

October 2000 LQI (\$2.50) <MediTrust > by mike105

Description:

Companies selling at a significant discount to book value are normally difficult to find. After all, if they fell in your lap, investing wouldn't be any harder than opening up presents on Christmas morning. One place to look for these bargains are in industries which have lost favor with Wall Street, which is where I stumbled upon MediTrust (MT). MediTrust is a paired share REIT, meaning it is comprised of two entities, an operating company and an REIT. The advantage of this is MediTrust is not required to pay any corporate income tax, so long as it passes through ninety percent of earnings as dividends.

Investors don't want to touch MediTrust with a ten foot pole. In late 1998 MT was trading at almost \$15 a share, from which it gradually slid to its current price of below \$3. Why? In late 1998 the company announced a restructuring plan which involved the selling of golf and racetrack assets in order to focus on long term healthcare and mid priced lodging. The REIT portion of the company owns and manages the healthcare and lodging properties, while the operating company operates the lodging properties, which consists of La Quinta Companies, a chain of 300 mid priced hotels. The bad news is that due to changes in Medicare regulations the long term healthcare sector has taken a severe hit. Many providers, including some MediTrust does business with, have been forced to declare bankruptcy. At the same time, the mid priced lodging industry is facing an oversupply of rooms, especially in the geographic areas La Quinta is located. So within a short period of time, both industries the company operates in have fallen on hard times.

Setting aside the difficulties the company faces for a moment, take a look at the reported book value as of June 30, 2000:

Total assets:	5.047 billion
Total liabilities:	(2.456 billion)
Preferred stock:	(0.2 billion)
Goodwill:	(0.47 billion)

Share holder's equity applicable to common:	1.92 billion
Share's outstanding:	142,013,000
Reported book value per share:	13.52

Therefore, after backing out goodwill and \$200 million worth of preferred stock, there is \$13.52 of reported book value behind every share of common, which has been selling below \$3.

Of course, the question is how solid is that book value. As of early 2000, MediTrust has embarked on yet another restructuring plan. Anticipating an eventual rebound of the mid priced lodging segment when supply and demand rebalances, the company has elected to focus on La Quinta. A significant amount of the healthcare assets were sold off to pay down debt, a number of executives left and management more familiar with the mid priced lodging industry was brought in, including some who had worked at Red Roof Inns. The company has succeeded in selling

almost a billion dollars worth of healthcare assets at about 75 cents on the dollar. On the other hand, in my opinion La Quinta can be taken for its reported value. In the words of Thierry Perrein, head of REIT research at DLJ, "What investors tend to forget is that La Quinta assets are very good properties, mostly brand new." The total assets number of 5.047 billion above breaks down as 2.659 La Quinta and 2.388 health care. Taking the health care at 75 cents on the dollar leaves 4.45 billion in total assets, reducing the book value per share to \$9.32.

As part of the 2000 restructuring the company also decided to begin paying the minimum dividend possible to maintain REIT status, or ninety percent of earnings. As the company has been reporting a loss due to losses on the sale of their health care assets, the dividend has been suspended, further depressing the stock price.

Another method of valuing La Quinta would be to use EBITDA. Red Roof Inns, another mid priced lodging provider, went for 7.6x EBITDA in a buy out. Assuming MediTrust were able to dispose of it's healthcare assets at 75 cents on the dollar, that leaves 665 million of long term debt for La Quinta. Working from the company's last 10Q, namely the six month results for MediTrust operating company, a cocktail napkin calculation of EBITDA for an independent La Quinta would look like (all numbers in thousands except per share numbers):

Revenue from hotels:	307,120
Expenses:	
Hotel Operations:	(151,536)
General and Administrative:	(13,992)
Debt Maintenance at 13% for six months:	(43,225)
EBITDA for 6 months:	98,367
Per share for full year:	1.38

For those of you following along at home, all rents and royalties due to MediTrust would be moot as La Quinta would be independent. EBITDA of 1.38 per share makes a 7.6x valuation of \$10.49 per share.

These two valuations of \$10.49 and \$9.32 leave a significant margin of safety over the current price, which has dipped as low as \$2.50. A valuation this low leads me to think the market assumes MediTrust is headed for the bankruptcy courts, but I would beg to differ. Since January the company has succeeded in liquidating almost a billion dollars worth of health care assets at better than 75 cents on the dollar. Total debt is now down to \$1.6 billion, \$676 million coming due in 2001. MediTrust has also voluntarily reduced its revolving credit line from \$850 million to \$400 million, not the sign of an insolvent company.

Catalyst:

At about a \$10 value selling for \$2.50, in my opinion MediTrust represents a good enough value to not need any catalyst to eventually rebound. With that in mind, as more sales of health care assets go through, the stock should see a significant pop. Also, as cash flow becomes positive MT will be forced to resume paying a dividend or lose REIT status, which will buoy the stock price short term, although pulling possible investing capital from La Quinta. The new management has also instituted a franchising plan, which if successful could be a significant growth engine.