THC: Revenue Producing Asset Base is Undervalued!

Healthcare: Hospitals

RUTGERS *Student Research*

Tenet Healthcare

Shiraz Hasan
coverbuy@yahoo.com
609 -332-4571

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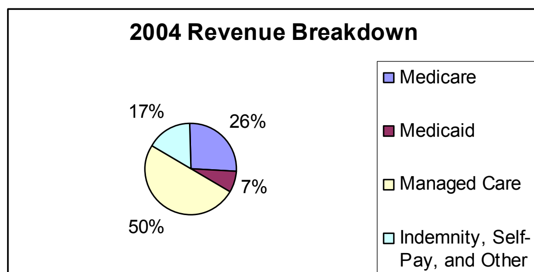
Ticker: THC
Price: $11.41

Recommendation: BUY
Price Target: $17.60

Analyst Certification: *I, Shiraz Hasan, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers.*

In addition I am long 5 THC Jan 2007 12.5 calls.



EPS: pre charges

	Q1	Q2	Q3	Q4	Year
2004A	$0.13	($0.27)	($0.11)	($0.06)	($0.30)
2005E	($0.01)	$0.01	($0.01)	($0.01)	($0.03)
2006E					$0.99
2007E	-	-	-	-	$1.23

Highlights

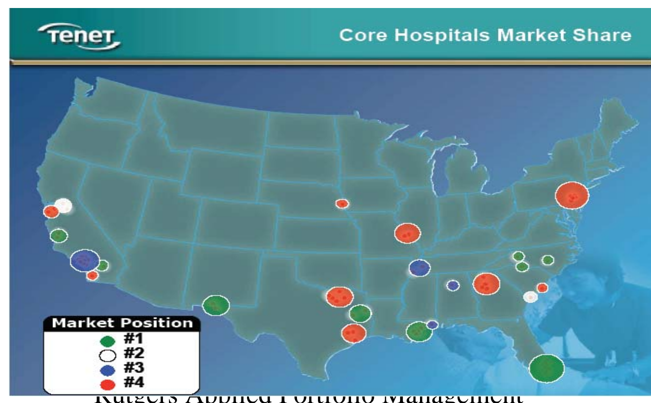
- **Favorable secular trends at beginning stage of cyclical turn:** Hospital management stocks are operating in an environment of relatively fairly stable costs and decent pricing. Although government payments will continue to be squeezed in the short term, volumes should rise and bad debt expenses should fall as a cyclical response to the economy and favorable demographic trends push volumes higher in the long term. 85% of Tenet's hospitals are in areas with above average population growth and 50% of hospitals are either numbers 1 or 2 in the market.

- **Restructuring nearly complete**: Tenet is putting all the puzzle pieces in place to be profitable in the near future. THC has exited several non-strategic markets and now operates 69 hospitals, down from 114. 75% of the senior management has been replaced. Billing system has been overhauled. Strategy has changed from a pure structure based approach to a quality execution based approach. Focus is on adding higher and more recurring revenue producing services, retention and recruitment of doctors who drive admission volumes, and a bettermanaged care contracts/relationships.

- **Costs, Volumes, and Pricing continue to be the key levers in THC business:** THC's volumes, prices, and costs have all been negatively affected by the litigation procedures and bad publicity that accompanies. They are aggressively taking actions to further improve managed payer care contracting, procurement efficiencies, cost standardization, as well as bad debt expense reduction. We believe THC initiatives will be successful and will act as a catalyst to propel volumes higher and allow them to achieve favorable pricing while managing and reducing costs wherever they can.

- **Resurgent of core fundamentals should take place in 2006**: We believe 2006 will be a profitable year for THC and EPS will be $0.99. In addition this will improve their image which should allow them to sure up their negotiation position with the managed care companies. Every 1% increase in managed care pricing yield adds $50M in pre-tax income annually or nearly $0.10 per share to EPS per year.

- **We estimate the high range of litigation expenses to be $1.5Bil:** We believe this risk is already reflected in the depressed stock price. Although this is severe and will hurt Tenet's road back to profitability in the short run, it would not be enough to drive them out of business or into bankruptcy. The company is carrying $4.4Bil in debt but 90% of that comes due after 2011. Also note that we believe the government would not look to send a knock out blow to THC unless their hospitals were killing people.



Licensed beds as % of total

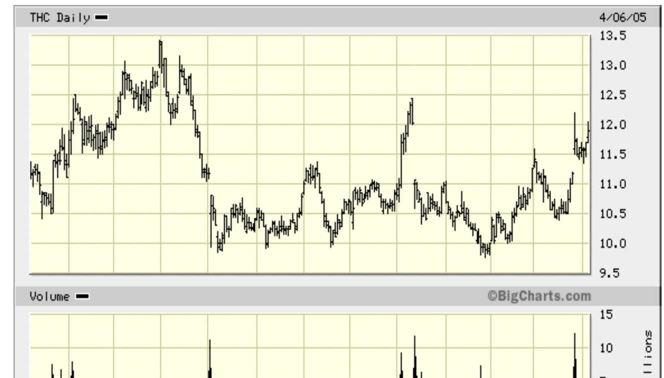
State	# of Hospitals	# of Beds	% of Total Beds
Florida	14	4,560	25.4%
California	17	3,540	19.7%
Texas	12	2,892	16.1%
Pennsylvania	5	1,289	7.2%
Georgia	4	1,204	6.7%
Louisiana	5	1,099	6.1%
Tennessee	2	741	4.1%
Alabama	1	586	3.3%
Missouri	2	523	2.9%
North Carolina	2	517	2.9%
South Carolina	3	481	2.7%
Nebraska	1	358	2.0%
Mississippi	1	189	1.1%
	69	17,979	100%

Source: Company reports and Smith Barney

Market Profile	
52 Week Price Range:	9.77 - 13.43
Average Daily Volume:	2,699,545
Dividend Yield:	0%
Shares Outstanding:	468.32M
Market Capitlization:	$5.4B
Institutional Holdings:	91.57%
Insider Holdings:	0.75%
Debt to Equity:	2.561
Return on Equity:	-64.40%

Figure 1: THC 5YR Performance

Figure 2: THC 1YR Performance



Source: Bigcharts.com

Investment Summary

Tenet appears to be undervalued and this coupled with it restructuring plan, improved liquidity, and new management team makes THC an appealing investment.

Our BUY recommendation is derived from our valuation model, in conjunction with our views of THC competitive position, and other metrics. From a Price/Sales, Price/EBITDA (2006E), and Price/Earnings (2006E) perspective, the stock is undervalued. For 2004 THC was well below the industry price to sales average of 1.6x, trading at 0.55x sales. THC is currently trading at 6.6x our 2005 estimated EBITDA and 3.5x our 2006 estimated EBITDA, whereas the industry group currently trading at 7.8x 2005 estimated EBITDA. THC is also trading at 11.5x our 2006 estimated earnings, when the peer group typically trades at 5 year average PE ratio of 22 and it closest competitor is trading at a 19.6x earnings. We could argue that THC current valuation is rightfully so with all of the uncertainties in Tenet's business and the litigation matters overhanging the company as well as general visibility into earnings. However, looking forward, THC should trade closer in line with the industry average and approach its historical norms. In addition, volume growth is the most significant driver in returning Tenet to profitability. Because the hospital business has very high fixed costs, and can create negative operating leverage when volumes drop, like in 2004, the opposite is true and will act as a catalyst to propel earnings dramatically as volumes return.

We believe that the by implementing managed care-style discounts for most of THC uninsured patients under the *Compact with Uninsured Patients* (''Compact''), will act as a catalyst which will allow for the current trend of rising bad debt expenses to reversed and in the long run produce greater amounts of revenue even though the short term economic effectives is a push. The discounts for uninsured patients began to be phased in during the second quarter of 2004 and should be completed at most hospitals by the end of 2005.

We also believe that by consolidating the operating regions from 5 to 4 and the decision to make most purchasing and supply chain decisions centralized, THC will be able to achieve greater economies of scale with it suppliers and be able to reduce costs greater than most expect throughout FY05 & FY06.

We believe Tenet's current portfolio asset base can generate EBITDA operating margins in the mid to high-teens under normalized conditions as evidence by our margin analysis (see figure X).

We forecast expansion in EBITDA margins to 7.8% in 2005, and we forecast normalized EBITDA margins of 14.6% to return in 2006. The earnings power of the asset base is under-appreciated by the Street, and estimates should increase as operations continue to improve. 2005 EBITDA estimates have risen significantly since 4Q 2004 results. The shares were recently trading at about 6.8x our 2006 EBITDA estimate, below the range of other hospital operators, despite currently depressed earnings, representing attractive valuation, in our opinion.

Although, we feel THC is trading at an extremely attractive valuation the following factors could negatively adverse Tenet from achieving our predicted target price:

1) Unpredictable natural disasters
2) Future changes in Medicare regulations
3) The timing and magnitude of negotiations and resolutions of disputes with managed care companies
4) Fluctuations in revenue allowances and discounts, including the impact of phasing in the discounting components of THC *Compact with Uninsured Patient*

5) The increase in the number of patients who are uninsured
6) THC ability to collect accounts receivable, particularly in light of recent trends in patient accounts receivable collectibles and associated increases in provisions for doubtful accounts
7) Levels of malpractice expense and settlement trends
8) The ultimate resolution of investigations and lawsuits
9) Changes in interest rates, tax rates, occupancy levels and patient volumes.

Bear Case:

The bear case for THC also holds some strong validation points. Bears argue that THC business has fundamentally changed. They argue that the outlier payments disappearing and managed care pricing coming under pressure with consolidation in the managed care business, will transform the hospital industry and THC will most likely under perform for many years to come. The Bears argue that hospital volumes will continue to decline for many years to come even though demographic trends point toward volumes increasing. They make this argument by believing that advances in medicine to this point and in the future will allow for less and less people to need to be treated in hospitals and outpatient facilities. They also believe that the rising labor costs along with the squeeze in medical healthcare expenses will end up crippling the hospital industry forcing many hospitals holding companies into reorganization/bankruptcy. The Bears believe that Tenet will face additional lawsuits for many years to come keeping the valuation of THC down in both the near term and long time. The Bears argue that Bad Debt Expenses will continue to rise as long as Healthcare costs are rising faster than the rate of inflation and employers continue to look for ways to squeeze out labor costs.

Restructuring:

We believe that management is taking the necessary steps in order to improve the business in the future even though these steps are having negative performance on the fundamentals in the short term. And feel that this has created a unique buying opportunity. Management's goal is to make the company and its hospital more appealing to payors, physicians, patients, employees, and investors. They have the right long term initiatives to drive volume growth going forward and the first two months of this year are starting to show signs but will be slow. They have continued to make progress on managed care pricing in the contracts they signed this past quarter and are consistently achieving fully competitive increases, and are forecasting mid to high single digit growth in commercial contract pricing in 2005. Even though they are achieving results in individual contract pricing, the managed care market continues to consolidate and their covered care population has shifted to lower paying products. We believe this will continue in the future and as a result we expect low single digit percentage growth from all payors.
Management's efforts to reduce costs and create efficiencies are starting to take hold, on a same hospital basis; controllable operating expenses were up only 4.2% which is good relative the overall industry and medical inflation.
Bad debt expenses over the past few years have been a considerable problem across the industry and have seemed to affect Tenet especially hard. On an apple to apple basis bad debt expenses are about 13% of net revenue. These figures have stabilized and indications are that they will come down in the future. We believe that these bad debt expenses are lagging numbers from the economic downturn and jobless recovery we witnessed in the early 2000s.

They have also completed the disposition of 22 of the 27 hospital they identified as non-core facilities and have cleared the way to concentrate on other avenues of their business restructuring.

Most of the restructuring elements are now in place with the exceptions of the legal resolution. They can now concentrate on improving the operation and quality of the business going forward

Other Restructuring Highlight:
• Net inpatient revenue per patient day and per admission increased by 0.7% and 1.2%, respectively.
• Net outpatient visits and outpatient revenue decreased by 4.3% and 4.7%, respectively.
• Two material patient litigation matters (Redding and Palm Beach Gardens) were settled in the fourth quarter of 2004.
• THC refinanced debt and increased liquidity through private placements of debt, pushing the next major maturity out to December 2011.
• Cash used in operating activities was $82 million (prior to capital expenditures and asset sale proceeds), which included payments for restructuring, litigation and settlement costs of $280 million and a use of cash in their

discontinued operations of $408 million, which included a $395 million legal settlement related to Redding Medical Center.
• Loss per diluted share from continuing operations increased $1.61 to $(3.85), reflecting lower revenues due to lower volumes and the closure or sale of certain home health agencies, hospices, clinics, skilled nursing facilities, and rehabilitation units.

3 Main Business Drivers

Volumes:
Volumes are one of the key business drivers in the success of hospital related companies. Any drops in volume can reduce their operational leverage dramatically. As well as a rises in volume can leap frog earnings upward.

Volumes declined the past year for THC but in the last few weeks are showing signs of stabilizing. We feel predicting volumes in the short run is futile but by looking at demographic trends over the long run we can more accurately get a picture of the potential for volume growth. 85% of THC hospitals are in areas of above average population growth, which should drive volumes higher over time if management executes on their game plan, and we believe they will.

Most of the items that affected THC's volumes in FY04 were unique or local in nature.
Items that affected volumes:

1) Decision to de-emphasize certain acute and sub-acute services
2) Tough managed care negotiations in certain markets
3) Use of InterQual standards to assign inpatient and outpatient status
4) Splitter physician using other hospital because of bad press
5) Weak Flu Season
6) Florida unusually high hurricane season

Other factors that affect patient volumes and the results of operations at THC hospitals and related health care facilities are unemployment levels, local economies, the number of uninsured and underinsured individuals in local communities, seasonal cycles of illness, climate and weather conditions, physician recruitment/retention/attrition, local health care competitors, managed care contract negotiations or terminations, unfavorable publicity, which impacts relationships with physicians and patients, and factors that affect the timing of elective procedures.

THC has began to really focus it efforts on attracting physicians that split their time between hospitals in order to improve volumes by striving to equip their hospitals with technologically advanced equipment and quality physical plant, properly maintaining the equipment and physical plant, sponsoring training programs to educate physicians on advanced medical procedures, providing high-quality care to our patients and otherwise creating an environment within which physicians prefer to practice. This initiative has added to capital expenditures, which have added to the losses in the short run for THC but should propel volumes in the future as they strive to have their hospitals become top performing ones.

Figure 3: Hospital Locations

Costs:
Health care costs are running well ahead of the inflation rates in other sectors of the economy and it is not possible for any hospital to achieve year-over-year declines in same-hospital aggregate costs. Therefore controlling the rate of unit inflation becomes the key benchmark. THC has reduced it rate of increase in same-hospitable controllable costs to 4.2%, which is below the industry average and they look to continually bring this down in the future.
We expect THC's cost containment initiative to save over $100M for the FY2005. This initiative focuses on numerous items in the supply management as well as other controllable expenses such as: medication use management, transcription, reprocessing of sterile supplies, records management and off contract purchasing.

THC's benefits redesign initiative could produce labor cost savings of approximately $50M. They should achieve this by standardizing their medical plan design across all hospitals and improvements in the bidding and negotiation process with their carriers.
Outsourcing of their information systems produced an 8% reduction in total IS development resources in 2004 and we expect THC to improve upon that in coming year.

In January THC began to implant a program to improve worker productivity by 2% year-over-year and this could produce another $80M in savings.

Overall we are estimating that THC will save an aggregate over $200M in costs in the FY2005.

Pricing:
Pricing is one biggest drivers of potential profitability for THC as well as extremely complex to understand as a whole for the investing public. Every 1% increase in managed care pricing yield adds $50M in pre-tax income annually or nearly $0.10 per share to EPS per year.

THC continues to make progress on managed care pricing by showing improvements in those contracts they signed in the quarter. With virtually all of the rebasing behind them, they are in position to consistently achieve fully competitive increases, and we expect mid- to high- single digit growth in individual commercial contract pricing in 2005. Unfortunately, a good part of this growth in individual contract pricing is being offset by market share shifts among managed care payors and shifts within their covered populations to lower paying products. As a result, their overall pricing increases from their entire managed care contract portfolio in 2005 are expected to be low single-digit percentage growth from all payors.

Changes in the Medicare and Medicaid programs and other government health care programs have and will continue to greatly impact the hospital industry as well as THC. Many states have adopted or are considering self-referral statutes, some of which extend beyond the Medicaid program to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of the source of the payment for the care. Tenets participation in and development of joint ventures and other financial relationships with physicians could be adversely affected by these amendments and similar state enactments.

Valuation

Our 3-pronged valuation model, suggest THC is extremely undervalued and should approach our target price of 17.60 (see figure 12) in the future. The model consists of a Price/Sales (25%) valuation, a Price/EBITDA (25%) valuation, and a Price/Earnings (50%) valuation.

Price/Sales (25%):
Since we feel that THC revenue producing asset base in under valued and that their revenues have been somewhat depressed because of the restructuring process, we should valued THC on those revenues that they produce. Tenet is currently trading at a .55x 2005E sales whereas the industry typically trades at 1.6x 2005E sales. But THC closest competitor HCA currently trades at 1.1x 2005E sales. THC is still in the final stages of their restructuring process and that indicates that we should value them at a 20% discount to their closest competitor at 0.9x 2005E sales which arrives at a target price of $19.51/share.

Price/EBITDA (25%)
THC on a Price/EBITDA basis over is trading at 6.8x our 2005 estimated EBITDA and 3.5x our estimated 2006 EBITDA, whereas the THC peers are trading 7.5x their 2005 estimated EBITDA.

For our valuation model we assume that in 2006 THC should trade in line with its peers and applied the 7.5x EBITDA to our 2006 estimated EBITDA to come up with a target of 24.42. We then discounted the 2006 target price by 20% to come up with our one year target price of $20.35 per share. We choose to use a discount rate of 20% because of the uncertainty in the litigation and restructuring as well as it gives us room for error.

Before we could use the Price/EBITDA valuation we had to first determine what the normalized EBITDA margins would look like since the business has fundamentally changed since 2002. We determined the Normalized EBITDA would be ~14.5% (see figure 11). We did this by looking at the EBITDA margins in 2002 and reduced outlier payments to 5% of managed care revenue and reduced managed care revenues by 10% to reflect the changes that occurred in the business since 2002. We then applied our normalized EBITDA margins to our estimated 2006 revenue to come our with our 2006 EBITDA. We believe that the 14.4% EBITDA margin is fair since we believe all the restructuring will be completed at the end of 2005(see figure 10).

THC Hospital Portfolio EBITDA Margins			
	THC Core Portfolio	**THC 2004 Divestitures**	**THC 2003 Divesitures**
Average Margins FY 2002	14.10%	1.10%	-2.60%

Note: Margins adjusted for outlier payments

Source: Data Advantage, American Hospital Directory and company reports

Price/Earnings (50%)
Earnings are what drives stock price and it should not be any different for THC. Again, since we believe the revenue producing asset base is undervalued, we should value THC on the earnings its revenue producing assets will generate once they return to more normal levels. Currently THC is trading at 11.5x our 2006 estimated earnings, whereas the industry average is 22.3x.

We arrived at our 2006 earnings estimated by assuming that EBITDA margins would revert back to the more normalized 14.5% number and arrived at our earnings per share estimate for 2006 of $0.99 per share (see figure 10). Again because of the legal issues and the uncertainty about the timing of profitability, we feel that THC should trade at a 20% discount to its peers until either the litigation is settled or earnings consistency returns to the street. We therefore believe that THC should trade at 18.5x earnings. We arrive at our price target by applying 18.5x our estimated 2006 earnings of $0.99 per share to come up with a price of $18.32 and we then discounted that by 20% to arrive at our one year target price of $15.26 per share. We choose to use a discount rate of 20% because of the uncertainty in the litigation and restructuring as well as it gives us room for error.

Legal Proceedings

One of the most important issues weighing on Tenants stock price has been the litigation issues and THC is subject to a significant number of claims and lawsuits. THC is also the subject of federal and state agencies' heightened and coordinated civil and criminal investigations. They have received subpoenas and other requests for information relating to a variety of subjects. We have estimated that most these issues at hand could cost in the range of $1Bil - $1.5Bil. We arrived at this number through a general consensus of industry analysts as well as our views on the lawsuits.

Physician Relationships:

Alvarado Case: The indictment alleged conspiracy to violate the federal anti-kickback statute and included substantive counts alleging the payment of illegal remuneration related to physician relocation, recruitment and consulting agreements. On February 17, 2005, the trial judge declared a mistrial after the members of the jury indicated that they were unable to reach a verdict in the case. We believe that this is an indication of the complexity and open ended interpretations of the law and see this as extremely favorable for THC. At a subsequent hearing, the judge set March 29, 2005 as the date a second trial in the matter would commence.

Other Physician Relationships:

Southern California Investigations, Florida Medicaid Investigation, El Paso Investigation, New Orleans Investigation, St. Louis Investigation, San Ramon Regional Medical Center, Women's Cancer Center

Pricing Investigations:
In addition to the general physician relocation agreement investigations THC is also being investigated for numerous pricing strategies at their current and previously owned facilities.

Outlier Investigations*:* The investigations are focused on whether THC receipt of outlier payments violated federal law and whether they omitted material facts concerning outlier revenue from their public filings.

Pricing Litigation:
THC has been sued in class actions in a number of states regarding the pricing of pharmaceuticals and other products and services at hospitals that they owned and operated. The cases have been brought primarily on behalf of uninsured patients, who were billed at the hospitals' undiscounted gross charge rates. While the specific allegations and relief sought vary from case to case, the plaintiffs generally allege violations of state consumer protection statutes, breach of contract and other state law claims, and seek the alleged unfair pricing practices look to recover all sums obtained by those practices, including compensatory and punitive damages, restitution, and attorneys' fees and costs. At December 31, 2004, THC accrued $30 million as a minimum liability to address the potential resolution of these cases.

California Pricing Cases:
Bishop v. Tenet Healthcare Corp, Castro v. Tenet Healthcare Corp, Colon v. Tenet Healthcare Corp, Congress of California Seniors v. Tenet Healthcare Corp, Delgadillo v. Tenet Healthcare Corp, Geller v. Tenet Healthcare Corp, Jervis v. Tenet Healthcare Corp, Moran v. Tenet Healthcare Corp, Plocher v. Tenet Healthcare Corp, Vargas v. Tenet Healthcare Corp, Walker v. Tenet Healthcare Corp, Watson v. Tenet Healthcare Corp, Yslas v. Tenet Healthcare Corp

Other Pricing Cases:
Wade v. Tenet Healthcare Corporation, Wright v. Tenet Healthcare Corp, Miranda v. Tenet Louisiana, Tenet Healthcare Corp, Garcia v. Tenet Healthcare Corp, Comer v. Tenet Healthcare Corporation, Atherton v. Tenet Healthcare Corp, Grubb v. Tenet South Carolina, Robert A. Singletary, Sr. v. Tenet HealthSystem Medical, Allen Singletary, Jr. v. TenetHealthSystem Medical Inc., Wright v. Tenet Healthcare Corp, Fernandez v. Park Plaza Hospital and Tenet Healthcare Corporation, Zimmerly v. Tenet HealthSystem, Sims v. Brookwood Medical Center Hospital,

In addition, the Attorney General of the State of Florida and 13 Florida county hospital districts, systems and non-profit corporations filed a civil action in federal district court in Miami on March 2, 2005 alleging that Tenet's past pricing policies and receipt of Medicare outlier payments violated federal and Florida state Racketeer Influenced and Corrupt Organizations (RICO) Acts, causing harm to the plaintiffs. The civil complaint asserts claims of RICO violations and unjust enrichment on behalf of the plaintiff hospital systems. The complaint also asserts a claim for violation of the Florida Deceptive and Unfair Trade Practices Act on behalf of the State of Florida and the plaintiff hospital systems. The complaint seeks unspecified amounts of damages (including treble damages under RICO), restitution and disgorgement. THC was served with this suit on March 4, 2005 and plan to vigorously defending the company in this matter.

Business Description

Tenet Healthcare Corporation operates in one line of business—the provision of health care services, primarily through the operation of general hospitals. All of Tenet's operations are conducted through its subsidiaries. THC is the second largest investor-owned health care services company in the United States. At December 31, 2004, our subsidiaries operated 80 general hospitals (two of which were classified as critical access hospitals) with 19,668 licensed beds, serving urban and rural communities in 13 states. Of those general hospitals, 64 were owned by our subsidiaries and 16 were owned by third parties and leased by our subsidiaries (including one facility owned located on land leased from a third party).
At December 31, 2004, Tenet's subsidiaries also owned or leased various related health care facilities, including two rehabilitation hospitals, one specialty hospital, four skilled nursing facilities and 85 medical office buildings—each of which is located on the same campus as, or nearby, one of our general hospitals. In addition, their subsidiaries own or lease physician practices, captive insurance companies and various ancillary health care businesses, including outpatient surgery centers, occupational and rural health care clinics, and an interest in a health maintenance organization, all of which comprise a minor portion of our business.

From March 2003 to February 2004, THC organized their general hospitals and other related health care facilities into two divisions with five underlying regions. In February 2004, they announced a streamlining of our operational structure by eliminating two divisions and having five regions report directly to the newly appointed chief operating officer. In July 2004, they consolidated their operating regions from five to four in an effort to continue streamlining the operational structure.

Four regions are:

- California, which includes all of our hospitals in California, as well as our hospital in Nebraska;
- Central Northeast-Southern States, which includes all of our hospitals in Georgia, Missouri, North Carolina, Pennsylvania, South Carolina and Tennessee;
- Florida-Alabama, which includes all of our hospitals in Florida, as well as our hospital in Alabama;
- Texas-Gulf Coast, which includes all of our hospitals in Louisiana and Texas, as well as our hospital in Mississippi.

Recent Developments

On February 7, 2005, the White House released its FFY 2006 budget proposal to Congress. The President's budget proposal included a number of reform measures to the Medicaid program, which could reduce federal Medicaid spending, as well as proposed new spending initiatives designed to improve access to health insurance. We believe this will negatively affect Medicaid revenues in the hospital industry slightly.

Industry Overview and Competitive Positioning

Tenet Healthcare is in a highly competitive and regulated industry that has large barriers to entry

Hospitals are feeling pressure from payers and it is negatively affecting their businesses. Third-party payers continue to ask them to accept lower rates of payment even in the face of rising medical costs. The consolidation among managed care payers is taking place with the small higher paying managed care companies being bought by the larger ones that tend to pay less. Managed care revenues in the industry will continue to come under pressure as long as these acquisitions take place and hospitals need to come up with additional ways to compensate for areas where margins will be reduced. Having said that, pricing still remains pretty decent in the industry and demographics trends will allow the secular volume growth to continue over the long run.

Recently we are seeing indications of volume increases across the entire hospital sector as well as a slight reductions and stabilization of bad debt expenses and believe this trend should continue to hold throughout FY05 &FY06.

THC continually strives to reduce the impact of gross charges on their contractual rates; however, certain payers are unwilling to accept such a change without a reduction in overall net reimbursement. In the light of the lawsuit media attention, THC has had backlash and disputes with a number of third-party payers over payment for past services, but, we believe this is winding down and should alleviate itself over the FY05.

Tenet and others in the hospital industry have witnessed uninsured and underinsured patients continue to grow. This trend is due to a combination of broad economic factors, including unemployment levels, reductions in state Medicaid budgets, increasing numbers of individuals and employers who choose not to purchase insurance, and an increased burden of co-payments and deductibles to be made by patients instead of insurers. Additionally, many of these patients, who delay or do not seek routine medical care because of the costs, are being admitted through the emergency department and often require more costly care, resulting in higher billings, which are the least collectible of all accounts. The Bankruptcy reduction bill that has been currently passed in the senate may allow for better collections of portions of these bad debt expenses in the future and could act as a catalyst for the sector going forward. Although, THC's Compact is expected to reduce the accounts receivable and provision for doubtful accounts recorded in the consolidated financial statements, it is not expected to mitigate the net economic effects of treating such patients in the short term.

The industry as a whole is challenged by the difficulty of providing quality patient care in a competitive and highly regulated environment. THC's *Commitment to Quality* (''C2Q'') initiative should help to position them competitively to meet these challenges. C2Q will improve patient safety and evidence-based practice, support physician excellence, improve the practice and leadership of nursing, and facilitate improved patient flow and care delivery. A year has passed since they launched C2Q in 10 hospitals and it has reduced emergency room wait

times, increased on-time starts in the operating rooms, and improved bed management and care coordination. All of these should be instrumental in driving revenue higher in the future and attracting higher volume physicians.

A significant cost pressure in the hospital industry is the ongoing increase in labor costs due to a nationwide nurse shortage and the enactment of state laws regarding nurse-staffing ratios. The nursing shortage is more serious in certain specialties and in certain geographic areas than others, including several areas in which THC operate hospitals (such as California), and has resulted in increased costs for nursing personnel. State-mandated nurse-staffing ratios adversely affect not only THC's labor costs, when they are unable to hire the necessary number of nurses to meet the required ratios, they will limit patient admissions with a corresponding adverse effect on their net operating revenues. The vast majority of hospitals in California, including THC's hospitals, are not at all times meeting the state-mandated nurse-staffing ratios that went into effect on January 1, 2004. THC, however, has gradually improved its monthly compliance and effort to make continued improvements into 2005. THC could be affected by the future availability or cost of nursing personnel, and they should expect to continue to experience significant wage and benefit pressures created by the current nursing shortage throughout the country as well as state-mandated nurse staffing ratios.

Financial Analysis

Revenue/Earnings

Tenet receives revenues from a variety of sources, primarily, the federal Medicare program, state Medicaid programs, managed care payers (including preferred provider organizations and health maintenance organizations), indemnity-based health insurance companies, and self-pay patients.

Revenue Mix	2004	2003	Change
Medicare	26.1%	25.1%	1.0%
Medicaid	7.4%	7.7%	-0.3%
Managed Care	49.7%	51.0%	-1.3%
Indemnity, Self-Pay, and Other	16.8%	16.2%	0.6%

During the year ended FY04, THC reported net operating revenues from continuing operations of $9.9 billion compared to $10.1 billion in FY03. Outpatient visits, admissions and patient days from continuing general hospitals were lower during the FY04 compared to the year FY03 by 4.3%, 1.4% and 0.9%, respectively. The following factors are contributing to the decline in their inpatient and outpatient volume levels: loss of volume to competing health care providers, physician recruitment, retention and attrition, managed care contract negotiations or terminations, the negative impact from various hurricanes in the southeastern United States, a milder flu season in 2004 compared to 2003 and negative publicity about THC as a result of lawsuits and government investigations, which impacts their relationships with physicians and patients. The inpatient and outpatient volume levels were also impacted by the sale or closure of certain home health agencies, hospices, clinics, and skilled nursing and rehabilitation units during 2004.

For the quarter, adjusted EBITDA decreased 43% to $141 million. Year over year, EBITDA margins fell 427 basis points to 5.8%. The deterioration in EBITDA and margin was due to the decline in sales coupled with the inflating of expenses. Year over year and adding back sales taken out of net revenues as a result of the implementation of the Compact with the uninsured, SW&B was 42.1% of revenues versus 42.2%, supplies expense was 17.4% versus 16.7%, bad debt expense was 12.7% versus 11.7% and other operating expenses were 21.8% versus 20.8%. As a percentage of total revenues (now including the Compact with the uninsured), bad debt expense was 8.5%. With the implementation of the Compact for the uninsured, this ratio may drop further. With total uncompensated care totaling $484 million during the quarter, or 16.7% of net revenues plus uncompensated care, Tenet appears to have appropriately reserved for bad debt during the quarter.

Managed care stop-loss payments decreased to approximately $590 million during FY04 from approximately $778 million during FY03. Net outpatient revenues decreased approximately $149 million or 4.7% during FY04 compared to last year.

The amount of our net patient revenue under managed care contracts during the FY04 and FY03 was $4.8Bil and $5.0Bil, respectively, and we estimate FY05 of $5.0Bil. Approximately 34% of the managed care net patient revenues during 2004 related to the top five managed care payers.

Tenet has dramatically improved the liquidity of its balance sheet and 90% of THC debt isn't coming due until after 2011, which gives THC plenty of room to operate going forward.

Balance Sheet/Financing/Cash Flow

Tenet has dramatically improved the liquidity of its balance sheet and 90% of THC debt isn't coming due until after 2011, which gives THC plenty of room to operate going forward. With $771Mil in cash on the books, expected restructuring to be completed by 2006, expected positive cash flow by end of 2005, and our outlook for the hospital industry going forward Tenet should continue to build upon its financial position.

	Maturity Date, Year ending Dec 2004							
(Dollars in Millions)	**2005**	**2006**	**2007**	**2008**	**2009**	**Thereafter**	**Total**	**Fair Value**
Fixed-rate long-term debt	$41	$219	$207	$2	$1	$4,067	$4,537	$4,464
Average interest rates	6.62%	5.28%	4.95%	4.56%	4.56%	7.36%	6.97%	

Cash flow was weak in 2004 but we expect dramatic improvements to be made in the 2nd half of FY05 and FY06 respectively. Net cash used in operating activities was $82 million in FY04 compared to net cash provided by operating activities of $838 million in FY03.
Adding back $426 million in litigation settlement payments, operating cash flow was a positive $135 million, but it was supported by the collection of approximately $100 million in receivables retained from sold hospitals.

Proceeds from the sales of facilities, long-term investments and other assets during the FY04 aggregated $431 million. The proceeds from the actual and anticipated divestitures of their domestic hospitals and the hospital in Barcelona, and any anticipated tax benefits associated with such divestitures should further bolster THC liquidity. A significant portion of the proceeds to be received in the form of tax refunds from will result from these divestitures. In June 2004, THC issued $1 billion of senior notes due in 2014 and subsequently used a portion of that to repurchase $552 million of senior notes due in 2006 through 2008. At the end of FY04, THC terminated its existing credit agreement and replaced it with a new $250 million, one-year secured letter of credit facility. The new facility provides for the issuance of up to $250 million in letters of credit and does not provide for any cash borrowings. The new facility is secured by the stock of certain subsidiaries and cash collateral equal to 105% of the facility amount. In January 2005, THC sold $800 million of unsecured 91⁄4% senior notes with registration rights in a private placement. The net proceeds from the sale of the senior notes were approximately used to redeem their remaining $400 million outstanding senior notes due in 2006 and 2007, and for general corporate purposes. As of end of FY04, THC had approximately $216 million of letters of credit outstanding under the letter of credit facility, which was fully collateralized by the $263 million of restricted cash. In addition, they had $654 million of unrestricted cash and cash equivalents on hand.

Cap-ex was $558 million and $833 million in the FY04 and FY03, respectively. Included in cap-ex are costs related to the construction of two new hospitals that opened in 2004, in the amount of $84 million and $80 million in the FY04 and FY03, respectively.

Cap-ex for the FY05 should be approximately $500 million. These capital expenditures include approximately $7 million in 2005 of the estimated $300 million required to meet the California seismic requirements by 2012 for the remaining California facilities after all planned divestitures.

Investment Risks

Litigation: It is possible that more bad practices and illegalities could be uncovered at THC and have adverse effects on the share price. It is also possible that the litigations expenses that we are estimating could be significantly higher than we thought forecasting.

Volume Declines: Volumes could continue to decline over the long run due to numerous an advances in pharmacological medicine that prevents people from using hospitals as frequently.

Pricing Get Squeezed: Manage care pricing could continue to get squeezed as more and more employers and individuals move to less expensive plans that require larger out of pocket expenses which would increase bad debt expenses in the long run. Also the higher paying managed care companies could become acquired by the lower paying managed care companies and they press to re-negotiate favorable terms.

Labor Costs Escalate: With the continued nursing shortage labor cost could rise greater than the rate of medical inflation in attempts to attract and retain talent in the understaffed hospitals and in areas of the country where the states have imposed nursing staffing ratio.

Natural Disasters: Tenet could become adversely affected by natural disaster such as hurricane in Florida and earthquakes in California, as well as other areas in the country too.

Changes in the Medicare and Medicaid programs: If modifications are made to patient eligibility requirements, funding levels, or the method of calculating payments or reimbursements change, THC could be adversely affected by these changes. THC would also be adversely affected if one of their hospitals or subsidiaries were removed from participation in the Medicare or Medicaid program or other government health care programs.

Technological and pharmaceutical improvements: Any pharmaceutical improvements that could dramatically increase the cost of providing, or reduce the demand for, health care would have serious consequences on THC business

Cost of Supplies: If the hospital suppliers were to consolidate significantly, perhaps they would have more pricing power on those supplies and then THC would be at risk of higher than average price increases in the future

Figure 4: Detailed Hospital List

Hospital	Location	Licensed Beds	Status
Alabama			
Brookwood Medical Center	Birmingham	586	Owned
California			
Alvarado Hospital Medical Center/SDRI	San Diego	311	Owned
Brotman Medical Center*	Culver City	420	Owned
Chapman Medical Center**	Orange	114	Leased
Coastal Communities Hospital**	Santa Ana	178	Owned
Community Hospital of Huntington Park*	Huntington Park	81	Leased
Community Hospital of Los Gatos	Los Gatos	143	Leased
Desert Regional Medical Center	Palm Springs	394	Leased
Doctors Hospital of Manteca	Manteca	73	Owned
Doctors Medical Center	Modesto	465	Owned
Encino-Tarzana Regional Medical Center*(1)	Encino	151	Leased
Encino-Tarzana Regional Medical Center*(1)	Tarzana	245	Leased
Fountain Valley Regional Hospital and Medical Center	Fountain Valley	400	Owned
Garden Grove Hospital and Medical Center	Garden Grove	167	Owned
Irvine Regional Hospital and Medical Center	Irvine	176	Leased
John F. Kennedy Memorial Hospital	Indio	145	Owned
Lakewood Regional Medical Center	Lakewood	161	Owned
Los Alamitos Medical Center	Los Alamitos	167	Owned
Mission Hospital of Huntington Park*	Huntington Park	109	Owned
Placentia Linda Hospital	Placentia	114	Owned
San Dimas Community Hospital	San Dimas	93	Owned
San Ramon Regional Medical Center	San Ramon	123	Owned
Sierra Vista Regional Medical Center	San Luis Obispo	200	Owned
Twin Cities Community Hospital	Templeton	84	Owned
USC University Hospital(2)	Los Angeles	329	Leased
Western Medical Center Santa Ana**	Santa Ana	280	Owned
Western Medical Center Hospital Anaheim**	Anaheim	188	Owned
Florida			
Cleveland Clinic Hospital(3)	Weston	150	Owned
Coral Gables Hospital	Coral Gables	256	Owned
Delray Medical Center	Delray Beach	372	Owned
Florida Medical Center	Fort Lauderdale	459	Owned
Good Samaritan Hospital	West Palm Beach	341	Owned
Hialeah Hospital	Hialeah	378	Owned
Hollywood Medical Center	Hollywood	324	Owned
North Ridge Medical Center	Fort Lauderdale	332	Owned
North Shore Medical Center	Miami	357	Owned
Palm Beach Gardens Medical Center	Palm Beach Gardens	204	Leased
Palmetto General Hospital	Hialeah	360	Owned
Parkway Regional Medical Center	North Miami Beach	382	Owned
Saint Mary's Medical Center	West Palm Beach	460	Owned
West Boca Medical Center	Boca Raton	185	Owned
Georgia			
Atlanta Medical Center	Atlanta	460	Owned
North Fulton Regional Hospital	Roswell	167	Leased
South Fulton Medical Center	East Point	338	Owned
Spalding Regional Hospital	Griffin	160	Owned
Sylvan Grove Hospital(4)	Jackson	25	Leased

Source: Company 10K

Figure 4 Continued: Detailed Hospital List

Hospital	Location	Licensed Beds	Status
Louisiana			
Kenner Regional Medical Center	Kenner	203	Owned
Meadowcrest Hospital	Gretna	207	Owned
Lindy Boggs Medical Center	New Orleans	172	Owned
Memorial Medical Center	New Orleans	333	Owned
NorthShore Regional Medical Center	Slidell	174	Leased
Mississippi			
Gulf Coast Medical Center	Biloxi	189	Owned
Missouri			
Des Peres Hospital	St. Louis	167	Owned
Saint Louis University Hospital	St. Louis	356	Owned
Nebraska			
Creighton University Medical Center(5)	Omaha	358	Owned
North Carolina			
Central Carolina Hospital	Sanford	137	Owned
Frye Regional Medical Center	Hickory	355	Leased
Frye Regional Medical Center—Alexander Campus(4)	Taylorsville	25	Leased
Pennsylvania			
Graduate Hospital	Philadelphia	240	Owned
Hahnemann University Hospital	Philadelphia	618	Owned
Roxborough Memorial Hospital	Philadelphia	125	Owned
St. Christopher's Hospital for Children	Philadelphia	161	Owned
Warminster Hospital	Warminster	145	Owned
South Carolina			
East Cooper Regional Medical Center	Mt. Pleasant	100	Owned
Hilton Head Medical Center and Clinics	Hilton Head	93	Owned
Piedmont Medical Center	Rock Hill	288	Owned
Tennessee			
Saint Francis Hospital	Memphis	561	Owned
Saint Francis Hospital—Bartlett	Bartlett	90	Owned
Texas			
Centennial Medical Center	Frisco	118	Owned
Cypress Fairbanks Medical Center	Houston	146	Owned
Doctors Hospital	Dallas	232	Owned
Houston Northwest Medical Center	Houston	498	Owned
Lake Pointe Medical Center	Rowlett	99	Owned
Nacogdoches Medical Center	Nacogdoches	150	Owned
Park Plaza Hospital	Houston	446	Owned
Providence Memorial Hospital	El Paso	508	Owned
RHD Memorial Medical Center(6)	Dallas	155	Leased
Shelby Regional Medical Center	Center	54	Owned
Sierra Medical Center	El Paso	351	Owned
Trinity Medical Center(6)	Carrollton	207	Leased

* We continue to work toward entering into definitive agreements to divest these facilities as part of the restructuring of our operations announced in January 2004.

** We have entered into a definitive agreement to divest these facilities as part of the restructuring of our operations announced in January 2004.

(1) Leased by a partnership in which Tenet subsidiaries own a 75% interest and of which a Tenet subsidiary is the managing general partner.

(2) Facility owned by us on land leased from a third party.

(3) Owned by a partnership in which a Tenet subsidiary owns a 51% interest and is the managing general partner. The partner owning the 49% interest, an affiliate of the Cleveland Clinic Foundation, has an option to acquire our interest at any time after July 2, 2006 pursuant to the terms of the related partnership agreement.

(4) Designated by CMS as critical access hospitals and, therefore, although not being divested, these facilities are not counted among the 69 general hospitals that will remain after all proposed divestitures are completed.

(5) Owned by a limited liability company in which a Tenet subsidiary owns a 74% interest and is the managing member.

(6) Leased from the Metrocrest Hospital Authority under a lease that expires in August 2007.

Source: Company 10K

Figure 5: Peer Group Analysis
Source: Reuters Data

Valuation Ratios	THC	HCA	UHS	HMA	TRI	LPNT	PRV	CYH	Industry	S&P 500
P/E Ratio (TTM)	n/m	20.2	19.4	19.6	27.8	20.0	25.0	22.0	22.3	22.8
P/E High - Last 5 Yrs.	n/a	108.5	n/a	31.8	n/a	n/a	60.9	n/a	52.3	42.7
P/E Low - Last 5 Yrs.	n/a	13.9	n/a	14.7	n/a	n/a	16.6	n/a	12.6	15.4
Beta	- 0.3	- 0.1	- 0.2	0.0	- 0.1	- 0.1	0.4	- 0.3	0.3	1.0
Price to Sales (TTM)	0.6	1.1	0.8	2.0	0.9	1.9	1.6	1.1	1.6	3.2
Price to Book (MRQ)	3.2	5.0	2.4	3.1	1.7	3.4	2.3	2.5	3.8	4.1
Price to Tangible Book (MRQ)	7.2	11.8	5.0	4.9	3.8	4.7	9.5	116.5	12.9	7.5
Price to Cash Flow (TTM)	n/m	10.1	9.9	13.8	11.7	13.9	14.9	11.5	13.5	15.8
Price to Free Cash Flow (TTM)	n/m	18.8	24.6	21.4	n/m	27.9	41.4	22.6	21.9	26.3
% Owned Institutions	91.6	75.5	92.3	95.0	95.0	95.0	95.0	95.0	57.3	65.5
Sales (MRQ) vs Qtr. 1 Yr. Ago	n/m	6.1	15.3	8.7	12.1	12.3	22.3	10.9	11.8	16.1
Sales (TTM) vs TTM 1 Yr. Ago	- 8.3	7.8	16.1	20.8	19.2	13.9	18.3	19.2	12.8	15.1
Sales - 5 Year Growth Rate	- 2.8	7.1	14.0	18.8	27.3	14.1	20.6	25.3	14.7	9.7
EPS (MRQ) vs Qtr. 1 Yr. Ago	n/m	11.1	- 5.6	9.7	349.3	13.4	17.7	25.1	18.3	16.2
EPS (TTM) vs TTM 1 Yr. Ago	n/a	- 0.9	- 14.4	14.1	28.4	21.6	15.1	21.4	15.7	25.8
EPS - 5 Year Growth Rate	n/m	18.3	17.8	17.5	93.3	41.7	19.0	83.9	35.4	13.1
Capital Spending - 5 Year Growth Rate	- 2.1	3.3	28.6	4.8	26.9	4.8	34.1	16.3	10.1	3.1
Quick Ratio (MRQ)	1.4	1.0	1.5	2.4	1.4	1.7	0.9	1.9	1.6	1.3
Current Ratio (MRQ)	1.9	1.5	1.7	3.0	2.0	2.9	1.1	2.3	2.0	1.8
LT Debt to Equity (MRQ)	2.5	2.3	0.7	0.4	0.7	0.4	0.8	1.5	1.1	0.6
Total Debt to Equity (MRQ)	2.6	2.4	0.7	0.5	0.7	0.4	1.0	1.5	1.1	0.8
Interest Coverage (TTM)	- 3.9	4.8	7.7	37.4	2.8	12.3	3.6	n/m	10.2	12.7
Return on Assets (TTM)	- 16.2	5.9	5.7	9.6	2.8	10.2	4.5	4.5	6.4	7.4
Return on Assets - 5 Yr. Avg.	- 3.0	4.7	6.4	10.5	1.8	7.3	4.4	3.0	5.7	6.6
Return on Investment (TTM)	- 20.0	6.9	6.9	10.7	3.2	11.2	4.9	5.1	7.7	11.2
Return on Investment - 5 Yr. Avg.	- 3.8	5.7	7.5	11.7	2.0	8.1	4.7	3.4	7.1	10.7
Return on Equity (TTM)	- 64.4	21.0	14.3	17.5	6.2	18.6	10.4	12.0	14.0	20.1
Return on Equity - 5 Yr. Avg.	- 11.1	17.1	16.2	18.1	4.0	16.7	9.4	7.6	14.0	19.0
Gross Margin (TTM)	39.0	83.4	76.7	30.9	42.2	47.0	40.0	100.0	49.9	46.5
Gross Margin - 5 Yr. Avg.	44.2	83.9	76.6	32.9	42.0	47.6	38.1	100.0	50.3	46.0
EBITD Margin (TTM)	- 9.3	16.8	12.4	21.4	11.4	20.4	17.5	14.8	15.8	21.6
EBITD Margin - 5 Yr. Avg.	6.6	16.2	13.3	22.8	13.2	18.7	17.5	16.6	15.8	20.3
Operating Margin (TTM)	- 13.2	9.1	7.4	16.6	4.7	14.3	8.9	10.1	11.3	21.6
Operating Margin - 5 Yr. Avg.	2.4	8.1	7.9	17.4	3.8	10.9	9.0	10.8	10.4	17.9
Pre-Tax Margin (TTM)	- 16.3	8.4	6.9	16.5	5.0	14.3	8.9	7.8	10.3	18.0
Pre-Tax Margin (TTM) - 5 Yr. Avg.	- 0.6	7.4	7.3	17.4	3.9	10.9	9.0	6.2	8.9	17.0
Net Profit Margin (TTM)	- 18.1	5.3	4.3	10.2	3.1	8.7	5.7	4.7	5.7	13.9
Net Profit Margin - 5 Yr. Avg.	- 2.7	4.4	4.6	10.6	2.1	6.3	5.5	3.5	5.1	11.2
Effective Tax Rate (TTM)	n/m	36.8	37.3	38.2	38.2	39.2	36.0	39.2	37.9	29.9
Effective Tax Rate - 5 Yr. Avg.	43.7	43.1	36.7	38.8	57.1	43.1	39.2	47.1	40.1	34.1
Revenue/Employee (TTM in $1000)	108.2	170.4	106.4	116.8	158.4	100.7	105.1	159.5	218.2	705.4
Net Income/Employee (TTM in $1000)	- 100.0	9.0	4.6	11.9	4.9	8.8	6.0	7.6	14.2	97.3
Receivable Turnover (TTM)	4.8	7.6	6.4	5.1	7.1	8.5	7.0	5.8	9.2	10.2
Inventory Turnover (TTM)	32.3	7.2	14.5	21.0	22.7	22.5	26.1	0.0	23.7	12.3
Asset Turnover (TTM)	0.9	1.1	1.3	0.9	0.9	1.2	0.8	1.0	1.2	0.9

Figure 6: SWOT Analysis

Strengths:	**Weaknesses**
• Market share is 1 or 2 in 50% of hospitals • 85% of hospitals are in areas of above average population growth • Hospitals are hard assets with strong ties to local communities •	• Past behavior with manage care payers allowed them to retaliate • Bad Publicity drive patients and physicians away from hospitals • Past high margins allowed hospitals to operate inefficiently
Opportunities	**Threats**
• Consolidation in the industry • IT/Cost Savings initiatives should remove inefficiently • Bad publicity ending should allow the splitter physicians to return	• Liabilities from ongoing litigation • Nationwide nursing shortage • Uninsured population of people increases • Natural disasters

Figure 7: PEST Analysis

Political	**Economical**
• Bankruptcy reform bill should allow for more collection of Bad Debt expenses in long term • Changes in Medicare & Medicaid Program will have an effect on THC	• Healthcare costs are rising faster than the rate of inflation and wage increases. • THC is sensitive to local economies and unemployment trends
Social	**Technological**
• Larger % of population is more health concerned	• IT will allow for greater long term cost savings and more efficiencies • Advances in medicine/new drugs could prevent patients from seeking hospital medical attention. •

Figure 8: Revenue Model
Source: 10K and Student Estimates

Tenet Healthcare Revenue Model 2004 - 2007E

	2004A					2005E						
	Q1	Q2	Q3	Q4	YR	Q1	Q2	Q3	Q4	YR	2006E	2007E
Revenues ($MM)												
Inpatient	$ 1,765	$ 1,690	$ 1,597	$ 1,605	$ 6,657	$ 1,699	$ 1,635	$ 1,600	$ 1,600	$ 6,534	$ 6,665	$ 6,931
Outpatient	$ 779	$ 760	$ 746	$ 714	$ 2,999	$ 810	$ 812	$ 800	$ 793	$ 3,215	$ 3,376	$ 3,545
Other	$ 30	$ 55	$ 85	$ 93	$ 263	$ 100	$ 100	$ 100	$ 100	$ 400	$ 400	$ 420
Total	$ 2,574	$ 2,505	$ 2,428	$ 2,412	**$ 9,919**	$ 2,609	$ 2,547	$ 2,500	$ 2,493	**$ 10,149**	**$ 10,440**	**$ 10,896**
% Chg Y/Y												
Inpatient	4%	3%	-1%	0%	2%	-4%	-3%	0%	0%	-2%	2%	2%
Outpatient	-3%	-4%	-6%	-6%	-5%	4%	7%	7%	11%	7%	5%	5%
Other	-88%	-78%	-59%	-52%	-70%	233%	82%	18%	8%	52%	0%	5%
Total	-6%	-6%	-7%	-5%	-6%	1%	2%	3%	3%	2%	3%	4%
% of Total												
Inpatient	69%	67%	66%	67%	67%	65%	64%	64%	64%	64%	64%	64%
Outpatient	30%	30%	31%	30%	30%	31%	32%	32%	32%	32%	32%	33%
Other	1%	2%	4%	4%	3%	4%	4%	4%	4%	4%	4%	4%

Figure 9: Operating Performance Model
Source: 10-K, Student Estimates

Tenet Healthcare Operating Performance Model

	2004A					2005E						
	Q1	Q2	Q3	Q4	**YR**	Q1	Q2	Q3	Q4	**YR**	**2006E**	**2007E**
# of Hospitals	67	69	69	69	69	69	69	69	69	69	69	69
End Licensed Beds	17770	17976	17933	17902	17902	17952	17952	17952	17952	17952	18216	18216
Avg. Licensed Beds	17770	17839	17932	17902	17861	17927	17952	17952	17952	17952	18216	18216
Patient Days (000s)	944	876	869	877	3566	950	894	872	912	3628	3701	3775
% Chg Y/Y	1%	-2%	0%	-2%	-1%	1%	2%	0%	4%	2%	2%	2%
Admissions (000s)	179	170	169	169	687	185	170	172	172	699	713	727
%Chg Y/Y	1%	-2%	-2%	-3%	-1%	3%	0%	2%	2%	2%	2%	2%
Length of Stay	5.3	5.2	5.1	5.2	5.2	5.3	5.2	5.1	5.2	5.2	5.2	5.2
Occupancy	58.40%	54%	52.70%	53.30%	54.50%	59%	54%	55%	55%	55.50%	56%	57%
Net Inpatient Rev/Day	$ 1,806	$ 1,885	$ 1,826	$ 1,830	$ 1,836	$ 1,806	$ 1,885	$ 1,826	$ 1,830	$ 1,836	$ 1,836	$ 1,836
% Chg Y/Y	-1%	3%	-1%	3%	1%	0%	0%	0%	0%	0%	0%	0%
Net Rev/Admission	$ 9,495	$ 9,715	$ 9,379	$ 9,478	$ 9,517	$ 9,156	$ 9,700	$ 9,400	$ 9,475	$ 9,433	$ 9,500	$ 9,500
% Chg Y/Y	-1%	2%	0%	3%	1%	-4%	0%	0%	0%	-1%	2%	0%
Inpatient Rev (MM)	$ 1,765	$ 1,690	$ 1,597	$ 1,605	$ 6,657	$ 1,699	$ 1,635	$ 1,600	$ 1,600	$ 6,534	$ 6,665	$ 6,931
% Chg Y/Y	4%	3%	-1%	0%	2%	-4%	-3%	0%	0%	-2%	2%	4%
Outpatient Visits (000s)	1517	1468	1329	1350	5664	1532	1483	1342	1364	5721	5835	5952
% Chg Y/Y	1%	-2%	-10%	-8%	-4%	1%	1%	1%	1%	1%	2%	2%
Outpatient Rev (MM)	$ 779	$ 760	$ 746	$ 714	$ 2,999	$ 810	$ 812	$ 800	$ 793	$ 3,215	$ 3,376	$ 3,545
% Chg Y/Y	-3%	-4%	-6%	-6%	-5%	4%	7%	7%	11%	7%	5%	5%
Outpat Rev/Visit	$ 513	$ 518	$ 561	$ 529	$ 529	$ 528	$ 534	$ 578	$ 545	$ 545	$ 561	$ 578
% Chg Y/Y	-5%	-3%	4%	2%	0%	3%	3%	3%	3%	3%	3%	3%

Figure 10: Earnings Model
Source: 10-K, Student Estimates

Income Model **Tenet Healthcare 2004-2007E Income Statement ($MM)**

	2004A					2005E						
	Q1	Q2	Q3	Q4	**YR**	Q1	Q2	Q3	Q4	**YR**	**2006E**	**2007E**
Net Revs	$ 2,574	$ 2,505	$ 2,428	$ 2,412	$ 9,919	$ 2,609	$ 2,547	$ 2,500	$ 2,493	$ 10,149	$ 10,440	$ 10,896
%Chg Y/Y	-6%	-6%	-7%	-5%	-6%	1%	2%	3%	3%	2%	3%	4%
Salaries/Ben	$ 1,091	$ 1,089	$ 1,069	$ 1,076	$ 4,325	$ 1,143	$ 1,142	$ 1,130	$ 1,137	$ 4,552	$ 4,385	$ 4,467
% of Rev	42.39%	43.5%	44.0%	44.6%	43.6%	43.8%	44.8%	45.2%	45.6%	44.9%	42%	41%
Supplies	$ 434	$ 425	$ 421	$ 444	$ 1,724	$ 440	$ 416	$ 411	$ 409	$ 1,676	$ 1,670	$ 1,743
%of Rev	16.9%	17.0%	17.3%	18.4%	17.4%	16.9%	16.3%	16.4%	16.4%	16.5%	16%	16%
Bad Debt	$ 277	$ 482	$ 251	$ 195	$ 1,205	$ 237	$ 224	$ 193	$ 189	$ 844	$ 773	$ 806
% of Rev	10.8%	19.2%	10.3%	8.1%	12.1%	9.1%	8.8%	7.7%	7.6%	8.3%	7.40%	7.40%
Other Exp	$ 531	$ 587	$ 569	$ 556	$ 2,243	$ 588	$ 567	$ 575	$ 560	$ 2,290	$ 2,088	$ 2,179
% of Rev	20.6%	23.4%	23.4%	23.1%	22.6%	22.5%	22.3%	23.0%	22.5%	22.6%	20%	20%
EBITDA	$ 241	$ (78)	$ 118	$ 141	$ 422	$ 201	$ 198	$ 192	$ 198	$ 787	$ 1,524	$ 1,700
Margin	9%	-3.1%	4.9%	5.8%	4.3%	7.7%	7.8%	7.7%	7.9%	7.8%	14.6%	15.6%
Depreciation	$ 90	$ 90	$ 92	$ 96	$ 368	$ 95	$ 95	$ 95	$ 95	$ 380	$ 380	$ 380
Amort	$ 5	$ 5	$ 6	$ 4	$ 20	$ 5	$ 5	$ 5	$ 5	$ 20	$ 20	$ 20
Operating Income	$ 146	$ (173)	$ 20	$ 41	$ 34	$ 101	$ 98	$ 92	$ 98	$ 387	$ 1,124	$ 1,300
margin	5.7%	-6.9%	0.8%	1.7%	0.3%	3.9%	3.8%	3.7%	3.9%	3.8%	10.8%	11.9%
Investment Incom	$ 4	$ 3	$ 6	$ 7	$ 20	$ 5	$ 5	$ 5	$ 5	$ 20	$ 20	$ 20
Interest Expense	$ (77)	$ (74)	$ (91)	$ (91)	$ (333)	$ (105)	$ (105)	$ (105)	$ (105)	$ (420)	$ (420)	$ (420)
Min, Int, Other	$ (5)	$ 6	$ (1)	$ 13	$ 13	$ (5)	$ 6	$ (1)	$ (6)	$ (6)	$ (10)	$ (10)
Pretax Income	$ 68	$ (238)	$ (66)	$ (30)	$ (266)	$ (4)	$ 4	$ (10)	$ (8)	$ (19)	$ 714	$ 890
% of Rev	2.6%	-9.5%	-2.7%	-1.2%	-2.7%	-0.2%	0.2%	-0.4%	-0.3%	-0.2%	6.8%	8.2%
Income Taxes	$ 7	$ (113)	$ (16)	$ (3)	$ (125)	$ (2)	$ 1	$ (3)	$ (3)	$ (6)	$ 250	$ 311
Tax Rate	9.6%	47.5%	24.2%	10.0%	47.2%	35%	35%	35%	35%	35%	35%	35%
Net Income	$ 61	$ (125)	$ (50)	$ (27)	$ (141)	$ (3)	$ 3	$ (6)	$ (6)	$ (12)	$ 464	$ 578
EPS	$ 0.13	$ (0.27)	$ (0.11)	$ (0.06)	$ (0.30)	$ (0.01)	$ 0.01	$ (0.01)	$ (0.01)	$ (0.03)	$ 0.99	$ 1.23
%Chg Y/Y												
Shares Outstanding	465.3	465.9	466.6	467	466.2	466.7	467.7	468.7	469.5	468.2	470	470

EPS excluding gains and charges

Figure 11: Normalized EBITDA Margins

Source: 10-K Company Document

2002 Normalized EBITDA Margins

State	No Adjustments	w/ Outlier adjustments (1)	w/ Outlier and managed care adjustments (2)
AL	-0.4%	-4.7%	-9.8%
CA	26.8%	23.7%	19.9%
FL	14.6%	11.0%	6.7%
GA	13.0%	9.3%	4.9%
LA	15.2%	11.5%	7.2%
MO	23.5%	20.2%	16.4%
MS	13.4%	9.7%	5.3%
NE	25.2%	22.0%	18.2%
NC	31.2%	28.2%	24.8%
PA	9.1%	5.3%	0.7%
SC	34.0%	31.2%	27.8%
TN	19.1%	15.7%	11.6%
TX	30.8%	27.9%	24.4%
Weighted Avg.	21.7%	18.3%	**14.4%**

Notes:

(1) Reduced outlier payments to 5% of managed care revenues.

(2) Reduced outlier payments to 5% of managed care revenues and reucedmanaged care revenues by 10%

Figure 12: Valuation

$ in millions

Source: 10-K , Reuters, and Student Estimates

Price/Sales	
($mil)	**THC**
	2005E
Sales	10149
P/S 20% discount to closest peer	0.9
Mkt Cap	9134.1
Shares Outstanding	468.2
Target Price	**19.51**

Price to EBITDA		
	2005E	**2006E**
EBITDA	$ 787	1524
Current MKt Cap	5400	5400
EBITDAx	6.86	3.54
peer average	7.5	7.5
Target	5,906	11,432
Shares Out	468.2	468.2
Target Prices	12.61	24.42
Discounted rate 20%		20.35
Target:		**20.35**

Price to Earnings	**2005E**	**2006E**
EPS		0.99
peer average	22.3	22.3
THC PE (20% discount)	18.5	18.5
Target		18.315
20% discount rate		15.2625
Target		**15.26**

3-Pronged Valuation Model		**Targets Components**	**Target Weight**	
Price to Earnings		15.26	50%	7.63125
Price to Sales		19.51	25%	4.877243
Price to EBITDA		20.35	25%	5.086978
Target Price:				**17.60**

Figure 13: Balance Sheet in Millions
:10-K Company Document

	12/31/2004	12/31/2003	12/31/2002	5/31/2002	5/31/2001
Cash & cash equivalents	654	619	210	38	62
Restricted cash	263	-	-	-	-
Investments in debt securities	117	123	85	100	104
Accounts receivable, gross	2,386	2,915	2,940	2,740	2,719
Allowance for doubtful accounts	698	500	350	315	333
Accounts receivable, net	1,688	2,415	2,590	2,425	2,386
Inventories of supplies, at cost	188	224	241	231	214
Income tax receivable	530	-	-	-	-
Deferred income taxes	118	401	245	199	155
Assets held for sale	114	-	-	-	-
Other receivables	192	231	292	252	162
Prepaid expenses & other current items	128	106	95	107	87
Assets held for sale or disposal, net	-	129	34	42	56
Other current assets	320	466	421	401	305
Total current assets	3,992	4,248	3,792	3,394	3,226
Investments & other assets	296	386	185	363	395
Land	397	565	592	594	530
Buildings & improvements	4,127	4,439	5,216	5,412	4,949
Construction in progress	323	386	297	262	199
Equipment	2,547	2,723	3,268	3,303	2,905
Property & equipment, gross	7,394	8,113	9,373	9,571	8,583
Less accumulated depreciation & amortization	2,574	2,556	3,014	2,986	2,607
Property & equipment, net	4,820	5,557	6,359	6,585	5,976
Goodwill	800	1,949	3,260	-	-
Cost in excess of net assets acquired, gross	-	-	-	3,899	3,781
Less: Accumulated amortization	-	-	-	610	516
Cost in excess of net assets acquired, net	-	-	-	3,289	3,265
Other intangible assets, gross	271	270	294	290	223
Less: Accumulated amortization	101	112	110	107	90
Other intangible assets, net	170	158	184	183	133
Total assets	10,078	12,298	13,780	13,814	12,995
Current portion of long-term debt	41	18	47	99	25
Accounts payable	937	987	898	968	775
Accrued compensation & benefits	390	464	555	591	476
Income taxes payable	-	36	213	-	-
Accrued professional liability reserves	137	115	-	-	-
Accrued interest payable	96	53	24	59	132
Accrued legal settlement costs	40	203	-	-	-
Other current liabilities	489	518	644	867	758
Total current liabilities	2,130	2,394	2,381	2,584	2,166
Loans payable to banks, unsecured	-	-	830	975	60
Senior notes	4,450	4,000	3,044	2,644	2,217
Other senior & senior subordinated notes	22	24	2	2	1,525
Exchangeable subordinated notes	-	-	-	282	320
Zero-coupon guaranteed bonds	-	-	-	45	45
Notes payable & capital lease obligs, secured	65	88	97	100	71
Other promissory notes, primarily unsecured	-	34	14	37	53
Unamortized note discounts	-101	-89	-68	-67	-64
Long-term debt including current portion	4,436	4,057	3,919	4,018	4,227
Less current portion	41	18	47	99	25
Long-term debt, net of current portion	4,395	4,039	3,872	3,919	4,202
Professional liability reserves	591	511	-	-	-
Other long-term liabils & minority interests	919	989	1,278	1,003	994
Deferred income taxes	311	4	526	689	554
Total liabilities	8,346	-	-	-	-
Common stock	26	26	26	26	25
Additional paid-in capital	4,131	4,124	3,483	3,367	2,898
Accumulated other comprehensive income (loss)	-13	-8	-15	-44	-44
Retained earnings (accumulated deficit)	-930	1,710	3,514	3,055	2,270
Less common stock in treasury, at cost	1,482	1,491	1,285	785	70
Total shareholders' equity	1,732	4,361	5,723	5,619	5,079

Figure 14: Cash Flow Statement in Millions
Source: 10-K Company Document

	12/31/2004	12/31/2003	12/31/2002	5/31/2002	5/31/2001
Net income (loss)	-2,640	-1,477	459	785	643
Depreciation & amortization	388	471	302	604	554
Provision for doubtful accounts	1,205	1,575	676	986	849
Deferred income taxes	495	-563	-255	90	48
Net gain (loss) on sale of discontinued opers	-	-274	-	-	-
Income tax benefit related to stock options	-	-	37	176	74
Stock-based compensation charges	101	139	-	-	-
Impairment & restructuring charges	1,272	2,088	460	99	143
Extraord charges fr early extinguish of debt	-	-	4	240	35
Loss from early extinguishment of debt	13	-	-	-	-
Pre-tax (inc) loss fr discontinued operations	1,056	-	-	-	-
Net gain on sales of facils & lg-tm invests	-	-	-	-	-28
Other items	-16	43	44	46	27
Accounts receivable	-899	-1,403	-841	-1,075	-735
Inventories of supplies & oth current assets	-40	-	-26	-104	45
Income taxes payable	-562	-181	208	-	-
Accts pay, accrued exps & other curr liabils	166	401	-195	526	312
Other long-term liabilities	67	167	271	-	-
Pays agnst rsrvs for restruct chrgs<gtn cst	-280	-	-	-	-
Net csh prod by oper actvts fr discont opers	-408	-	-	-	-
Other long-term liabils & minority interests	-	-	-	19	-20
Net exps for discont opers & restruct charges	-	-148	-18	-77	-129
Net cash flows from operating activities	-82	838	1,126	2,315	1,818
Purchases of property & equipment	-454	-753	-490	-889	-601
Purch of property & equipment,discont opers	-20	-	-	-	-
Construction of new hospitals	-84	-80	-	-	-
Net csh rlsd fr escrow acct to fnd cnstrctn	88	-	-	-	-
Proc fr sales of facils, invests & oth assets	431	730	6	28	132
Purchases of new businesses, net	-	-39	-27	-324	-29
Investment in hospital authority bonds	-3	-107	-	-	-
Other items, including expenditures	30	-84	122	-42	-76
Net cash flows from investing activities	-12	-333	-389	-1,227	-574
Proceeds from borrowings	-	49	1,332	4,394	1,387
Sale of new senior notes	954	979	395	2,541	-
Repurch sr, sr subord & exchble subord notes	-555	-	-282	-4,063	-
Payments of borrowings	-17	-926	-1,551	-3,513	-2,945
Repurchases common stock	-	-	-500	-	-
Purchases of treasury stock	-	-208	-	-715	-
Rstrctd csh rltd to letter of credit facility	-263	-	-	-	-
Proceeds from exercises of stock options	2	5	43	273	254
Proceeds from sales of common stock	-	-	15	21	15
Other items	8	5	-17	-50	-28
Net cash flows from financing activities	129	-96	-565	-1,112	-1,317
Net incr (decr) in cash & cash equivalents	35	409	172	-24	-73
Cash & cash equivalents at beginning of year	619	210	38	62	135
Cash & cash equivalents at end of year	654	619	210	38	62
Interest expense paid	260	235	175	389	462
Income taxes paid	46	351	307	268	257

Figure 15: Income Statement in Millions
Source: 10-K Company Document

	12/31/2004	12/31/2003	12/31/2002	5/31/2002	5/31/2001
Net operating revenues	9,919	13,212	8,743	13,913	12,053
Salaries & benefits	4,325	5,713	3,327	5,346	4,680
Supplies	1,724	2,085	1,245	1,960	1,677
Provision for doubtful accounts	1,205	1,441	676	986	849
Other operating expenses	2,231	2,912	1,819	2,824	2,603
Depreciation	368	435	284	472	428
Other amortization	20	25	18	-	-
Amortization	-	-	-	132	126
Impairment of long-lived assets & goodwill	1,236	-	-	-	-
Restructuring charge	36	-	-	-	-
Impair of gdwill & lg-lived assets & restruct	-	1,881	396	99	143
Cost of litigation & investigations	74	282	-	-	-
Loss from early extinguishment of debt	13	-	4	-	-
Operating income	-1,313	-1,562	974	2,094	1,547
Interest expense	333	296	147	327	456
Investment earnings	20	18	14	32	37
Minority interests	-3	12	19	38	14
Net gains on sales of facils & lg-tm invest	10	16	-	-	28
Impairment of investment securities	-	-5	-64	-	-
Income (loss) from cont oper bef income taxes	-1,613	-1,841	758	1,761	1,142
Currently payable federal income taxes	-116	102	490	569	361
Currently payable state income taxes	7	21	64	77	55
Currently payable foreign income taxes	-	3	-	-	-
Total current income taxes	-109	126	554	646	416
Deferred federal income taxes	274	-487	-240	58	32
Deferred state income taxes	19	-76	-15	32	16
Total deferred income taxes	293	-563	-255	90	48
Income taxes	184	-437	299	736	464
Income (loss) from continuing operations	-1,797	-1,404	459	1,025	678
Income (loss) fr operations of asset group	-293	-30	-	-	-
Impair of lg-lvd asst& gdwill&restruct charge	-439	-	-	-	-
Litigation settlements	-395	-	-	-	-
Net gains on sales of asset group	71	274	-	-	-
Impairment & restructuring charges	-	-202	-	-	-
Income tax expense	213	-115	-	-	-
Total income (loss) fr discontinued operation	-843	-73	-	-	-
Extraord charges fr early exitinguish of debt	-	-	-	-240	-35
Net income (loss)	-2,640	-1,477	459	785	643
Weighted average shares outstanding-basic	466.226	465.927	484.877	489.17	479.621
Weighted average shares outstanding-diluted	466.226	465.927	493.53	502.899	490.728
Year end shares outstanding	467.236	464.786	473.738	488.541	488.201
Earnings (loss) per share-cont opers-basic	-3.85	-3.01	0.95	2.09	1.413
Earnings (loss) per share-discont opers-basic	-1.81	-0.16	-	-	-
Earnings (loss) per share-extraord item-basic	-	-	-	-0.49	-0.073
Net earnings (loss) per share-basic	-5.66	-3.17	0.95	1.6	1.34
Earnings (loss) per share-cont opers-diluted	-3.85	-3.01	0.93	2.04	1.387
Earnings (loss) per sh-discont opers-diluted	-1.81	-0.16	-	-	-
Earnings (loss) per sh-extraord item-diluted	-	-	-	-0.48	-0.073
Net earnings (loss) per share-diluted	-5.66	-3.17	0.93	1.56	1.313
Total number of employees	[illegible]	109,759	115,129	113,887	106,900
Number of common stockholders	9,296	9,600	9,700	10,100	10,600
Depreciation & amortization	-	-	-	-	554

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