CommonSpirit Health, Colorado

New Issue Report

Ratings

Long Term Issuer Default Rating	BBB+

New Issues

$196,780,000 Chattanooga Health, Educational, and Housing Facility Board (CommonSpirit Health) Revenue Bonds, Series 2019A–1	BBB+
$81,700,000 Chattanooga Health, Educational, and Housing Facility Board (CommonSpirit Health) Revenue Bonds, Series 2019A–2	BBB+
$577,705,000 Colorado Health Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–1	BBB+
$1,055,445,000 Colorado Health Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–2	BBB+
$131,815,000 Colorado Health Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019B–1	BBB+
$216,255,000 Colorado Health Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019B–2	BBB+
$2,717,060,000 CommonSpirit Health Bonds (Taxable), Series 2019	BBB+
$73,750,000 Kentucky Economic Development Finance Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–1	BBB+
$105,930,000 Kentucky Economic Development Finance Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–2	BBB+
$91,570,000 Washington Health Care Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–1	BBB+
$217,910,000 Washington Health Care Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019A–2	BBB+
$89,565,000 Washington Health Care Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019B–1	BBB+
$87,875,000 Washington Health Care Facilities Authority (CommonSpirit Health) Revenue Bonds, Series 2019B–2	BBB+
$139,535,000 Washington Health Care Facilities Authority (CommonSpirit Health) Revenue B Bonds, Series 2019B–3	BBB+

Rating Outlook

Stable

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New Issue Summary

Sale Date: Aug. 8, 2019

Series: CommonSpirit's debut bond offering totals approximately $5.7 billion in par, with an additional expected $520 million in premium, in series 2019A, series 2019B and taxable series 2019 bonds issued through various issuing authorities.

Purpose: Approximately $600 million in proceeds will be used to reimburse CommonSpirit for prior capex, with the remaining proceeds used to refinance a portion of the commercial paper program (approximately $314 million), refund various outstanding debt previously issued by Catholic Health Initiatives (CHI) and Dignity Health ($5.2 billion) and pay costs of issuance.

Security: Upon closing this financing, CommonSpirit will create one unified credit group that will secure both the new bonds as well as legacy bonds previously issued by Dignity Health and CHI. The significantly amended CHI Capital Obligation Document and the Dignity Health Master Trust Indenture (MTI), with the necessary consents, will be combined to form the new CommonSpirit MTI that will secure all CommonSpirit obligated group debt. The bonds will be a joint and several obligation secured by a gross revenue pledge of the CommonSpirit obligated group (OG).

Analytical Conclusion

CommonSpirit was created by the alignment of Dignity Health ('A–'/Rating Outlook Stable) and Catholic Health Initiatives (CHI; 'BBB+'/Rating Outlook Stable) that closed on Feb. 1, 2019, forming the largest not-for-profit and largest Catholic health system in the country. CommonSpirit's 'BBB+' long-term rating is primarily driven by Fitch Ratings' belief that the combined system's leverage position is high when compared to the system's pro forma liquidity position and thin pro forma operating margins.

CommonSpirit has aggressive goals for advocacy and becoming a leader in the transformation of healthcare delivery in the U.S. while achieving the necessary profitability to support these efforts and fulfill its mission. Fitch has incorporated the system's substantial size, diversity and scale as a positive factor in the final rating, believing that CommonSpirit has additional credit strength beyond the face value numbers to support achievement of its goals.

Fitch believes that in the intermediate to long term, CommonSpirit should be able to leverage its better-performing assets to find a balance between profitability and supporting its mission in some of its ministries. However, in the more immediate years, the nascent system's high debt load and the need to respond to the headwinds in different markets will pressure the system's ability to bolster pro forma cash and cash flow versus outstanding debt and debt equivalents.

Fitch expects that it will be three to five years before the system fully realizes synergies, executes on difficult decisions and builds a sustained track record of improved profitability. Until current strategic plans are successfully implemented and further strategies are outlined for the next phase of growth, Fitch believes that the system's overall credit profile is best represented by the high end of the 'BBB' rating category as bondholders have adequate, but somewhat more limited, protection than would be expected at the 'A' rating level from operating disruptions or economic cycles over the next several years.

Fitch believes that the system's diverse portfolio, scale and operating model provide the system with the control and flexibility to make the changes necessary to generate an operating EBITDA margin that will bring the system's overall metrics in line with a higher rating, providing upside

rating potential beyond the outlook period. Fitch anticipates that the system will plan its capital spending within the parameters of its cash flow to maintain the midrange operating risk assessment in the coming years, likely eventually transitioning to a strong operating risk assessment.

While the combination of midrange revenue defensibility, midrange operating risk and a weak financial profile assessment in Fitch's scenario analysis initially suggest a lower rating, Fitch's criteria allow for ratings that fall outside of the suggested rating category outcome when considering all the relevant credit factors, such as CommonSpirit's substantial size, diversity and national scale.

Key Rating Drivers

Revenue Defensibility: 'bbb'; Extensive Size and Revenue Diversity

CommonSpirit's revenue defensibility is supported by its broad revenue composition, ranging across different services and markets. Many of the system's hospitals are in higher growth markets where they command solid market share. Overall, the system is experiencing a shift to more governmental payors, which may continue to temper its revenue growth rate in future years.

CommonSpirit Health by the Numbers

Operating Revenue	$30 Bil.
Total Debt	$13.7 Bil.
No. of States	21
No. of Hospitals	142
Operating Divisions	13
Licensed Acute Beds	21,408
No. of Employees	148,000
Affiliated Physicians	25,000
Clinically Integrated Networks	15

Source: CommonSpirit Health.

Operating Risk: 'bbb'; Operating Improvement Expected as Synergies are Realized

CHI began to show improvement in fiscal 2018 (June year-end) after years of widely reported low cash flow margins (averaging 3.9% operating margin over the last five years), the result of a number of operating challenges in its main markets. While Dignity Health's profitability was much stronger, averaging approximately 7.3% operating EBITDA over the past five years, there was volatility in the annual results given Dignity Health's high exposure to California's provider fee program. On a combined basis, pro forma operating EBITDA for CommonSpirit is expected to be modest, at approximately 5% in the recently concluded fiscal 2019.

Fitch believes that with identified financial synergies, CommonSpirit should be able to generate incremental cash flow within a couple of years closer to a 7% operating EBITDA margin.

Financial Profile: 'bb'; Weak Leverage Profile Reflects Limited Resiliency to Economic Cycles

CommonSpirit's financial profile assessment reflects the expectation for the system's gradual improvement in the base case. The stress case, however, results in net adjusted debt to adjusted EBITDA of approximately 1.7x (unfavorable) even in the recovery years and cash to adjusted debt just above 60%, both of which are consistent with a 'bb' financial profile assessment given the midrange (bbb) operating risk assessment and reflecting limited balance sheet cushion in case of any economic or operating disruption.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were applied in this rating determination.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
BBB+	Assigned	Stable	7/15/19

Related Research

Fitch Assigns a 'BBB+' IDR & Rev Rtg to CommonSpirit Health's (CO) $5.7B 2019 Bonds; Outlook Stable (July 2019)

Related Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (May 2019)

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (May 2019)

Rating Sensitivities

Transition to Strong Operating Risk Assessment: Fitch has assessed the operating risk profile as midrange given Fitch's expectation that operating EBITDA margin will range between 7% and 8% in the coming years. Nevertheless, Fitch believes that there is definite potential that the system may generate cash flow exceeding 8% operating EBITDA margin in the near future while maintaining a continuous level of capital reinvestment to remain competitive. If these higher levels are achieved on a sustainable basis and liquidity shows modest improvement, it would signal upgrade momentum. Given its revenue and geographic diversity, an upgrade may be possible even if profitability and balance sheet metrics lag the medians for the 'A' rating category.

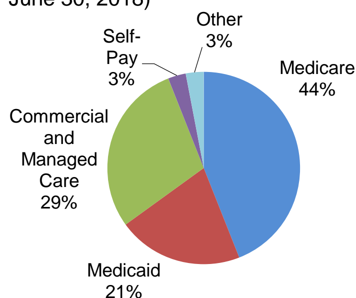
Alternatively, if further margin compression continues over a prolonged period of time and/or high capital spending requires significant additional cash or debt commitments, there may be rating pressure.

Credit Profile

CommonSpirit was formed on Feb. 1, 2019 and is headquartered in Chicago, IL. This integrated system operates 142 hospitals and more than 700 care centers across 21 states. The system has combined revenue of approximately $30 billion and 25,000 affiliated physicians and practitioners. In addition to hospitals, the system offers a wide continuum of care in its individual market divisions that may include micro hospitals, imaging centers, urgent care centers, specialty clinics, virtual care and home health and hospice services. Members of the CommonSpirit OG represent 92% of the system's revenues and 89% of the system's assets. CHI St. Luke's Health Baylor College of Medicine Medical Center, which is operated as a joint venture with Baylor College of Medicine, will become a Restricted Affiliate under the CommonSpirit Health MTI upon closing of the 2019 financing.

Revenue Defensibility

CommonSpirit Payor Mix
(% Gross Revenues as of June 30, 2018)



Source: CommonSpirit Health.

Across its different markets, CommonSpirit has an aggregate pro forma payor mix consisting of 24% of gross revenues derived from Medicaid and self-pay, which is factored into the 'bbb' revenue defensibility assessment. Many of the historical CHI hospitals are in higher growth markets with less reliance on governmental payors than historical Dignity Health hospitals, as reflected in 19% Medicaid/self-pay for CHI compared to 30% Medicaid/self-pay for Dignity Health. Like other systems in the country, CommonSpirit is continuing to experience modest payor mix shifts toward more governmental payors in addition to constrained revenue increases from commercial payors.

CommonSpirit divides its markets into 13 operating divisions. The system's largest divisions (not market operating divisions) by revenue include Greater Sacramento, Arizona, Southern California (part of the Southwest division), Pacific Northwest, Colorado, Texas and Nebraska, all of which individually generate over $2 billion in net revenue annually. Aside from the broad geographic diversity, there is also revenue diversity from a portfolio that provides a wide array of acute and non-acute healthcare services.

Although CommonSpirit garners a leading or a near-leading market share in many of its key markets, most of them are competitive markets with strong regional competitors. To remain competitive, CommonSpirit has to be agile to respond in a timely fashion to individual market pressures while implementing best practices and standards from its national operating model. Additionally, there may be patient or physician preference toward what is viewed as local providers in the market.

Of note, adjusted admissions on a same-facility basis decreased in fiscal 2018 and again in the first nine months of fiscal 2019 as outpatient growth failed to outpace the decline in inpatient

admissions. Inpatient and outpatient surgeries in the first nine months of fiscal 2019 also number less than the surgical volume in the same nine months of fiscal 2018. Stabilizing volumes throughout the system will be a key factor for success over the next couple of years.

CommonSpirit still expects to divest itself of Jewish Hospital and St. Mary's Healthcare Inc. in Louisville, part of its KentuckyOne Health division, in 2019. KentuckyOne had been in discussion with the University of Louisville to purchase the hospital assets but the negotiations ended in June when the University of Louisville announced that it would not be able to finance the acquisition on its own. Consequently, CommonSpirit resumed negotiations with two other interested parties with an expectation to close on the sale of the Louisville assets during fiscal 2020. While reported as discontinued operations and excluded from operating income, losses at the Jewish Hospital and St. Mary's Healthcare continue due to volume declines, and CommonSpirit reported negative $45 million EBITDA from these operations through the first nine months of fiscal 2019.

Fitch believes that CommonSpirit benefits from diverse service area characteristics that offset reliance on any one or two markets. The system operates in high-growth service areas like Houston and Omaha as well as markets in Arizona, Colorado, Nevada and Washington. This is offset by areas with less growth and more challenged payor mixes such as Southern California, where CommonSpirit feels that its presence helps provide healthcare access to otherwise underrepresented communities.

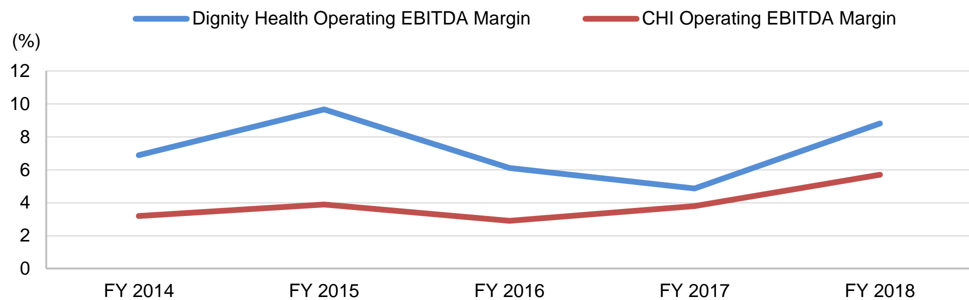
Operating Risk

Core to CommonSpirit's strategy for operating improvement is the realization of $2 billion in financial synergies over the next four-year period. Almost $1 billion is derived from merger-related savings that reduce redundancies, particularly in support functions, as well as other efforts such as standardization of initiatives, consolidation of vendors and re-bidding of administrative contracts. The remaining $1 billion in synergies will come from traditional operating improvement efforts such as reducing length of stay, labor productivity and leveraging best operating practices to lower the overall cost of care.

Fitch believes these are mostly a continuation of efforts already underway at the two historical systems, although there may be more opportunity to achieve stretch goals with CommonSpirit's larger platform. Constant discipline in identifying operating improvements is needed to offset many of the industry pressures, including eroding payor mix, more modest commercial payor increases and inflation.

The operating EBITDA margin of 5.5% for the first three quarters of fiscal 2019 trails the 8.2% margin for the same period in fiscal 2018 due to prior-period payments from the California provider fee program that boosted fiscal 2018 results. Dignity Health received a $217 million net provider fee payment from the program in fiscal 2018 related to services provided in fiscal 2017. Additionally, there was a one-time gain on sale from the U.S.HealthWorks transaction ($121 million) included in EBITDA in the initial nine-month period of fiscal 2018. On a same-facility basis, normalized (assuming payments from the California provider fee program had been timely) operating revenue is flat, year-over-year.

Operating EBITDA Margin for the Historical Organizations



Source: Fitch Ratings, Fitch Solutions, Dignity Health and Catholic Health Initiatives.

Capital Spending

CommonSpirit's combined size allows it to better allocate cost of capital for technology, which is an important component of the system's strategic plans. The system's electronic medical records are on three different legacy platforms but there is no plan to convert to one platform at this time. Instead, the system is focusing on maximizing interoperability and enhancing data analytic outputs using primarily Cerner and Epic.

On an aggregate pro forma basis, average age of plant is just under 10 years, indicating manageable routine capital needs. CommonSpirit is planning to reinvest at or just above depreciation level but is committed to funding capital within EBITDA expectations.

Capital needs throughout the markets are required to demonstrate high return on invested capital as cash flow to fund projects is somewhat limited compared to the size of its portfolio assets.

Fitch anticipates that capex may increase in later years once the system is on stronger financial footing and begins to pursue larger growth opportunities.

Financial Profile

CommonSpirit's financial profile assessment reflects the expectation for the system's gradual improvement in the base case. Pro forma liquidity is expected to be just under 150 days cash on hand (DCOH) at year-end fiscal 2019, an improvement from 146 days at the end of the first nine months (March 31) of fiscal 2019 primarily due to a $450 million payment received after March 31 from the California provider fee program. This should result in an increase in pro forma cash to debt to approximately 83% from 81% at the end of the first nine months of fiscal 2019.

CommonSpirit's debt equivalents (included in adjusted debt) reflect only operating lease exposure (5x multiple) as the system maintained a pro forma funded status for defined benefit pension plans as of fiscal year-end 2018 at 82%. In prior years, pro forma funded status would have been below 80% and Fitch would have added the pension liability below the 80% level to the system's debt equivalents. Fitch's debt equivalent liability for the operating leases as of 2018 was $2.5 billion, resulting in a cash to adjusted debt expectation of approximately 70% at fiscal year-end 2019.

Fitch's scenario analysis annualizes the first nine-month results for fiscal 2019 as the most recent historical fiscal year, making 2020 the first year of the forward look. Fitch's stress case scenario incorporates a standard revenue stress and a portfolio sensitivity stress based on CommonSpirit 's asset allocation that is invested in 29% fixed income, 18% domestic equities,

20% international equities, 15% hedge funds and 15% private equity and other, with the balance in cash. In Fitch's forward-looking scenario, a 1.5% GDP drop results in an almost 13.0% decrease to CommonSpirit's portfolio valuation followed by a stable 6.0% return assumption in the later periods of the five-year scenario.

The stress case scenario incorporates reduced capex in the base case of 25% in 2021 and 2022 and 10% in 2023 to reflect management's flexibility in pulling back on non-fixed capital spending in a continued revenue stress scenario. The scenario also incorporates the $600 million in unrestricted new money bond proceeds from the series 2019 taxable debt issuance in fiscal 2020. There is no other debt anticipated in the other years of the forward look.

With the assumptions described above, the results of a forward look stress scenario in the fourth and fifth year reflect cash to adjusted debt of roughly 62%, net adjusted debt to adjusted EBITDA of 1.5x (unfavorable) and DCOH as low as 105 days. These metrics more closely align with the suggested 'bb' financial profile assessment based on midrange revenue defensibility and midrange operating risk as they reflect a comparatively weaker resiliency to stress events.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were applied in this rating determination.

Management and Governance

Dignity Health and CHI signed the definitive agreement to align their organizations in December 2017 but did not close until Feb. 1, 2019. After a two-year period of due diligence and planning, the combined system was ready with a corporate structure, credit group plan and organizational structure that it felt would best position the system for growth. This structure includes the Office of the CEO, where each of the historical CEOs is responsible for different areas. Lloyd Dean has authority for operations and all of the clinical, financial and human resources. Kevin Lofton has authority for advocacy, compliance, digital, information technology, international business, legal services, philanthropy, mission and sponsorship and governance. Fitch believes there is already significant operational oversight occurring, which supports our expectation for margin improvement in the coming years.

Debt Profile

This refinancing represents significant de-risking of the pro forma debt portfolio by reducing variable rate debt (from 42% to 25% of total debt, including synthetic debt), reducing bank exposure and reducing event/put risk by $3 billion while generating cash flow savings.

Pro forma interest rate mix after the financing will comprise 68% fixed rate debt, 17% synthetic fixed rate, 8% variable and 7% total return swap. Although the commercial paper exposure will be reduced, the program is still authorized to $881 million.

Financial Summary

($000, Fiscal Years Ended June 30)	Proforma 2017	Proforma 2018	Proforma Nine Mos. Ended 3/31/19[a]
Balance Sheet Data			
Unrestricted Cash & Investments	11,638,265	12,134,524	11,018,034
Total Assets	25,026,918	38,664,538	38,393,894
Total Debt (Including Current Portion)	13,938,301	13,721,164	13,655,270
Adjusted Debt	16,613,346	16,188,664	13,655,270
Net Adjusted Debt	4,975,081	4,054,140	2,637,236
Unrestricted Net Assets	13,930,463	14,677,532	14,592,508
Income & Cash Flow Data			
Net Patient Revenue	25,535,154	26,819,737	19,895,314
Other Revenue	2,308,019	2,322,268	1,626,413
Total Revenues	27,843,173	29,142,005	21,521,727
Depreciation & Amortization	1,430,608	1,458,188	1,059,197
Interest Expense	485,236	471,523	369,173
Total Expenses	28,601,077	28,959,882	21,761,437
Income from Operations	(757,904)	182,123	(239,710)
Operating EBITDA	1,157,940	2,111,834	1,188,660
Non-Operating Gains (Losses)	709,883	693,618	474,779
Excess (Deficiency) of Revenues over Expenses	(48,021)	875,741	235,069
EBITDA	1,867,823	2,805,452	1,663,439
Operating Lease Expense	454,600	493,500	—
Total Pension Expense	331,250	296,841	—
Adjusted EBITDA	2,653,673	3,595,793	1,663,439
Net Unrealized Gains (Losses)	424,101	179,877	(206,000)
Net Capital Expenditures	1,338,595	1,302,621	1,106,000
Maximum Annual Debt Service (MADS)	809,787	809,787	809,787
Liquidity Ratios			
Days Cash on Hand	156.3	161.1	145.7
Days in Accounts Receivable	—	51.9	56.5
Cushion Ratio (x)	14.4	15.0	13.6
MADS Coverage - EBITDA (x)	2.3	3.5	2.7
MADS Coverage - Operating EBITDA (x)	1.4	2.6	2.0
MADS / Total Revenue (%)	2.9	2.8	2.8
Profitability & Operational Ratios (%)			
Operating Margin	(2.7)	0.6	(1.1)
Operating EBITDA Margin	4.2	7.3	5.5
EBITDA Margin	6.5	9.4	7.6
Capital Related Ratios			
Cash / Debt (%)	83.5	88.4	80.7
Cash / Adjusted Debt (%)	70.1	75.0	80.7
Net Adjusted Debt / Adjusted EBITDA	1.9	1.1	1.2
Average Age of Plant (Years)	9.7	9.8	—
Capital Expenditures / Depreciation (%)	93.6	89.3	104.4

[a]Unaudited. EBITDA: Earnings before interest, taxes, depreciation & amortization.
Note: Fitch may have reclassified certain financial statement items for analytical purposes.

Sources: Fitch Ratings, Fitch Solutions, CommonSpirit Health (CO)

Utilization Data

(Fiscal Years Ended June 30)	Proforma 2017	Proforma 2018	Proforma Nine Mos. Ended 3/31/19[a]
Operated Beds	18,171	17,257	17,166
Acute Adult Admissions / Discharges	872,001	852,756	625,951
Acute Adult Patient Days	3,943,291	3,849,766	2,860,302
Average Length of Stay (Days)	4.5	4.5	4.6
Average Daily Census	10,804	10,547	10,449
Occupancy (%)	59.5	61.1	60.9
Hospital Stays (Admissions plus Observation Cases)	872,001	852,756	625,951
Births	—	107,268	79,666
Inpatient Surgeries	225,571	238,951	171,734
Outpatient Surgeries	367,843	355,618	263,970
Emergency Department Visits, Net of Admissions	3,518,062	3,458,317	2,616,582
Outpatient/Clinic Visits	29,375,539	24,327,644	16,450,371
Medicare Casemix Index	1.82	1.97	1.89

Sources: Fitch Ratings, Fitch Solutions, CommonSpirit Health (CO)

Payor Mix

(% Gross Revenues; Fiscal Years Ended June 30)	Proforma 2017	Proforma 2018	Proforma Nine Mos. Ended 3/31/19[a]
Medicare	42.0	44.0	44.0
Medicaid	22.0	21.0	21.0
Commercial & Managed Care	30.0	29.0	28.0
Self-Pay	3.0	3.0	3.0
Other	3.0	3.0	3.0
Total	100.0	100.0	99.0

Sources: Fitch Ratings, Fitch Solutions, CommonSpirit Health (CO)

Key Definitions

Terms	Definition	Significance
Issuer Default Rating (IDR)	An expression of overall enterprise risk and relative vulnerability to default.	Provides an opinion of the relative ability of an entity to meet financial commitments, expressed as an ordinal measure of credit risk.
Adjusted Debt	Total long-term debt + unfunded pension liability below 80% PBO + 5.0x operating lease expense	Provides an inclusive evaluation of total long-term liabilities.
Cash to Adjusted Debt	Unrestricted cash and investments / adjusted debt	Indicates financial flexibility and cushion against decline in operating profitability.
Net Debt	Total debt - unrestricted cash and investments	Indicates the level of unrestricted liquid asset cushion available to cover debt.
Adjusted EBITDA	EBITDA + pension expense + annual operating lease expense	Provides an indication of cash flow available for the payment of debt service, adjusting for pension and operating lease obligations.
Net Adjusted Debt to Adjusted EBITDA	(Adjusted debt - unrestricted cash and investments) / adjusted EBITDA	Provides an indication of net total leverage position against available operating cash flow.
Base Case	The expected forward-looking case in the current macro-economic environment.	Provides the analytical starting point in the forward- looking analysis, and also informs the rating case.
Rating Case	The potential performance under a common set of assumptions.	Illustrates how cycles affect individual issuers differently, and informs the level of rating stability and credit resiliency.

The FAST scenario results are not a forecast. The results are intended only to illustrate performance under a given set of assumptions made by Fitch for a specific issuer that fall within the range of performance that is consistent with a stable rating. In this sense, the rating case scenario depicts a rating sensitivity and suggests the level of change in performance in stress consistent with the rating assigned. It should not be interpreted as a prediction of actual performance under stress. As an issuer can respond to a decline in portfolio value and profitability in the rating case in varied ways, actual metrics may also vary from those depicted in the scenario analysis.

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