

## Sample LP Letter to Leonard Green & Partners Re: Prospect Medical Holdings

Dear [NAME],

As you know, [FUND] invests with Leonard Green & Partners. Leonard Green owns safety net hospital chain Prospect Medical Holdings. As investors in Leonard Green funds that own health care companies, we are concerned that issues at Prospect may reflect a troubling pattern at Leonard Green-owned health care companies.

We have learned that Leonard Green is selling its majority stake in Prospect to Prospect's management for \$10 million<sup>1</sup>—a fraction of what it acquired Prospect and many of its hospitals for. Further, rather than an arm's length sale to a third party, Prospect, which Leonard Green controls, is buying out Leonard Green's stake using its own "corporate cash."<sup>2</sup>

This is troubling, especially given that in 2016, the *Wall Street Journal* reported that Leonard Green was exploring a sale that might have valued Prospect at as much as \$1 billion.<sup>3</sup>

We are long-term investors, and Leonard Green's aggressive financial policies raise questions about whether our perspectives are aligned. Dividend recapitalizations such as those that Leonard Green has undertaken at Prospect may ultimately weaken the long-term value of companies by saddling them with debt, weakening their credit ratings, and diverting money that could be invested in improving operations.<sup>4</sup> Considering that Leonard Green claims health care as one of its core areas of investment, we are concerned that this may be the case not only with Prospect, but also with other health care companies that we have exposure to.

Prospect saw its EBITDA decline dramatically in recent years, from \$142 million in 2015 to \$17 million in 2018. Prospect's EBITDA margin dropped from 10.8% in 2015 to just 0.62% in 2018.<sup>5</sup> In addition, Prospect faced \$260 million in unfunded pension liabilities as of September 2018.<sup>6</sup>

Yet since Leonard Green acquired Prospect in 2010, the private equity firm and other owners have collected approximately \$658 million in fees and debt-funded dividends from the hospital company, significantly increasing its overall leverage.<sup>7</sup>

Last year, in an effort to pay down some of the existing \$1.1 billion debt it had accrued in part to fund dividends, Prospect sold much of its hospitals' real estate to health care REIT Medical Properties Trust and leased it back.<sup>8</sup> The real estate sale added significant additional lease obligations to Prospect's balance sheet. Moody's analysts in July 2019 noted that the transaction did not merit a change in the company's B3 credit rating and negative outlook, as it "does not address the company's continuing operating challenges and lease-adjusted leverage will likely remain high."<sup>9</sup>

Prospect subsequently shut down all of its health care facilities in Texas.<sup>10</sup>

In addition to what appears to be a dramatic drop in value, Prospect carries substantial headline and regulatory risk in light of the COVID-19 pandemic.

The \$457 million dividend the Leonard Green-led investment group collected in 2018 contradicted a 2014 commitment Prospect made to state regulators in Rhode Island to not pay additional dividends.<sup>11</sup>

Members of Congress with Prospect hospitals in their districts have written to Leonard Green twice raising concern about the firm's treatment of the safety net hospital company and asking it to return the fees and dividends it collected.<sup>12</sup>

The system's hospitals currently have some of the lowest quality ratings from the Centers for Medicare and Medicaid Services—all but one have received one or two stars, the lowest quality ratings from CMS.<sup>13</sup> In Connecticut, state regulators placed Prospect's three hospitals under review last year for deteriorating conditions that place patients in "immediate jeopardy."<sup>14</sup> In Rhode Island, Prospect-owned hospitals' pensioners are suing Prospect for allegedly hiding the pension plan's poor health to shield its own liability from regulators.<sup>15</sup>

We have questions about Leonard Green's planned exit from Prospect and the aggressive financial policies that may have negatively impacted the value of the company and created regulatory and headline risk:

- Why is Leonard Green selling its stake in Prospect for \$10 million when, according to the *Wall Street Journal*, the company was valued for as much as \$1 billion in 2016?
- Why is Leonard Green selling its stake to the company rather than through an arms-length transaction on the open market, where there is greater potential for a higher valuation?<sup>16</sup>
- Why are the quality ratings of most Prospect hospitals so low even after Leonard Green has owned the hospitals for several years?
- Why did Leonard Green choose to draw out money in dividends—despite its promise to regulators not to draw more dividends, and despite substantial operating challenges—rather than create long-term value by investing in the hospitals?
- Does Leonard Green plan to collect dividend payments from other health care companies it owns?

In addition to answering these questions, we believe Leonard Green should return the fees and dividends it collected from Prospect to ensure the hospitals and health care workers have as many resources as possible to respond to the COVID-19 pandemic.

Sincerely,

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- <sup>1</sup> 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\\_thgiz0qZA7UuPffWBS/view](https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgiz0qZA7UuPffWBS/view)
- <sup>2</sup> 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\\_thgiz0qZA7UuPffWBS/view](https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgiz0qZA7UuPffWBS/view)
- <sup>3</sup> <https://www.wsj.com/articles/leonard-green-to-buy-examworks-in-2-2-billion-deal-1461782126>
- <sup>4</sup> <https://pitchbook.com/news/articles/pe-firms-keep-deploying-dividend-recaps-despite-the-risks>
- <sup>5</sup> 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\\_thgiz0qZA7UuPffWBS/view](https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgiz0qZA7UuPffWBS/view)
- <sup>6</sup> 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\\_thgiz0qZA7UuPffWBS/view](https://drive.google.com/file/d/1vYdWVfRgKHQ3u_thgiz0qZA7UuPffWBS/view)
- <sup>7</sup> <https://pestakeholder.org/wp-content/uploads/2020/05/UPDATE-Leonard-Green-Prospect-Medical-Dividends-PESP-051420.pdf>; [https://www.moodys.com/research/Moodys-downgrades-Prospect-Medical-Holdings-Incs-CFR-to-B3-outlook--PR\\_397518](https://www.moodys.com/research/Moodys-downgrades-Prospect-Medical-Holdings-Incs-CFR-to-B3-outlook--PR_397518)
- <sup>8</sup> <https://www.businesswire.com/news/home/20190715005786/en/Prospect-Receive-1.55-Billion-Investment-Medical-Properties>
- <sup>9</sup> [https://www.moodys.com/research/Moodys-Prospect-Medicals-sale-leaseback-improves-liquidity-however-operating-challenges--PR\\_405116](https://www.moodys.com/research/Moodys-Prospect-Medicals-sale-leaseback-improves-liquidity-however-operating-challenges--PR_405116)
- <sup>10</sup> <https://www.ksat.com/news/2019/11/06/last-nix-health-care-facility-in-san-antonio-set-to-close/>
- <sup>11</sup> 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-sHDAL9qRmJPWmd1MXNpbEk/view>
- <sup>12</sup> <https://www.wsj.com/articles/lawmakers-and-leonard-green-spar-over-hospital-operator-11594076954>
- <sup>13</sup> CMS Hospital Compare, accessed March 2020. <https://www.medicare.gov/hospitalcompare/search.html>
- <sup>14</sup> <https://www.courant.com/news/connecticut/hc-news-waterbury-hospital-prospect-medical-protests-20190602-hqc3yulngngwnd6qftmeiogdsq-story.html>
- <sup>15</sup> <https://www.modernhealthcare.com/article/20180622/NEWS/180629970/lawsuits-allege-fraud-conspiracy-in-insolvency-of-st-joseph-health-services-of-rhode-island-plan>
- <sup>16</sup> <https://www.beckershospitalreview.com/hospital-transactions-and-valuation/prospect-medical-holdings-can-t-consider-50m-acquisition-offer.html>