



UPDATE: Leonard Green-led ownership collected \$658 million in dividends and fees from Prospect Medical Holdings despite challenges, commitment to regulators to forgo dividends

Private equity firm Leonard Green & Partners owns Prospect Medical Holdings, a safety net hospital company that owns 17 hospitals in 5 states.¹

Leonard Green acquired Prospect in December 2010 in a \$363 million leveraged buyout.² At the time, Prospect was a five-hospital community health system in Southern California.³ Over the course of Leonard Green’s ownership, Prospect bought hospitals in Connecticut, New Jersey, Pennsylvania, Rhode Island, and Texas.

Since 2010, the Leonard Green-led ownership group has drawn \$658 million dollars in fees and dividends from the company even as the hospitals suffered operating challenges, substantially underfunded pensions, and regulatory scrutiny.⁴ Prospect’s hospitals currently have some of the lowest quality ratings from the Centers for Medicare and Medicaid Services—all but one have received ratings of one or two stars, the lowest quality ratings assigned by CMS.⁵ In late 2019 Prospect permanently shuttered all of the facilities in Texas, claiming it was unable to find a buyer for the hospital system.⁶

Of the \$658 million collected from Prospect, at least \$400 million appears to have gone to Leonard Green & Partners and its affiliates.⁸

Now, Leonard Green is selling its majority stake in Prospect to the company’s management for just \$10 million⁹—a fraction of what it acquired Prospect and many of its hospitals for. Four years ago, in April 2016, *The Wall Street Journal* reported that Leonard Green was exploring a sale that might have valued Prospect at as much as \$1 billion.¹⁰

FEES AND DIVIDENDS PAID TO LEONARD GREEN AND OTHER PROSPECT OWNERS

| TYPE | DATE | AMOUNT |
|-------------------------------------|-----------|----------------------|
| Annual \$1 Million Management Fee | 2011-2019 | \$9,000,000 |
| Ivy Holdings Merger Transaction Fee | 2010 | \$4,441,000 |
| Dividend | 2012 | \$88,000,000 |
| Dividend | 2013 | \$100,000,000 |
| Dividend | 2018 | \$457,000,000 |
| Total | | \$658,441,000 |

Sources: SEC filings and Prospect Medical Holdings, Inc. Consolidated Annual Financial Statements.⁷

“Prospect’s management and representatives have given assurances that this [2013 dividend] was a one-time event and that there are no plans to make a similar distribution in the foreseeable future.”

Rhode Island Attorney General decision, May 16, 2014

UPDATE: LEONARD GREEN-LED OWNERSHIP

2018 DIVIDEND CONTRADICTED COMMITMENT TO RHODE ISLAND REGULATORS

The \$457 million dividend the Leonard Green-led investment group collected in 2018 directly contradicted a commitment Prospect made to state regulators. In their consideration of Prospect's conversion of the CharterCARE hospitals in Rhode Island from non-profit to for-profit in 2014, the Rhode Island Office of the Attorney General and the State Department of Health made note of the 2012 and 2013 dividends¹¹ stating that Prospect assured the regulators that it did not intend to make additional dividend distributions. The Attorney General's decision states: "Prospect's management and representatives have given assurances that this was a one-time event and that there are no plans to make a similar distribution in the foreseeable future."¹² At the same time, the Rhode Island Department of Health noted, "PMH [Prospect Medical Holdings] has represented that there are no intentions to make additional distributions."¹³

Prospect paid out the \$457 million debt-financed dividend to its owners four years later.¹⁴

DECLINING FINANCIAL PERFORMANCE AT PROSPECT MEDICAL HOLDINGS

The Leonard Green & Partners-led ownership group collected the 2018 dividend despite declining financial performance at Prospect Medical Holdings.

Operating Challenges

Prospect has faced substantial operating challenges in recent years.

Prospect's revenue grew by more than 2.3x between 2015 and 2018, likely due to its acquisition of three hospital systems in 2016. However, the company's EBITDA for the same period declined dramatically, from \$142 million in 2015 to \$17 million in 2018—an 88% decrease. Its EBITDA margin shrank from 10.8% in 2015 to just 0.6% in 2018.¹⁵

Cash on hand declined from \$65.9 million in 2015 to just \$7.7 million as of September 30, 2018.¹⁶

Underfunded Pensions

Prospect's hospitals' pensions were substantially underfunded as of September 30, 2018 – the company faced \$260 million in unfunded retirement benefit obligations.¹⁷

Between 2016 and 2018, the funded ratio of the Prospect Medical Holdings' pension funds fell from 68.3% funded to 60.7% funded.¹⁸

In addition, the pension for Prospect's CharterCARE hospitals in Rhode Island, which is not included in these figures, is currently the subject of ongoing litigation. In 2018, pensioners filed a class action lawsuit against Prospect and other defendants for allegedly hiding the pension plan's poor health to shield its own liability from regulators. A year before, the plan's managers put the fund in receivership and cut benefits 40% across the board. Several other defendants in the suit have settled, but as of April 2020 Prospect has not settled.¹⁹

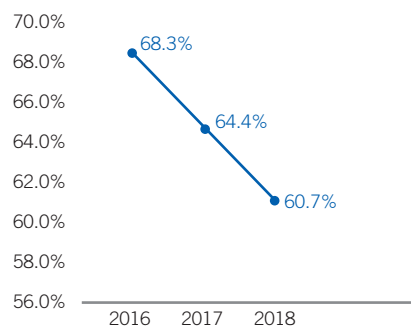
In connection with its acquisition of Crozer-Keystone Health System in Pennsylvania, Prospect planned to terminate the pension within the five-year period after acquiring it (i.e. by July 2021):

"Company will liquidate, fully fund and satisfy, and pay all benefits owed to participants and beneficiaries of the plan by providing lump sum distributions to participants, purchas-

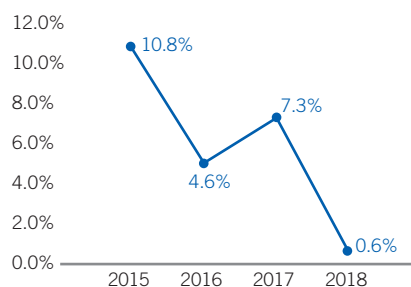
ing annuities for participants who do not elect a lump sum distribution."²⁰

Prospect has made modest contributions to the pensions in recent years. In 2018, the company issued \$1.2 billion debt to refinance existing debt, reduce the underfunded pension liability, and pay a dividend to shareholders. Of the money the company raised, it contributed just \$40 million to the pension while paying a \$457 million dividend to Leonard Green and other owners.²¹

FUNDED RATIO OF PROSPECT MEDICAL HOLDINGS' PENSION FUND



PROSPECT MEDICAL HOLDINGS EBITDA MARGIN



UPDATE: LEONARD GREEN-LED OWNERSHIP

Endnotes

- ¹ <https://pmh.com/>. Accessed May 6, 2020.
- ² SEC Contribution and Subscription filing, August 16, 2010 (<https://www.sec.gov/Archives/edgar/data/1063561/000095012310079639/v57129exv99w3.htm>) and "Leonard Green Buying Prospect Medical," PE Hub August 16, 2010 (<https://www.pehub.com/leonard-green-buying-prospect-medical/>).
- ³ "Prospect Medical Holdings, Inc. to Be Acquired by Leonard Green & Partners, L.P. and Management for \$8.50 Per Share," Prospect Medical Holdings press release, August 16, 2010. <https://www.businesswire.com/news/home/20100816005890/en/Prospect-Medical-Holdings-Acquired-Leonard-Green-Partners>
- ⁴ <https://pestakeholder.org/wp-content/uploads/2020/02/Raiding-the-Safety-Net-Leonard-Green-PESP-012920.pdf>
- ⁵ CMS Hospital Compare, accessed March 2020. <https://www.medicare.gov/hospitalcompare/search.html>
- ⁶ <https://www.ksat.com/news/2019/11/06/last-nix-health-care-facility-in-san-antonio-set-to-close/>
- ⁷ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2013 and 2012.
- ⁸ Assuming \$13.4 million in fees, 60% of \$645 million in dividends went to Leonard Green and its affiliates. Leonard Green ownership stake in Prospect stood at 61.3% in 2014 and 59.2% as of February 2019. <https://health.ri.gov/applications/submitted/merger/ProspectCharterCare/OwnershipDecision.pdf>
https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ⁹ Change in Effective Control Application submitted by Prospect CharterCARE to State of Rhode Island Department of Health, Center for Health Systems Policy and Regulation. Submitted February 19, 2020. Accessed May 5, 2020. https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ¹⁰ <https://www.wsj.com/articles/leonard-green-to-buy-examworks-in-2-2-billion-deal-1461782126>
- ¹¹ See: State of Rhode Island Department of the Attorney General, CharterCARE/Prospect Final Decision, (pg. 48). <http://www.riag.ri.gov/documents/5-16-14AGFinalDecision.pdf>; and Department of Health, Committee of the Health Services Council, Submitted May 2014 (pg. 22) <https://drive.google.com/file/d/0B9lx-sHDAL9qR-mJPWmd1MXNpbEk/view>
- ¹² State of Rhode Island Department of the Attorney General, CharterCARE/Prospect Final Decision, pg. 48. <http://www.riag.ri.gov/documents/5-16-14AGFinalDecision.pdf>
- ¹³ Report of the Committee of the Health Services Council, May 13, 2014. <https://drive.google.com/file/d/0B9lx-sHDAL9qR-mJPWmd1MXNpbEk/view>
- ¹⁴ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ¹⁵ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2016 and 2015. https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ¹⁶ Ibid.
- ¹⁷ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2016 and 2015. https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ¹⁸ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2016 and 2015. https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ¹⁹ Hazel Bradford, "Lawsuits allege fraud, conspiracy in insolvency of St. Joseph Health Services of Rhode Island plan," Modern Healthcare, June 22, 2018 (<https://www.modernhealthcare.com/article/20180622/NEWS/180629970/lawsuits-allege-fraud-conspiracy-in-insolvency-of-st-joseph-health-services-of-rhode-island-plan>) and Parker Gavigan, "Judge weighs \$11.15 million settlement for hospital pensioners," NBC 10 News, September 10, 2019. (<https://turnto10.com/i-team/nbc-10-i-team-judge-weighs-1115-million-settlement-for-hospital-pensioners>)
- ²⁰ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2016 and 2015. (pg. 1049) https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view
- ²¹ Prospect Medical Holdings Consolidated Financial Statements as of and for the Years Ended September 30, 2018 and 2017. (pg. 1033) https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgjz0qZA7UuPffWBS/view