15 NOV 2021

Fitch Revises CommonSpirit Health's (CO) Outlook to Positive from Stable; Affirms 'BBB+' Rating

Fitch Ratings - New York - 15 Nov 2021: Fitch Ratings has revised the Rating Outlook to Positive from Stable for CommonSpirit Health (CO) and affirmed the 'BBB+' Issuer Default Rating and revenue rating on debt issued by CommonSpirit Health or by various issuing authorities on behalf of CommonSpirit. Fitch has also affirmed the 'F2' Short-Term rating on bonds backed by the system's self-liquidity, which includes $96.7 million of series 2004C variable rate demand bonds as well as CommonSpirit's CP notes. The 'F2' Short-Term rating correlates to the 'BBB+' rating and self-liquidity coverage of less than 2.0x.

SECURITY

The bonds are a joint and several obligation under CommonSpirit's Master Trust Indenture (MTI) and secured by a gross revenue pledge of the obligated group (OG). Catholic Health Initiatives (CHI) Baylor St. Luke's Medical Center, which is operated as a joint venture with Baylor College of Medicine, is a Restricted Affiliate under the MTI.

ANALYTICAL CONCLUSION

Fitch's analytic focus since CommonSpirit's initial financing in 2019 has been concentrated on tracking the system's ability to deliver on its plans to realize synergies and build a sustained track record of improved profitability within three to five years. Fitch believes that fiscal 2021 (ended June 30) demonstrates the system's first discernable progress towards its financial goals with an operating margin of 2.8% and operating EBITDA margin of 8.7%, in addition to a material improvement in unrestricted cash to $17.7 billion as of FYE 2021 compared to $12.8 billion as of FYE 2020.

Despite our belief that the system has been successfully working on system alignment, portfolio optimization and standardization to create an effective operating model, Fitch recognizes that the results in 2021 are not sustainable in the short to mid-term. Fitch does not anticipate that CommonSpirit will generate consistent operating EBITDA of 8% or above for at least another three to four years. Fitch's forward look factors expectations of operating EBITDA in a band of roughly 6.5% to 7.5% over the next four years.

Although unrestricted cash and investments have materially improved, primarily as a result of strong investment returns and proceeds from sale of investments, the system remains highly leveraged, and will remain so for a number of years, as highlighted by a financial profile that is assessed at the 'bbb' level. However, Fitch's criteria allow for ratings that fall outside of the suggested rating category outcome when considering all relevant credit factors. Fitch believes that CommonSpirit's substantial size, diversity and national scale suggest credit strength beyond the face value metrics in supporting achievement of CommonSpirit's goals.

Fitch continues to believe that given CommonSpirit's revenue and geographic diversity, an upgrade may be possible even if profitability and balance sheet metrics lag the medians for the 'A' rating category.
CommonSpirit's overall financial profile has improved since the system's initial 2019 rating, which supports today's Outlook revision and signals rating momentum towards an 'A-' rating. Nevertheless, the system will need to continue to make progress on efficient cost management, revenue growth in key markets, and synergies to prevent cash deterioration while funding its long-term strategy initiatives given its moderate operating cash flow level.

**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, competitive markets where they command solid market share. Aside from the broad geographic diversity, there is also revenue diversity from a portfolio that includes a wide array of acute and non-acute health care services. The system has focused on growth in Colorado, Arizona and Pacific Northwest in recent years and is still working on stabilizing its Texas operations, which Fitch believes may take another couple of years.

Medicaid represents 21% of gross patient revenues and self-pay represents 3% of gross patient revenues. The payor mix has been stable at these levels and no significant changes are expected in the coming years.

**Operating Risk: 'bbb'**

Financial Results Improved in FY 2021

CommonSpirit's operating EBITDA margin improved significantly in FY 2021 to 8.7% following a low 4.7% margin in FY 2020, a year which was heavily affected by the pandemic's disruption. (Fitch reclassifies contributions from operating to non-operating income). FY 2021 benefited from $690 million recognized in CARES Act funding ($826 million was previously recognized in FY 2020), a one-time gain on sale of joint venture share ($523 million), the consolidation of Yavapai Regional Medical Center and Virginia Mason Health System, and from improved volumes through a mix of COVID and non-COVID patients. Operating EBITDA measures at 5.0% excluding CARES funding and the gain on sale.

Fitch expects continued pressure from labor and supply costs in fiscal 2022 for CommonSpirit and throughout the health care sector. Nevertheless, Fitch believes that with ongoing realization of financial synergies, CommonSpirit should be able to generate incremental cash flow closer to a 7% operating EBITDA margin in fiscal 2023. Full realization of the $2 billion in financial synergies originally targeted by 2023 is only slightly behind schedule given the pandemic's disruption to supply chains and other initiatives.

CommonSpirit's combined size allows it to better allocate cost of capital for technology, which continues to be an important component of the system's strategic plans. With higher liquidity reserves and improving cash flow, the system is likely to increase capital spending in the coming years to above depreciation levels but is still committed to funding capital within EBITDA expectations.

Capital spending averaged $1.4 billion over the past two fiscal years, but is expected to be above $2.0 billion in each of the next five years, including approximately $800 million still to be spent at the McNair campus of Baylor St. Luke's Medical Center. The higher capital spending assumptions are incorporated in Fitch's forward look analysis.
Financial Profile: 'bbb'

Improved Leverage Profile With Higher Liquidity

CommonSpirit's financial profile assessment is now assessed at a higher 'bbb' level from the prior 'bb' assessment, reflecting improved balance sheet cushion. Primarily through exceptionally high investment returns for the year, unrestricted cash and investments improved to $17.7 billion as of FYE 2021, excluding $2.5 billion in Medicare accelerated funds and $416 million in deferred payroll taxes that will be paid in December 2021 and December 2022. Days cash on hand improved to 211 days in FY 2021 from 163 days as of FYE 2020. Unrestricted cash measured $16.8 billion as of 1Q Sept. 30, 2021.

Total adjusted debt also improved in fiscal 2021 with higher pension funding at 77% as of FYE compared to 63% in the prior year, reducing this debt equivalent to $429 million from $2.4 billion. Fitch includes the operating lease liability as reported on the balance sheet as part of total debt. With higher liquidity and lower adjusted debt for the year, cash-to-adjusted debt materially improved to 98.6% from 65.8%.

Fitch's forward-look scenario analysis includes both a margin stress as well as a stress on the system's investment portfolio. Fitch's analysis focuses on the recovery years after the stress, which in CommonSpirit's case indicates that the system's leverage metrics remain within the 'bbb' assessment with cash-to-adjusted debt of roughly 80% and net adjusted debt to adjusted EBITDA below 1.0x.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were applied in this rating determination.

CommonSpirit's CEO, Lloyd Dean, has announced his intention to retire in the summer of 2022 and the board has begun a search for his replacement.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Sustainable improved operating cash flows margins of close to 7% or above;

--An ability to generate higher cash flows that allow for continuous level of capital reinvestment to remain competitive without diminishing cash;

--Sustained cash-to-adjusted debt expectations of roughly 100% while maintaining a solid mid-range operating risk assessment.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--Margin compression over a prolonged period of time such that operating EBITDA is consistently closer to 6% or less;

--High capital spending that requires significant additional cash or debt commitments without commensurate EBITDA growth;

--Cash-to-adjusted debt that decreases to 80% and/or growing pension liability that significantly weakens leverage metrics may result in an Outlook revision to Stable at the 'BBB+' rating;

Best/Worst Case Rating Scenario
International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

CommonSpirit was created by the alignment of Dignity Health and CHI that closed on Feb. 1, 2019, forming the largest not-for-profit and largest Catholic health system in the country. This integrated system operates 140 hospitals and more than 1,500 care centers across 21 states. The system has combined revenue of approximately $33 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.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were applied in this rating determination.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Olga Beck
Senior Director
Primary Rating Analyst
+1 212 908 0772
Fitch Ratings, Inc. Hearst Tower 300 W. 57th Street New York, NY 10019

Kevin Holloran
Senior Director
Secondary Rating Analyst
+1 512 813 5700
Eva Thein  
Senior Director  
Committee Chairperson  
+1 212 908 0674

**Media Contacts**

Sandro Scenga  
New York  
+1 212 908 0278  
sandro.scenga@thefitchgroup.com

**Rating Actions**

<table>
<thead>
<tr>
<th>ENTITY/DEBT</th>
<th>RATING</th>
<th>RECOVERY</th>
<th>PRIOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>CommonSpirit Health (CO)</td>
<td>LT IDR</td>
<td>BBB+</td>
<td>Affirmed</td>
</tr>
<tr>
<td>Catholic Health Initiatives (CO) /General Revenues/1 LT</td>
<td>LT</td>
<td>BBB+</td>
<td>Affirmed</td>
</tr>
<tr>
<td>CommonSpirit Health (CO) /General Revenues/1 LT</td>
<td>LT</td>
<td>BBB+</td>
<td>Affirmed</td>
</tr>
<tr>
<td>Dignity Health (CA) /General Revenues/1 LT</td>
<td>LT</td>
<td>BBB+</td>
<td>Affirmed</td>
</tr>
<tr>
<td>ENTITY/DEBT</td>
<td>RATING</td>
<td>RECOVERY</td>
<td>PRIOR</td>
</tr>
<tr>
<td>-------------</td>
<td>--------</td>
<td>----------</td>
<td>-------</td>
</tr>
<tr>
<td>Catholic Health Initiatives (CO) /Self-Liquidity/1 ST</td>
<td>ST</td>
<td>F2</td>
<td>Affirmed</td>
</tr>
</tbody>
</table>

**RATINGS KEY**

<table>
<thead>
<tr>
<th>OUTLOOK</th>
<th>WATCH</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>POSITIVE</td>
<td>⬤</td>
<td>🎈</td>
</tr>
<tr>
<td>NEGATIVE</td>
<td>⬤</td>
<td>🎈</td>
</tr>
<tr>
<td>EVOLVING</td>
<td>⬤</td>
<td>🎈</td>
</tr>
<tr>
<td>STABLE</td>
<td>O</td>
<td></td>
</tr>
</tbody>
</table>

**Applicable Criteria**

- Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)
- U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub.18 Nov 2020) (including rating assumption sensitivity)

**Applicable Models**

- Portfolio Analysis Model (PAM), v1.3.2 (1)

**Additional Disclosures**

**Solicitation Status**

**Endorsement Status**

- Catholic Health Initiatives (CO) EU Endorsed, UK Endorsed
Disclaimer

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE OR ANCILLARY SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF PERMISSIBLE SERVICE(S) FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

Copyright

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

**Endorsement policy**

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](https://www.fitchratings.com/site/regulatory) page on Fitch's website. The endorsement status of international credit ratings is provided within the...
entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.