

CREDIT OPINION

30 September 2022



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CommonSpirit Health

Update to credit analysis

Summary

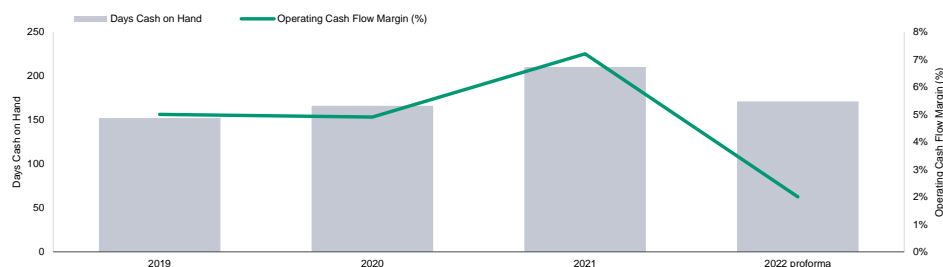
CommonSpirit Health's (Baa1 positive) favorable and improving credit profile is based on our view that operating margins will strengthen in 2023 following a more challenged 2022, that debt measures will improve over time, and that liquidity will not decline below current levels (excluding the repayment of Medicare Advance Payments and deferred payroll tax). Additional strengths which contribute to CommonSpirit's good strategic position include: exceptional size and good diversification across 21 states; high acuity service offerings; and good market share 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 a number of efficiencies and synergies have been achieved, despite the disruption from COVID over the last 2.5 years. Nevertheless, certain markets remain particularly challenged (including the Southeast and Texas), creating a drag on overall performance. Additional challenges include: major labor pressures in all markets consistent with industry-wide trends; significant operating challenges in certain markets; debt measures that remain modest for the rating category; material, although improved, pension and operating lease debt; and relatively high exposure to Medicaid.

The VMIG2 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.

On September 26, 2022, Moody's assigned Baa1 ratings to the Series 2022 bonds, and maintained the positive outlook.

Exhibit 1

While ratios have weakened due to industry headwinds, improvement is expected in 2023



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 are excluded (\$124 million in 2019, \$6 million in 2020); imputed pension expense is added to operating expenses; In 2021, \$598 million gain on sale is excluded from operating revenue; in 2022, \$190 million gain on sale is excluded from operating revenue; 2022 proforma

includes normalized provider fee and \$750 million of additional cash from Series 2022 bond proceeds; Medicare Advance Funds and deferred payroll tax excluded from all numbers
 Source: Moody's Investors Service

Credit strengths

- » CommonSpirit will continue to benefit from good cashflow diversification and economies of scale derived from its very large size (approximately \$34 billion of operating revenues in fiscal 2022) and significant presence in 21 states
- » CommonSpirit will continue to maintain a strong competitive position, supported by its strong brand, high concentration of assets in specific regions and good marketshare in most markets
- » 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 2023
- » Access to California's provider fee program (approximately 34% of CommonSpirit's revenues are generated in California) will continue to provide needed and material operating support; annual net receipts average approximately \$516 million
- » Liquidity (excluding Medicare advances and deferred payroll tax), while weaker, remains above historical levels, and is expected to not decrease below current levels

Credit challenges

- » Operating pressures will remain pronounced across the system, driven by labor issues and other industry wide challenges; margins are expected to improve in 2023 but not yet reach long-term management targets
- » CommonSpirit will continue to face significant competition in most markets; labor unions are active in certain markets
- » Certain markets will continue to underperform, including Texas where margins are very weak and progress has been slow
- » Debt measures remain modest for the rating category and compared to similarly sized peers
- » Pension and operating lease liabilities have improved, but remain material

Rating outlook

The positive outlook reflects our expectation that operations will see material improvement in 2023 and continue to improve thereafter, that debt measures will strengthen over time, and that liquidity balances will not decline below current levels

Factors that could lead to an upgrade

- » Achievement of targeted operating margins in 2023
- » Maintenance of liquidity (excluding the repayment of Medicare Advance Payments and deferred payroll tax)
- » Short term ratings: Improvement in overall credit quality of borrower; improved coverage levels

Factors that could lead to a downgrade

- » Persistence of weak operating margins
- » Further dilution of liquidity (excluding the repayment of Medicare Advance Payments and deferred payroll tax)
- » Material decline in debt measures
- » Sizable acquisition that is dilutive
- » Short term ratings: Decline in overall credit quality of borrower: decline in coverage levels

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

CommonSpirit Health

	2019	2020	2020 excl. advances	2021	2021 excl. advances	2022	2022 proforma
Operating Revenue (\$'000)	28,832,600	29,579,000	29,579,000	32,655,000	32,655,000	33,717,000	34,230,000
3 Year Operating Revenue CAGR (%)	n/a	1.3	1.3	4.0	4.0	5.9	5.9
Operating Cash Flow Margin (%)	5.0	4.9	4.9	7.2	7.2	1.3	2.0
PM: Medicare (%)	44.0	44.0	44.0	45.0	45.0	44.6	44.6
PM: Medicaid (%)	21.0	21.0	21.0	21.0	21.0	21.2	21.2
Days Cash on Hand	152	201	166	245	210	175	171
Unrestricted Cash and Investments to Total Debt (%)	85.9	107.7	89.0	136.6	117.1	108.0	101.2
Total Debt to Cash Flow (x)	6.6	6.5	6.9	4.4	4.6	11.9	10.5

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 are excluded (\$124 million in 2019, \$6 million in 2020); swap cashflow expense is added to interest expense; imputed pension expense is added to operating expenses; investment returns are normalized at 5%; In 2021, \$598 million gain on sale is excluded from operating revenue and \$93 million of income tax related to that sale is excluded from non operating expense; in 2022, \$190 million gain on sale is excluded from operating revenue; 2022 proforma excludes advances (consisting of Medicare Advance Payments and deferred payroll tax), includes normalized provider fee, includes incremental debt from the Series 2022 financing, and includes \$750 million of additional cash from bond proceeds.

Source: Moody's Investors Service

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 \$34 billion of consolidated revenues and is headquartered in Chicago. It operates in 21 states, with its largest markets consisting of California, the Pacific Northwest and the Southwest (including Arizona).

Detailed credit considerations

Market position: size and scope of integrated system provides diversification of cashflows 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. Following the merger, management originally set out to achieve \$2 billion in synergistic benefit in the first four years of operation. While the time frame for this has been pushed back due to COVID, management estimates that \$1.3 billion of benefit has already been achieved. 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 certain strategic assets, 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 significant improvements over the next couple of years. CommonSpirit's most challenging market 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, and it is the only market where CommonSpirit is not either first or second in market share (it is fourth). The Texas region has produced operating cashflow losses every year since the merger. The other chronically underperforming market is the Southeast Region, which includes Kentucky, Ohio, Arkansas, Tennessee and Georgia. Other markets perform well, and certain markets are exceptionally strong, including the Southwest (including Arizona) and Colorado, where the margins have been consistently strong, even in 2022. This general pattern of strengths and weaknesses is expected to continue into 2023. Overall, we see this combination of well developed markets with geographic diversity as a fundamental strength, which is proving to provide growth and stability, despite current challenges. Management will likely continue to consider both acquisitions and divestitures in the year ahead.

Operating performance, balance sheet, and capital plans: margins are expected to improve in 2023 after significant losses in the second half of 2022; liquidity should stabilize

Operating results are expected to improve in fiscal 2023, following much weaker performance in fiscal 2022 (fiscal year ended June 30). The first half of fiscal 2022 showed some modest deterioration from fiscal 2021, but nevertheless appeared stable. The second half of the year, however, experienced a very significant drop in performance, with operating cashflow measuring negative for the six month period. The primary driver was the increased cost of labor coupled with a shortage of labor, which is consistent with industry wide trends. Also, length of stay spiked, further driving up costs. Other challenges included high inflation, inconsistent volumes, modest payor increases, and reduced CARES funding.

Management is aggressively focused on improving performance. Strategies include: reduced reliance on temporary nurses; managing labor costs; improved efficiencies; reduced length of stay; improved supply costs; and better reimbursement rates. Additionally, management will continue to strategically invest in growth markets, which will help top line growth, and help grow cashflow. An additional source of support to the organization is the California State Provider Fee. With approximately 34% of net patient revenues generated in the state of California, CommonSpirit is a significant beneficiary of the program, reflecting the high number of Medi-Cal patients served within CommonSpirit's facilities. Total net receipts were approximately \$523 million in fiscal 2021. In 2022 they dropped to \$304 million due to timing issues, and would be \$561 million on a normalized basis. The run rate going forward is expected to be approximately \$516 million, which will continue to be an important boost to cashflow. Over all, long term, management has the stated goal of reaching 8% operating cashflow margins, which still may be several years away.

LIQUIDITY

Due to weak operations and investment losses, unrestricted cash and investments weakened in 2022, with days cash on hand dropping to 171 days at FYE 2022 (proforma, inclusive of \$750 million of reimbursement from the 2022 bonds) from 210 days at FYE 2021 (all numbers exclude Medicare Advance Payments and deferred payroll tax). Management expects liquidity to not drop much below current levels.

Investment allocation is consistent with other organizations of this size and stature, with 37% invested in cash and fixed income (inclusive of operating cash), 33% in equities, and 30% in alternatives (including hedge funds, private equities, and real assets). Approximately 57% 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 compared to similarly sized peers

CommonSpirit's high debt load continues to be a significant relative credit weakness. Debt measures remain below the medians for the rating category and are weaker than similarly sized peers. In fiscal 2022, cash to debt measured 101% (excluding Medicare Advance Payments and deferred payroll tax; and inclusive of the Series 2022 debt offering), peak debt service coverage was at 1.6 times (per Moody's calculations), and debt to cashflow measured an unfavorably high 10.7 times. Nevertheless, headroom to all covenants is sufficient, with historic debt service coverage measuring 2.5 times in fiscal 2022 per CommonSpirit's calculations.

DEBT STRUCTURE

Despite including a wide variety of debt instruments, CommonSpirit's debt structure is relatively conservative, with 73% of CommonSpirit's debt consisting of long dated fixed rate bonds. Other debt instruments include self liquidity debt, put bonds, direct purchases, floating rate notes, and auction reset securities. Monthly liquidity to demand debt is good, at 4.8 times.

Due to a number of bullet maturities, put bonds, and direct placements, CommonSpirit has elevated exposure to market access risk. Smoothed maximum annual debt service (proforma) is \$934 million. Actual peak debt service is \$2.3 billion occurring in 2025, with other peaks occurring in subsequent years. CommonSpirit actively manages its debt portfolio and is a frequent participant in the debt capital markets. A significant mitigant to CommonSpirit's market access risk is its good liquidity, consisting of \$16 billion in unrestricted cash and investments, 57% of which would be available within a month or less. CommonSpirit also has a \$900 million bank syndicated line of credit which is often used to manage debt maturities between bond financings.

USE OF PROCEEDS

The Series 2022 bonds consist of up to \$1.2 billion of taxable fixed rate bonds, and up to \$500 million of traditional tax-exempt fixed rate bonds and put bonds. Bond proceeds will be used to refund prior bonds, reimburse up to \$750 million for prior capital expenditures, fund general corporate purposes, and pay costs of issuance.

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 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 for two consecutive years 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.

DEBT-RELATED DERIVATIVES

CommonSpirit has a sizable swap portfolio, with total notional of \$2.8 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 \$84 million in collateral. The current mark to market of the entire portfolio is -\$234 million.

PENSIONS AND OPEB

The organization's pension obligation has decreased in recent years, measuring \$2.2 billion at FYE 2022. Long term operating lease liability in 2022 was \$1.6 billion. This adds to CommonSpirit's already high debt load.

ESG considerations

Environmental

CommonSpirit's exposure to environmental risks is generally low, consistent with most other not for profit hospitals. The one exception is in the area of physical climate risk. Particularly in the Pacific Northwest, California, and Colorado, hospitals outside of dense urban areas can be subject to fire and smoke risk. Other markets have exposure to hurricanes, and extreme heat. CommonSpirit has insurance and an active risk management program in place. Other mitigants to these risks include CommonSpirit's sizable balance sheet, and the organization's size, scope, and geographic diversification. All other sub categories of environmental risk measure low.

Social

CommonSpirit's exposure to social risks is highly negative, in line with national averages and reflecting exposure to demographic and societal trends, and to customer relations. 66% of CommonSpirit's payer mix consists of governmental payers, limiting the organizations negotiating power, and constraining the system's ability to grow margins. Other social challenges include the current labor shortage, the increased cost of labor, and ongoing reliance on temporary employees. Mitigants to these challenges include CommonSpirit's size, negotiating strength, and solid liquidity.

Governance

CommonSpirit's exposure to governance risks is low, reflecting governance characteristics that are in line with the average for the sector. CommonSpirit is in its fourth year of integration following the February 1, 2019 merger. Earlier this year, CommonSpirit appointed a new CEO. He is among the first senior managers in the organization who didn't originate from one of the legacy organizations. We believe this could help the organization further integrate and operate under its new identity. Otherwise, senior management is very stable and long tenured. The board was originally formed with an equal number of board members from each legacy system, with an additional board member who was new to the system. It now operates as a self-perpetuating 501-C-3, with new board members appointed without regard to former affiliation. Four new Board members joined the organization as of July 1, 2022 replacing four of CommonSpirit's original Board members. Disclosure and planning practices are good.

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