

# Turning creditors into owners

## Nursing home chains emerge from bankruptcy with lenders in charge

BY VINCE GALLORO

When large, public companies emerge from Chapter 11 bankruptcy protection, usually more than their debt has been restructured. Boards and shareholders tend to be quite different, too, in ways that have direct effects on how the companies are managed and operated after leaving bankruptcy.

Consider three of the giant nursing home chains that declared bankruptcy in recent years: Vencor, Louisville, Ky., now known as Kindred Healthcare; Genesis Health Ventures, Kennett Square, Pa.; and Sun Healthcare Group, Albuquerque. Genesis and Kindred both left bankruptcy earlier this year, and Sun has filed a reorganization plan and expects to emerge by year-end.

Both Genesis and Kindred emerged from bankruptcy with their creditors owning all or nearly all of the new common stock they each issued. In Kindred's case, a 10% stake went to its main landlord, Louisville-based Ventas. Most of the remaining shares went to other noteholders. The owners of the pre-bankruptcy common and preferred shares of both companies received nothing. Sun's pending plan is similar in both respects. All three cases were or are being heard in U.S. Bankruptcy Court in Wilmington, Del.

The result for such companies is a smaller group of very sophisticated investors, relative to the wider distribution the companies' stock used to have, says Eric Scroggins, a managing director at Chanin Capital Partners, a Los Angeles-based investment banking firm. Scroggins

and Robert Stobo, vice president, head the firm's healthcare group. The two worked on the Genesis bankruptcy proceedings and are handling the Sun case.

"There is definitely much more oversight," Scroggins says. "In one of the healthcare companies (mentioned above), it is ruffling the feathers of the incumbent management team because they are not used to having to answer to the board" in the detailed, specific financial terms that the company's new board members demand. "Before, the boards were filled with too many friends of the management team," he says.

"I think it's fair to say that the new shareholders know a lot more about the company than prior shareholders," Stobo says. "It's much more of an institutional investor situation."

In the run-up to the bankruptcies declared in 1999 and 2000 (in addition to Genesis, Sun and Vencor, skilled-nursing chains Integrated Health Systems, Sparks, Md., and Mariner Post-Acute Network, Atlanta, also filed for Chapter 11 protection during that period), the boards of nursing home companies had included a lot of executives from other companies in skilled nursing, Scroggins says. "There was so much commonality between boards; there was a green light for acquisition," he says. "Now there's much more focus on the financial side (of a proposed deal) than there used to be"

because lenders-turned-shareholders are naming the board members.

Mike Segal, a healthcare lawyer and managing partner in the Miami office of Broad and Cassel, agrees. "(The creditor-named board members) will have limitations on

how much money gets paid to the executives," Segal says, and adds that executives' pay typically is tied closely to performance.

The creditors also tend to have shorter-term goals for the company than management, Segal says, because those creditors want to boost the value of the stock quickly and then sell to recoup the money they lent to the company before bankruptcy.

Typically, that process of selling is slowed by restrictions on the sale of the newly issued stock, he says.

Of course, by the time a company completes a long bankruptcy proceeding, many lenders have long since bailed out, Scroggins says. They often sell their debt for 50 cents on the dollar or less to what are known as "distressed players," Scroggins says. Distressed players "see a longer-term horizon for healthcare, and they feel much more comfortable holding an equity security when they have a significant stake in the company and can name members to the board," he says.

"A lot of these guys look at (bankruptcy proceedings) as a cheap way to effectively buy and run a company," Scroggins says. ■



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COMPANY NOTES

**Equity fund ready to invest.** MTS Health Partners, New York, has raised \$110 million for a private equity fund that it plans to invest in several healthcare ventures. Andrew Paul, a former senior partner at the New York-based healthcare equity firm Welsh, Carson, Anderson & Stowe, recently was named chairman of the company, which was founded last year. According to a

news release, the fund's biggest investor is CIBC Capital Corp. Other strategic investors include Well-Point Health Networks, Thousand Oaks, Calif., and Blue Cross and Blue Shield of Michigan.

**Vanguard reports loss.** Vanguard Health Systems, Nashville, for the first time publicly reporting its quarterly financial results, recorded

a net loss of \$4.2 million in its first quarter ended Sept. 30, compared with net income of \$191,000 in the year-ago quarter. Revenue rose 30% to \$207.3 million. Privately held Vanguard, which operates nine hospitals in three states, has begun to release its financial results because of a \$300 million public debt offering in July, a company spokesman says.