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Cain's Prescription for Growth

The boutique bond adviser has established a group that will work with nonprofit health care providers on sales and other transactions

By Kelly Holman

Cain Brothers, which has a long history of underwriting bond offerings for hospitals and long-term-care providers, is expanding its coverage of nonprofit health care systems.

In part, the New York investment banking boutique is responding to reform efforts that are driving up costs across the medical services industry. It is also banking on the clout it has built with health care executives for close to 30 years to give it an edge in what is expected to be a fertile market for mergers and acquisitions.

The specialist firm has formed a tax-exempt M&A group led by managing director and senior banker Carsten Beith, who will hire bankers to help the firm win mandates from nonprofits that are considering strategic alternatives such as divestitures, leveraged buyouts and mergers.

"There are a lot of hospital and senior living systems that are overleveraged," said **Robert Fraiman**, chief executive of Cain Brothers, which has 60 investment professionals in nine U.S. offices.

Figures from **Moody's Investors Service** back up that assertion. According to the agency, 498 rated nonprofit hospitals are carrying \$160 billion of debt, versus 17 rated for-profit hospitals carrying \$54 billion.

The CEO also said Cain Brothers would like to expand its five groups — asset management, corporate finance, tax-exempt capital markets, tax-exempt M&A and real estate — by hiring 10 investment banking professionals this year.



Rhett Thurman, COO and CFO; Robert Fraiman, CEO; Andrew Garvey, head of capital markets at Cain Brothers

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In March, it counseled Massachusetts' 10th-largest employer, **Caritas Christi Health Care**, a Catholic hospital system with 13,000 employees, on its \$830 million acquisition by the New York buyout group **Cerberus Capital Management LP**. This was the financial sponsor firm's first hospital purchase.

"I think the Caritas-Cerberus transaction is a real game changer in the hospital industry and illustrates the cross-over between private equity" and the not-for-profit health care industry, said Fraiman, who led his firm's efforts on that transaction. "I believe that you'll see other transactions like it and private-equity firms that will look at it and say, 'Wow, that's something we would be interested in doing.'"

The investment bank's corporate finance unit already advises a wide range of for-profit health care companies, including outsourcing, information technology and outpatient surgery centers, on strategic alternatives, restructuring, fairness opinions and valuation-related assignments. These businesses, often middle-market companies, are attracting plenty of interest from financial sponsors, just like the nonprofit segment, according to Fraiman, a 25-year M&A veteran who was part of **Bear Stearns'** health care investment banking group when it was established in 1986.

"We're seeing a real resurgence in interest among middle-market private-equity firms investing in deals in the \$50 million to \$250 million range," he said.

That's why the investment bank hired **Wyatt Ritchie**, head of health care banking at **Jefferies & Co.**, last month to bolster its private-equity sponsor coverage. Ritchie was named a managing director in the firm's San Francisco office. He and fellow managing director **Court Houseworth** will cover buyout groups and managed care businesses.

Cain Brothers is not a newcomer to nonprofit health care M&A. In April 2008, it advised **BlueCross BlueShield of Tennessee** and **Regence Group** on the \$1.4 billion LBO of Newport Beach, Calif.'s **TriZetto Group Inc.** by a group led by the New York buyout group **Apax Partners**. BlueCross BlueShield of Tennessee and Regence were equity investors in the transaction, which took TriZetto private.

"That was an incredibly unique transaction in that two not-for-profit Blue Cross Blue Shield plans invested in a going-private leveraged buyout alongside a private-equity firm," Fraiman said. "I can say with confidence that if it wasn't for the Blues teaming up with Apax, I don't think that deal would've happened."

He also says there are plenty of opportunities for the new M&A group, since roughly 80% of the country's 5,000 hospitals fall into the tax-exempt category.

Fraiman succeeded **Jim Cain**, a co-founder of Cain Brothers, as the CEO in January. (The firm announced the succession plan in October 2009.) Before becoming the CEO, Fraiman ran his firm's corporate finance group, which includes 19 dealmakers. Before joining Cain Brothers in 2004, he was head of health care investment banking at **BMO Capital Markets**.

Thurman sees reform efforts fueling "a substantial uptick in transaction volume," especially in the hospital sector.

Jim Cain, who will remain on his firm's executive committee and will contact executives about additional transactions, said Fraiman was brought aboard and named CEO to generate deals like the Cerberus one. "Rob helped build out a part of the business that focuses on the for-profit side [of health care], including private equity and venture capital firms."

Rhett Thurman, chief financial officer and chief operating officer of Cain Brothers, said many health care providers that were already grappling with capital constraints are now dealing with health care reform and other partially funded federal mandates, such as a requirement to invest in electronic health record systems.

As a result, he anticipates more transactions such as conversions of not-for-profit health systems into for-profit providers.

"I would expect to see a substantial uptick in transaction volume in health care overall, and in particular in the hospital services sector. While the pros and cons of for-profit medicine can be debated, access to capital and management resources often work to the advantage of investor-owned chains and are the catalyst for these deals," Thurman said.

Fraiman also expects higher costs — in everything from construction projects to acquiring the latest equipment —

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to raise the pressure on nonprofit hospitals to make deals.

“You may have a hospital system that owns ancillary businesses such as home health agencies, clinical labs or medical office buildings and decides that maybe they should divest them, because then they can concentrate their resources on their core business of operating acute care hospitals,” he said.

Last week, Cain Brothers, **Morgan Stanley** and **JPMorgan Chase** underwrote \$1 billion of 2010 bonds for the **Sisters of Charity of Leavenworth Health System** in Lenexa, Kan., which operates 11 hospitals in Kansas, Montana, Colorado and California. The hospital system used proceeds from the debt issuance, which commanded a AA-minus rating from Fitch, to refinance debt.

“The need for capital is high, particularly in the hospital and senior living space, and there is a real strain on the smaller and mid-sized participants in the market, who have a more limited access to the capital markets,” said **Andrew Garvey**, who heads the tax-exempt capital markets group at Cain Brothers.

Tax-exempt capital markets work has long been the bread-and-butter business at the boutique.

Garvey’s group typically underwrites fixed and floating-rate bond offerings ranging from \$30 million to \$250 million. From 2000 to 2009, it managed more than \$6.2 billion of tax-exempt finance offerings and acted as an agent on \$1.4 billion of variable-rate securities issuances. It employs 26 professionals, or nearly half the bankers at the firm.

Last year, the group underwrote \$333 million of bond issuances for nonprofit clients, including a \$70.5 million issuance for **South Dakota Health and Educational Facilities** and a \$28.8 million offering for the **Dormitory Authority of the State of New York**; in 2008, the firm underwrote \$825 million of bond deals, compared with \$1.1 billion in 2007.

In 2009, the capital markets group undertook one of its more complex transactions on behalf of the Austin senior assisted living facility **Westminster Manor**.

Cain Brothers arranged \$23.4 million of short-term bank qualified bonds, a \$10.6 million taxable bank construction loan supplied by **Frost National Bank** and \$64.6 million of long-term tax-exempt fixed-rate bonds. Westminster Manor used proceeds from the deal to finance a \$100 million project to build apartments and community and health care centers.

Lack of funding for tax-exempt medical centers and assisted living facilities has created a void that the investment

bank can fill, said Garvey, who joined the firm in 2008 from Morgan Stanley, where he headed the tax-exempt securities division.

“We think there is a role for us on larger bond issuances of \$500 million or more, often as a co-lead on deals that may already have a lead manager from one of the larger banks,” he said.

The ability to secure project financing has helped Cain Brothers secure a leading role in debt syndications for its nonprofit clients, and its history as an adviser has helped the boutique win underwriting business alongside bulge-bracket banks.

“Cain serves as an independent set of eyes and ears that can monitor the financial terms being brought forward to us by the banks,” said **Michael Rowe**, chief financial officer of the Sisters of Charity Leavenworth Health System. “They can tell us if the price is right.”

Fraiman said the relationship that produced the Caritas Christi assignment began in the summer of 2008, just months after Dr. **Ralph de la Torre**, a noted cardiac surgeon, was named Caritas Christi’s CEO.

Torre inherited a fiscally challenged hospital system and launched a turnaround that attracted its share of attention from Wall Street bankers who were eager to provide financing, Fraiman said.

He also said he and Torre were introduced through a mutual acquaintance. “They were talking to Caritas Christi about doing another bond offering. I don’t think anybody was talking to them about strategic financial alternatives.”

In its early days, the boutique was not really involved in dispensing M&A advice.

When Jim and **Dan Cain**, two former **Salomon Brothers** bankers, set up shop in 1982 in a skyscraper located on 40th Street and Park Avenue in midtown Manhattan, it wasn’t focused on M&A.

The pair teamed up with **Barbara Shattuck**, a former **Goldman Sachs** public finance banker, to launch a firm that would help hospital systems like the **Franciscan Sisters of the Poor** with debt financing, according to Jim Cain.

“Initially, the core business we had was advising hospitals and health care systems on raising capital. That was the launching pad of our business,” he said, though Cain Brothers got into the underwriting business in 1985. **IDD**

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