an "above-average" chance that government probes will grow even wider than some people expect. And he doubts that resolution of those probes -- likely necessary for a rebound in Tenet's stock -- will come any time soon.

He also hints that he may be wrong about Tenet's earnings power in the meantime.

"We believe earnings are likely not going to move much lower," he wrote. "However, this is the third time we have made this statement in recent months, suggesting that it is difficult to have high visibility."

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