What Ratings Agencies Look for in Independent Organizations

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Fitch Ratings 2022 Outlook - Revised
U.S. Not-for-Profit Hospitals and Health Systems

"The bumpy ride not-for-profit hospitals have been on will continue, with sector medians showing significant credit strength when looking backwards, but the forward look is much more concerning. Elevated expense pressure remains pronounced, particularly for nurses, and even as macro inflation cools, labor expenses may be reset at a permanently higher level for the rest of 2022 and likely well beyond. Fitch sees a deteriorating outlook for the rest of 2022 and into 2023, with a period of elevated downgrades and negative outlook pressure."

Kevin Holloran, Senior Director
August 16, 2022

Regarding Ratings of Independent Hospitals & Health Systems

- We do not penalize for smaller size and scale, nor do we reward for larger size and scale – that being said, there is a strong correlation between the size of a provider and the strength of their rating;
- Fitch rates everything from 25 bed critical access hospitals, all the way up to national systems;
- About one half of our rated universe is what we would call a stand-alone hospital;
- If there is one single metric that we key in on the most, it is cash to debt;
- Market essentiality (market density) is and key credit factor, and determines if you are a market maker, or a price taker

Fiscal 2021 Medians by Rating Category

Nonprofit Hospital and Health Care System Category Medians — 2021										
	2021	2020	2021	2020	2021	2020	2021	2020	2021	2020
	Median	Median	AA	AA	A	A	BBB	BBB	BIG	BIG
Sample Size	219	213	90	86	80	78	25	32	13	17
Total Operating Revenue ($ Mil.)	1,160,179	1,029,499	2,125,216	2,280,535	1,012,531	787,176	748,682	708,181	445,803	426,282
Days Cash on Hand	260.3	241.4	319.7	304.2	241.2	238.2	175.7	166.5	90.4	98.7
Days in Accounts Receivable	47.2	44.6	46.1	43.6	48.2	44.5	50.3	45.2	47.9	46.1
Cushion Ratio (x)	29.4	25.3	44.0	37.8	25.0	23.2	16.6	16.1	10.1	9.2
Days in Current Liabilities	89.4	91.4	92.8	97.5	83.9	83.6	94.7	92.4	92.1	91.4
Cash to Debt (%)	185.5	162.8	252.9	219.0	153.0	148.1	107.3	105.2	75.9	60.4
Cash to Adjusted Debt (%)	180.1	150.6	249.1	206.8	151.8	137.7	102.3	94.5	75.5	55.7
Operating Margin (%)	3.0	1.5	3.6	2.2	3.0	1.3	2.5	0.8	1.3	0.5
Op EBITDA Margin (%)	8.9	7.3	9.6	7.9	8.8	7.4	7.9	7.2	6.9	6.7
Excess Margin (%)	6.6	3.3	8.5	4.075	5.7	3.27	4.8	2.56	3.6	1.7
EBITDA Margin (%)	12.4	9.3	13.9	9.775	11.9	9.52	10.8	9.27	9.8	7.5
Net Adjusted Debt to Adjusted EBITDA	-2.1	-2.1	-3.2	-3.4	-1.6	-1.6	-0.1	0.2	1.0	1.3
Personnel Costs as % of Total Operating Revenue	52.8	55.0	52.0	54.0	52.8	55.1	51.6	55.2	55.1	57.9
EBITDA Debt Service Coverage (x)	5.6	4.0	7.4	5.1	4.9	3.7	4.0	3.3	3.3	2.4
OP EBITDA Debt Service Coverage (x)	3.8	3.1	4.7	3.8	3.7	3.0	3.0	2.6	2.5	2.0
Maximum Annual Debt Service as % of Revenues	2.2	2.3	2.0	2.1	2.4	2.6	2.5	2.7	2.8	3.3
Debt to EBITDA (x)	2.7	3.8	2.3	3.2	3.1	4.4	3.4	4.2	3.5	5.4
Debt to Capitalization (%)	31.7	33.6	24.4	27.0	34.7	36.1	41.1	44.6	56.6	58.5
Average Age of Plant (Years)	11.9	11.7	10.8	10.4	12.5	12.2	13.0	13.0	15.6	15.9
Capital Expenditures as % of Depreciation Expense	100.4	109.5	100.8	115.6	105.3	111.4	83.4	81.6	94.4	88.8

EBITDA – Earnings before interest, taxes, depreciation, and amortization. CFFOBI – Cash flow from operations before interest.

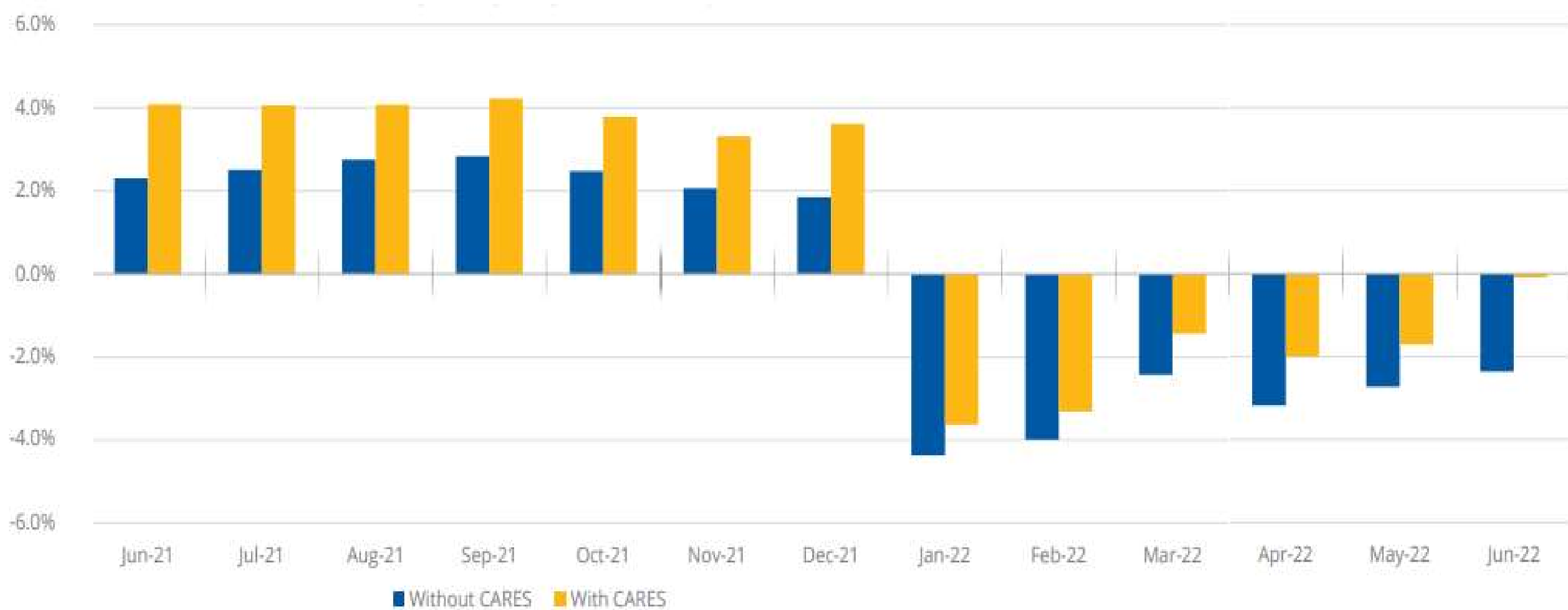
Fiscal 2021 Medians by Rating Category

Standalone	2021	2020	2019
	104	99	97
Days Cash on Hand	237.5	232.1	213.3
Days in Accounts Receivable	46.2	44.4	46.2
Cushion Ratio (x)	24.7	23.3	21.7
Days in Current Liabilities	89.4	88.1	61.2
Cash to Debt (%)	179.7	150.5	157.6
Cash to Adjusted Debt (%)	175.7	135.8	131.7
Operating Margin (%)	3.8	1.7	2.0
Op EBITDA Margin (%)	9.7	8.4	8.7
Excess Margin (%)	7.0	3.7	3.8
EBITDA Margin (%)	13.0	10.4	10.6
Net Adjusted Debt to Adjusted EBITDA (%)	-1.6	-1.6	-1.0
Personnel Costs as % of Total Operating Revenue	53.1	55.1	54.4
EBITDA Debt Service Coverage (x)	5.2	4.1	3.8
OP EBITDA Debt Service Coverage (x)	3.8	3.1	3.0
Maximum Annual Debt Service as % of Revenues	2.5	2.7	2.6
Debt to EBITDA (x)	2.5	3.4	3.2
Debt to Capitalization (%)	29.7	32.6	32.8
Average Age of Plant (Years)	12.3	12.0	11.7
Capital Expenditures as % of Depreciation Expense	101.2	108.4	107.0

Systems	2021	2020	2019
	115	114	106
Days Cash on Hand	270.4	255.0	230.2
Days in Accounts Receivable	47.7	44.6	46.8
Cushion Ratio (x)	31.7	29.0	26.5
Days in Current Liabilities	89.8	95.0	66.8
Cash to Debt (%)	189.4	169.9	165.7
Cash to Adjusted Debt (%)	185.0	161.1	149.9
Operating Margin (%)	2.7	1.3	2.5
Op EBITDA Margin (%)	8.1	6.7	8.9
Excess Margin (%)	6.1	3.1	4.9
EBITDA Margin (%)	12.1	8.5	10.6
Net Adjusted Debt to Adjusted EBITDA (%)	-2.5	-2.6	-1.5
Personnel Costs as % of Total Operating Revenue	52.3	55.0	53.0
EBITDA Debt Service Coverage (x)	5.8	3.9	4.5
OP EBITDA Debt Service Coverage (x)	3.8	3.2	3.7
Maximum Annual Debt Service as % of Revenues	2.1	2.2	2.2
Debt to EBITDA (x)	2.8	4.4	3.4
Debt to Capitalization (%)	31.9	35.2	32.9
Average Age of Plant (Years)	11.8	11.4	11.5
Capital Expenditures as % of Depreciation Expense	99.4	110.1	125.0

Month by Month Comparison

Kaufman Hall Operating Margin Index YTD by Month (12 Months)



Source: Kaufman Hall

Potential “Red Flags”:

- Flat or declining year over year net patient revenues (minimal or negative growth);
- Resistance to change;
- Sudden industry change that forces added expenses onto a provider (e.g., staffing)
- Once change begins, too slow to change;
- Unwillingness to course correct.

Potential Strategy Solutions:

- Stick to your mission;
- Adopt no regrets strategies;
- Partner – “half a loaf is better than no loaf”;
- Understand that we are likely two years before some level of "normal" returns to the sector in regards to staffing;
- Know your legal documents: Fitch is wary of covenant violations as fiscal 2022 audits are completed. Covenant violations could easily continue into fiscal 2023.

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