Moody's

Rating Action: **Moody's upgrades CommonSpirit Health's revenue bonds to A3, affirms VMIG 2 and P-2 short-term ratings, and assigns A3 to Series 2024 bonds; outlook revised to stable**

27 Feb 2024

New York, February 27, 2024 -- Moody's Investors Service has upgraded CommonSpirit Health to A3 from Baa1 and concurrently assigned an A3 to the proposed $2.8 billion Series 2024 bonds, consisting of: Revenue Bonds (CommonSpirit Health) Series 2024A issued by California Health Facilities Financing Authority; Revenue Bonds (CommonSpirit Health) Series 2024A issued by Colorado Health Facilities Authority; and Taxable Bonds, Series 2024A. The upgrade includes prior debt issued by Catholic Health Initiatives (CHI) and Dignity Health which combined to form Commonspirit in 2019. Dignity health joined CHI's obligated group and all debt is on parity. Consequently, we have upgraded ratings on Dignity Health's outstanding parity debt to A3 from Baa1. We have also affirmed CommonSpirit Health's VMIG 2 and P-2 ratings assigned to self-liquidity backed debt. The rating outlooks on CommonSpirit Health and Dignity Health have been revised to stable from positive at the new rating level. Total debt outstanding, inclusive of the Series 2024 bonds, is approximately $18.4 billion.

The assignment of the A3 rating and the upgrade of parity debt to A3 from Baa1 reflect the achievement of integration goals that will lead to continued improvement of operating performance.

RATINGS RATIONALE

CommonSpirit's A3 will continue to be supported by its exceptional size and good diversification across 24 states, and good market position with high acuity service offerings and diverse care delivery options in most markets. CommonSpirit has achieved many of the operational and organizational integration goals it established upon formation, driving margin improvement, and supporting stable liquidity and debt measures. Nevertheless, profitability remains modest with normalized operating cashflow (OCF) margin (excluding the 340B settlement and normalizing California State provider fee) measuring 2.9% through six months of fiscal 2024. OCF margins including one-time items should exceed 5% for full year 2024. Management expects normalized OCF margins to exceed 5% in 2025 and to surpass 6% in 2026, making progress towards their long term goal of 8%. CommonSpirit is highly leveraged relative to A3 peers, while liquidity is generally consistent with A3 medians.

The VMIG 2 and P-2 short-term ratings on debt that is backed by CommonSpirit's own liquidity reflect good coverage with daily liquidity, the continuation of good treasury management practices, and CommonSpirit's long-term credit profile.

RATING OUTLOOK

The stable outlook at the higher rating level reflects our expectation that OCF margins will continue to improve, exceeding 4% in 2025, and that liquidity will not drop below 150 days cash on hand. High leverage will continue to be a challenge, but cash to debt is expected to not drop below 80%, and as margins improve, debt to cashflow should be sustained below 6x.

FACTORS THAT COULD LEAD TO AN UPGRADE OF THE RATINGS

- Sustained improvement of operating measures to above 8%

- Strengthening of cash to debt and debt to operating revenue to levels consistent with the A2 rating

- Maintenance of liquidity above 200 days

- Short term ratings: Improvement in overall credit quality of borrower; improved coverage levels

FACTORS THAT COULD LEAD TO A DOWNGRADE OF THE RATINGS

- Inability to improve OCF margins to above 4% in 2025

- Sustained decline in liquidity resulting in days cash on hand below 150 days

or cash to debt below 80%

- Sizable acquisition that is dilutive

- Short term ratings: Decline in overall credit quality of borrower: decline in coverage levels

LEGAL SECURITY

Bonds are secured by a gross revenue pledge and are a joint and several obligation of the obligated group. As part of the 2019 financing, CHI's COD and Dignity Health's MTI were consolidated into a new MTI under CommonSpirit. Both legacy organizations are part of the obligated group and all MTI debt is on parity. The primary financial covenant under the MTI is a historic debt service coverage test of greater than 1.1 times. Less than 1.0 times is an event of default. Bank agreements have certain additional covenants, including: a minimum days cash on hand test of 75 days; a maximum debt to capitalization test of 65%; and a minimum bond rating requirement of Baa3 or BBB- by at least two rating agencies. Tests are measured annually. Failure to pass the bank covenants would be an event of default.

USE OF PROCEEDS

Proceeds will be used to refund prior bonds, reimburse up to $500 million for prior capital expenditures, fund future capital expenditures, fund general corporate purposes, and pay costs of issuance. Total debt will increase by approximately $400 million net of bond premium.

PROFILE

CommonSpirit Health is the product of the February 1, 2019 merger of Dignity Health and Catholic Health Initiatives, the latter of which changed its corporate name to CommonSpirit Health. CommonSpirit has approximately $36 billion of consolidated revenues and is headquartered in Chicago, with secondary headquarters in San Francisco and Denver. CommonSpirit operates in 24 states. Its largest markets include California, Colorado, Arizona, the Pacific Northwest and Texas.

METHODOLOGY

The principal methodology used in the long-term ratings was US Not-for-profit Healthcare published in February 2024 and available at https://ratings.moodys.com/rmc-documents/415013. The principal methodology used in the short-term ratings was US Municipal Short-term Debt Methodology published in May 2023 and available at https://ratings.moodys.com/rmc-documents/398329. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of these methodologies.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Eugene Spielman
Lead Analyst
PF Healthcare
Moody's Investors Service, Inc.
405 Howard Street
Suite 300
San Francisco 94105
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Eva Bogaty
Additional Contact
PF Healthcare
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653
