CommonSpirit Health
Update following revision of outlook to positive

Summary
CommonSpirit Health’s (Baa1 positive) solid and improving credit profile reflects our expectation that operating margins will be sustained at recently improved levels, that balance sheet measures will remain favorable, and that debt measures will continue to improve over time. Additional strengths include: exceptional size and good diversification across 21 states; high acuity service offerings; and good concentration and diverse care delivery options in most markets. Much progress has been made in consolidating the two legacy organizations (Catholic Health Initiatives, and Dignity Health, which merged on February 1, 2019), and we expect additional efficiencies and synergies to be achieved over time. Nevertheless, certain markets remain particularly challenging, and in some cases we expect improvement to be slow. Additional challenges include: debt measures that remain modest for the rating category and compared to large system peers; material, although improved, pension and operating lease debt; labor shortages in most markets; and ongoing challenges related to the pandemic.

Affirmation of the VMIG2 and P-2 short-term ratings on debt that is backed by CommonSpirit’s own liquidity is a function of CommonSpirit’s long term rating, sufficient liquidity headroom at those levels, and the continuation of good treasury management practices.

On November 22, 2021, Moody’s affirmed CommonSpirit’s Baa1 rating, and revised the outlook to positive from stable.

Exhibit 1
Improved operating margins and balance sheet measures support the positive outlook

Based on audited financial statements for CommonSpirit Health for fiscal years ended June 30; 2019 is proforma based on a full year of consolidated operations (organizations merged on February 1st); Medicare advances and deferred payroll tax excluded from calculations
Source: Moody’s Investors Service
Credit strengths

» Strong brand and regional focus help support competitive position; CommonSpirit is either first or second in all but one of its numerous markets

» CommonSpirit will continue to benefit from cashflow diversification and economies of scale derived from its very large size (nearly $33 billion of operating revenues in fiscal 2021) and significant presence in 21 states

» Liquidity (excluding Medicare advances and deferred payroll tax) has improved significantly and is expected to remain at current levels or better

» Operating margins may decline slightly in 2022, but remain above pre-2021 levels; margins are expected to further improve thereafter

» Access to California’s provider fee program (over 35% of CommonSpirit’s revenues are derived from California) will continue to provide needed and material operating support

» Much progress has been made on consolidating the two legacy organizations and on achieving CommonSpirit’s goal of producing $2 billion of synergistic benefit; more progress is expected in 2022

Credit challenges

» CommonSpirit will continue to face significant competition in most markets; labor unions are active and aggressive in certain markets

» Operating pressures remain pronounced across the system, including pressures related to the pandemic, and the severe labor shortage nationwide

» Certain markets will continue to underperform, including Texas where margins are very low and progress has been slow

» Despite significant improvement, debt measures remain modest for the rating category and are weak compared to large system peers

» Pension liability remains material at $3.3 billion and pressures comprehensive debt

Rating outlook

The positive outlook reflects our expectation that the recent gains to operating performance and balance sheet measures will be sustained, that certain underperforming markets will continue to improve, and that debt measures will strengthen over time.

Factors that could lead to an upgrade

» Demonstrated durability of improved operating and balance sheet measures

» Continued operating cashflow growth

» Continued successful integration of legacy organizations

» Short term rating: Improvement in overall credit quality of borrower; improved coverage levels

Factors that could lead to a downgrade

» Return to modest operating margins

» Material dilution of balance sheet measures

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.
» Weakening of debt measures
» Sizable acquisition that is dilutive
» Short term rating: Decline in overall credit quality of borrower: further decline in coverage levels

Key indicators

CommonSpirit Health

<table>
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<tr>
<th>Metric</th>
<th>2019</th>
<th>2020</th>
<th>2020 excl. advances</th>
<th>2021</th>
<th>2021 excl. advances</th>
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<tr>
<td>Operating Revenue ($'000)</td>
<td>28,832,600</td>
<td>29,579,000</td>
<td>29,579,000</td>
<td>32,730,000</td>
<td>32,730,000</td>
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<tr>
<td>3 Year Operating Revenue CAGR (%)</td>
<td>4.0</td>
<td>1.3</td>
<td>1.3</td>
<td>4.1</td>
<td>4.1</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
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<td>4.9</td>
<td>4.9</td>
<td>7.4</td>
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<tr>
<td>PM: Medicare (%)</td>
<td>44.0</td>
<td>44.0</td>
<td>44.0</td>
<td>45.0</td>
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<tr>
<td>PM: Medicaid (%)</td>
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<td>21.0</td>
<td>21.0</td>
<td>21.0</td>
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<td>Days Cash on Hand</td>
<td>152</td>
<td>201</td>
<td>166</td>
<td>245</td>
<td>210</td>
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<td>Unrestricted Cash and Investments to Total Debt (%)</td>
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<td>107.7</td>
<td>89.0</td>
<td>136.6</td>
<td>117.1</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>6.6</td>
<td>6.5</td>
<td>6.9</td>
<td>4.4</td>
<td>4.6</td>
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Based on audited financial statements for CommonSpirit Health for fiscal years ended June 30; 2019 is proforma based on a full year of consolidated operations (organizations merged on February 1st); non cash related restructuring expenditures excluded ($124 million in 2019, $6 million in 2020); swap cashflow expense added to interest expense; imputed pension expense added to operating expenses; investment returns normalized at 5%; $523 million gain on sale excluded from 2021; Medicare advances and deferred payroll tax together totaled $2.740 billion at fiscal year end (FYE) 2020, and $2.951 billion at FYE 2021 - they are either included or excluded from calculations as indicated

Source: Moody's Investors Service

Profile

CommonSpirit represents 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 $33 billion of consolidated revenues, is headquartered in Chicago, and operates in 21 states. Its largest markets include California, Colorado, Arizona, the Pacific Northwest and Texas.

Detailed credit considerations

Market position: size and scope of integrated system provides good diversification and a degree of overall stability

CommonSpirit will continue to benefit from its large size and good diversification, with significant operations in 21 states. The organization has a regional orientation, and is focused on being a leader in each of its markets, while developing a broad array of service offerings and delivery platforms in order to be competitive across the full spectrum of care delivery. Management originally set out to achieve $2 billion in synergistic benefit in the first four years of operation. Through the end of its second year, management estimates that it already has achieved approximately $800 million in savings and performance improvements, despite the disruptions caused by COVID. Areas of focus have included streamlining management, reorganizing the system’s regional structure, coordinating practices and purchasing across the entire system, divesting and investing in assets strategically, and integrating and optimizing the back offices. Management expects further benefits to be achieved over the next two years.

Certain markets continue to underperform, and management will endeavor to make further improvements in the next year. One of the most challenging markets continues to be Texas, where CommonSpirit operates 15 hospitals, including Baylor St. Luke’s Medical Center (BSLMC). The Houston area is highly competitive with several larger tertiary systems at the Texas Medical Center, and it is the only market where CommonSpirit is not either first or second in market share (it is fourth). Improvement here may continue. Other lower performing markets include the Midwest, the Southeast, and in 2021, Northern California (primarily for reasons related to the pandemic). Other markets perform well, and certain markets are exceptionally strong, including Arizona and Colorado, which in 2021 produced particularly strong margins. This general pattern of strengths and weaknesses is expected to continue into 2022. Overall,
we see this combination of geographic diversity with well developed markets as a fundamental strength of the organization, which is proving to provide growth and stability.

Management remains interested in making opportunistic acquisitions in current markets for assets that will be complementary and accretive. Two meaningful acquisitions have taken place in the last year. In Arizona, management entered into an affiliation agreement with Yavapai Regional Medical Center (A2 stable) which gives the system a presence in Prescott, and expands the greater Phoenix regional footprint. In Washington, CommonSpirit affiliated with Seattle-based Virginia Mason Medical Center (Baa3 negative), which gives CommonSpirit’s Tacoma-based regional system (under the brand Franciscan Health System, now called Virginia Mason Franciscan Health) additional prestige, research capabilities, geographical reach, and very high end clinical services. We believe both additions have the potential of being accretive. Additionally, CommonSpirit continues to make certain diversified and strategic investments, one of which it monetized in 2021 resulting in a gain of $523 million (excluded from our calculation of 2021 margins).

**Operating performance, balance sheet, and capital plans: 2021 showed material improvement despite ongoing operating pressures; liquidity reaches new high**

Operating results are likely to slightly moderate in 2022 versus 2021, but remain above pre-2021 levels, and continue to improve thereafter. The most significant sources of pressure on operations have been the pandemic, and the related labor shortage. Results in 2020 were suppressed in large part due to the mandated shutdown in the last quarter of the fiscal year (ended June 30). Results in 2021 fared much better despite ongoing pressures. In response to the pandemic, management implemented resource sharing and cost reduction measures system wide, which succeeded in minimizing some of the losses. We believe this is another benefit of the scale and scope of the organization, giving it the ability to pool and coordinate resources, and optimize its response across all regions. Additionally, CommonSpirit recognized $826 million of CARES funds in 2020, and another $690 million in 2021, which further helped bolster margins, representing 59% and 28% of cashflow in 2020 and 2021 respectively. CARES funds offset most, but not all, of the additional expenses and losses related to the pandemic. CommonSpirit’s response to the labor shortage has been similar, using its size and scale to optimize resources, and to employ a coordinated response. Nevertheless, both of these issues will likely pressure margins in 2022.

An additional source of support to the organization is the California State Provider Fee. With over 35% of net patient revenues generated from the state of California, CommonSpirit is a significant beneficiary of the program, reflecting the level of Medi-Cal patients served within CommonSpirit’s facilities. Total net receipts were approximately $523 million in fiscal 2021. We expect this level of support to continue going forward, which further helps stabilize performance.

Longer term, management has the stated goal of reaching 8% operating cashflow margins, which still may be several years away. The expected slight decline in 2022 not-withstanding, it will be important for CommonSpirit to sustain recent improvements, and make further progress towards its goal, in order to maintain its positive momentum.

**LIQUIDITY**

Unrestricted cash and investments increased impressively by $4 billion from FYE 2020 to FYE 2021 (excluding Medicare advances and deferred payroll tax), improving days cash on hand to 210 days at FYE 2021. Additionally, CommonSpirit benefited from Medicare advances and deferred payroll tax, which totaled $2.74 billion and $2.951 billion at FYE 2020 and 2021 respectively. Inclusive of these funds, days cash on hand reached 245 days at FYE 2021. Management intends to return these funds in full by the end of calendar year 2022.

Investment allocation is consistent with other organizations of this size and stature, with 42% allocated to cash and fixed income, 33% invested in equities, and 25% allocated to alternatives. Approximately 67% of all funds are available within 30 days, with 11% locked up for more than a year.

**Debt Structure and legal covenants: modest debt measures for the rating category**

Despite recent improvements, CommonSpirit’s high debt load continues to be its greatest challenge. Certain debt measures remain well below the medians for the rating category, and in the case of cash to debt, it is the weakest among Moody’s 20 largest rated hospital systems (all of which are in the A and Aa categories). At FYE 2021 (excluding Medicare advances and deferred payroll tax) cash to debt measured 117%, debt to cashflow was 4.6 times, debt to revenue was a fairly high 46%, and peak debt service coverage was 3.8 times. As cash balances and cashflow continue to grow, we would expect debt measures to continue to improve.
DEBT STRUCTURE
The large debt financings in 2019 and 2020 significantly simplified CommonSpirit’s debt structure, increasing the percentage of fixed rate debt, and reducing exposure to variable rate, put bonds and bank debt. Nevertheless, CommonSpirit continues to have exposure to market access risk, with peaks in debt service reaching $1.5 billion in 2023, and $2.1 billion 2025. Smoothed maximum annual debt service is $867 million. A significant mitigant to the market access risk is CommonSpirit’s balance sheet, which includes $13.7 billion of monthly unrestricted liquidity, and $17.7 billion of total unrestricted liquidity.

LEGAL SECURITY
Bonds are secured by a gross revenue pledge and are a joint and several obligation of the obligated group. All outstanding debt, including debt originally issued by CHI and Dignity Health, is on parity. As part of the 2019 financing, CHI's COD and Dignity Health's MTI were consolidated into a new MTI under CommonSpirit Health. Both legacy organizations are part of the obligated group.

Key MTI covenants include a rate covenant of 1.1 times. Less than 1.0 times for two consecutive years constitutes an event of default. There are additional requirements in certain bank agreements, including: minimum 75-days cash on hand; maximum debt to capitalization of 65%; and minimum rating of Baa3 or BBB- by at least two rating agencies.

DEBT-RELATED DERIVATIVES
CommonSpirit inherited a number of swaps from the two legacy organizations. Current swap obligations have a total notional of $2.9 billion. Swaps include fixed payer swaps, total return swaps, fixed receiver swaps, and basis swaps. Some of the swaps have collateral posting requirements, and the total return swaps have possible termination payments. CommonSpirit is currently posting $185 million in collateral. The total current mark to market of the portfolio is -$472 million.

PENSIONS AND OPEB
The organization's pension obligation decreased from FYE 2020 to 2021, but remains sizable at $3.3 billion. Operating lease liability is $1.7 billion. This adds to CommonSpirit’s already highly leveraged credit position.

ESG considerations

Environmental
With 38% of CommonSpirit's revenues concentrated in California, the system is exposed to environmental risks such as earthquakes, droughts, and fires. Other markets have exposure to hurricanes, winter storms, and extreme heat. Mitigants include good liquidity with nearly $18 billion of unrestricted cash and investments, market diversification, and diversity of revenue streams.

Social
Social risks include high reliance on the California State Provider Fee, which historically has had uneven timing and variable funding levels. Other social risks include potential labor issues, systemic nursing shortages, reliance on temporary labor, and recruitment challenges in certain markets. Social factors also include material exposure to Medicare and Medicaid, the need to care for the indigent population, and the ongoing impact of the pandemic.

Governance
CommonSpirit is in its third year of integration following the February 1, 2019 merger, and while much progress had been made in integrating senior management and streamlining the executive management team (including transitioning from an “office of the CEO” structure to one CEO), we believe more progress can be made in integrating the organization as a whole, and implementing best practices across all markets. The board was formed with an equal number of board members from each legacy system, with an additional board member who was new to the system. Since then it has become self-perpetuating with a focus on the organization as a whole. Disclosure practices are good and consistent with industry best practices.
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