FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms SCL Health's (CO) Long-Term Ratings and IDR at 'AA-'; Outlook Stable

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Fitch Ratings - Austin - 03 Sep 2021: Fitch Ratings has affirmed the long term rating on the following series of bonds issued on behalf of the SCL Health System, CO (SCL Health, fka Sisters of Charity of Leavenworth Health System) at 'AA-':

--$384,755,000 Colorado Health Facilities Authority revenue refunding bonds, fixed rate series 2019A CO;

--$119,980,000 Montana Facility Finance Authority revenue refunding bonds, fixed rate series 2019A MT;

--$98,070,000 Colorado Health Facilities Authority revenue refunding bonds, variable rate series 2019B CO;

--$300,000,000 Colorado Health Facilities Authority, fixed rate series 2013A.

Fitch has also affirmed SCL Health's Issuer Default Rating (IDR) at 'AA-'.

Fitch has also affirmed the 'AA-' long-term rating and 'F1+' short-term rating based on SCL Health's self-liquidity and the corresponding long-term rating on the following series of bonds:

--$55,490,000 Colorado Health Facilities Authority's variable rate demand bonds (VRDBs) series 2016B;

--$55,490,000 Colorado Health Facilities Authority's VRDBs series 2016D.

The 'F1+' short-term rating is supported by the adequacy of SCL Health's highly liquid resources available to fund any remarketed puts on the $111 million series 2016BD weekly VRDBs and also corresponds to SCL Health's 'AA-' long-term rating.

Fitch has also affirmed the 'AA-' rating on the following Colorado Health Facilities Authority bonds issued on behalf of NJH-SJH Center for Outpatient Health LLC (NJH-SJH COPH):

--$70,000,000 revenue bonds (NJH-SJH Center for Outpatient Health Project) series 2019.

The Rating Outlook is Stable.

SECURITY

Bonds are an unsecured obligation of the SCL Health corporate parent (the sole member of the obligated group). The NJH-SJH Center for Outpatient Health Project Series 2019 bonds are secured by a pledge of gross receipts. Gross receipts are defined as receipts, revenues, income and other moneys received by or on behalf of the NJH-SJH COHP that are derived from the payment of rentals and other amounts by National Jewish Health (NJH; BBB) to NJH-SJH COHP pursuant to the Building Lease and the Installment Sale Contract, as well as payments by the Sisters of Charity of Leavenworth Health System, Inc. (SCL Health; AA-) pursuant to the Guaranty.

ANALYTICAL CONCLUSION

SCL Health's 'AA-' IDR and long-term revenue bond ratings reflect the organization's long track record of exceptional operations, consistent improvement in unrestricted liquidity levels and significant financial flexibility at the current rating level. SCL Health remains well positioned for any future sector change or uncertainty, having successfully built up cash reserves over time. Additionally, SCL Health has remained focused on their clinical and operational transformation initiatives that drive standardization and quality improvements across their multiple access points.

Fitch expects that SCL Health's capital spending will remain manageable within the next several years, easily in excess of annual depreciation, and now including the expectation of a replacement of Lutheran Medical Center. Accordingly, Fitch has fully factored into this rating affirmation a future debt issuance of approximately $300 million around mid-2023. Even with heightened capital spending and a planned borrowing, SCL Health's balance sheet is expected to remain stable through a forward-looking scenario analysis, with metrics consistently in line with the 'AA' rating category.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Favorable Payor Mix; Solid Market Share; Growing Markets

SCL Health operates in multiple demographically favorable markets, with two service areas considered fairly rural in nature. SCL Health is a multi-state provider with strong (leading in two of three regions) market positions in the Front Range (Denver), Western Colorado and Montana regions. SCL Health is one of the largest providers in the Front Range market, with a 18.2% market share. SCL Health has been expanding their access points with growth in a retail (location and access) strategy and expanded clinic and urgent care hours. Further bolstering their market position, SCL Health enjoys key strategic relationships, most specifically with the nationally known National Jewish Health and an extensive and growing partnership with Kaiser Permanente (AA-/Stable).

SCL Health is also the market leader in Western Colorado, with a 69.0% market share, seeing roughly one in seven inpatient cases in the state of Colorado. SCL Health also leads in the Montana market, with 79.1%, 81.9% and 49.0% market shares for their St. James, Holy Rosary and St. Vincent facilities, respectively. While the Western Colorado and Montana regions are more rural in nature, the Front Range region is more diversified and characterized by the presence of solid competitors. All SCL Health regions have good population growth characteristics and stable payor mixes. SCL Health remains well-positioned as an integrated provider, with multiple hospitals, retail and ambulatory access points, and key strategic and clinical partnerships.

SCL Health's overall payor mix includes a limited amount (19.9%) of the organization's gross patient revenues derived from Medicaid and self-pay combined. The Denver PSA is economically diverse, and growing at an exceptionally fast rate, well in excess of national averages, with favorable unemployment rates as compared to the U.S. medians. Similarly, Western Colorado and Montana, while less economically diverse than Denver, and not growing as quickly, still possess stable payor mixes. Fitch does not expect any significant shifts in payor mix from economic changes in the service area for at least the next five years.

Operating Risk: 'aa'

Very Strong Operating Metrics; Limited Capital Needs

SCL Health has a long history of very strong and consistent operational results, which Fitch expects to continue over the long term. Profitability has been very strong with an average operating EBITDA margin of 12.7% over the five-year period between fiscal years 2016 and 2020.

Despite operational disruption from the coronavirus pandemic, which was reflected in both the temporary initial loss of elective surgeries and procedures, as well as elevated expenses mostly in the form of supplies and staffing, SCL Health produced a very strong operating EBITDA margin of 11.4% in fiscal 2020 (FYE Dec. 31). Operational stability was largely due to rapidly implemented expense mitigation efforts, quick recovery of postponed volume, and stimulus funding. In fiscal 2020, SCL Health received direct enhancements to revenue of $121.2 million through CARES Act funding and $183.2 million in Medicare Advance Payments (AAP).

SCL Health has maintained on their current pace, producing an EBITDA margin of 13.2% through unaudited six-month as of June 30, 2021. Fiscal 2021's results include $46.0 million of CARES Act funding, and their one-time adjustment of approximately $111.5 million in impairment and accelerated depreciation on the current Lutheran campus. SCL Health's interim results also include $165.6 million of CMS Advance Medicare Payment Funds on their balance sheet, that remain to be repaid. Fitch's expectation for the longer term, is that SCL Health will maintain operating EBITDA margins somewhere in the 11% to 13% range, consistent with prior performance and fully supporting the 'aa' assessment for Operating Risk.

Capital needs and related funding are elevated when considering capex requirements. With a healthy average age of plant of 9.5 years (fiscal 2020), and historical spending of around 120% of annual depreciation (over the last three fiscal years), SCL has balanced financial performance, cash flow, and capital spending. SCL Health's four-year capital plan (through FY 2024) is conservatively estimated to be around $1.5 billion, with a significant amount of spending concentrated on the Lutheran Medical Center Replacement in addition to SCL Health's routine spending.

SCL's asset allocation remains well balanced, with approximately 40% in cash and fixed income, 40% in equities, and around 20% in alternatives (private equity) and hedge funds.

Financial Profile: 'aa'

Very Strong Financial Profile; Highly Stable Over Time

SCL Health's unrestricted liquidity position has consistently improved over the last several years on an absolute level, increasing to almost $2.8 billion at fiscal 2020 year-end (excluding $183.2 million in advance Medicare payments). SCL Health has no unfunded pension liability, so cash to debt and cash to adjusted debt are the same figure, and are very strong at 206% as of fiscal 2020.

Net adjusted debt to adjusted EBITDA, which is a measure of how many years of cash flow would be required to repay debt, has remained strong at a favorable negative 2.3x as of fiscal 2020 year-end, indicating that SCL Health has sufficient resources to pay all outstanding debt and debt equivalents at this time.

Through Fitch's base case scenario, which is a reasonable trajectory of expected performance in light of current expectations for economic and financial performance, Fitch expects that SCL Health will see gradual improvement in our key metrics absent the issuance of a new money debt issuance in approximately two years. Even with a $300 million debt issuance factored into fiscal 2023, SCL Health's financial profile remains very strong (consistently in the 'aa' category assessment and at or above 200% cash to debt). Fitch's stress case scenario assumes both a significant economic stress (to reflect potential equity volatility and modeled after SCL Health's current asset allocation) and a business cycle stress (to reflect potential for future operational stress) in year one followed by a recovery and then growth and stability in years three through five. Despite a potential stress event, Fitch's forward-looking analysis shows cash to adjusted debt remaining consistent with a 'aa' category assessment, and at 150% or better, even with a planned debt issuance of $300 million in 2023.

It is Fitch's opinion that SCL Health will continue to see additional balance sheet accretion, and even with stress and debt issuance, SCL Health's leverage metrics will continue to support a rating in the 'AA' rating category.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

RATING SENSITIVITIES

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

--SCL Health currently has considerable flexibility at the current rating, and a higher rating is not anticipated over the two-year outlook period as SCL Health is poised to begin a significant capital expansion project to replace Lutheran Medical Center.

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

--Downward rating potential is remote, but would be considered if there were an unexpected decline in operating EBITDA levels such that operating EBITDA falls to below 9% over an extended period of time;

--Similarly, there could be downward rating pressure if there were a material degradation of SCL Health's unrestricted liquidity position such that cash to debt falls to below 120%, also for an extended period of time.

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

SCL Health is a regional health system located in three different regions, the Front Range (Denver), Western Colorado and Montana. The system comprises eight hospital care sites and one Community Clinic Emergency Centers (SCL Health Northglenn). SCL Health has approximately 1,796 beds in operation (fiscal 2020) and over 66,000 annual admissions. In addition, SCL Health has a full range of ambulatory facilities and clinic locations. Total operating revenue in fiscal 2020 was $2.9 billion. Total debt outstanding at fiscal year-end 2020 was approximately $1.3 billion and includes a mixture of fixed, variable and direct placement debt. SCL Health's senior management team has been stable for the last few years.

SCL Health also has a close affiliation with National Jewish Hospital (NJH), which is a national referral medical institute engaged in patient care, medical research and teaching, primarily in the areas of respiratory, cardiac, allergic and immunologic medicine. NJH is consistently ranked among the top two providers in its subspecialty category in the U.S., giving it a leading, nationwide market share in its service line. Additionally, NJH and Saint Joseph Hospital's (an SCL Health hospital in Denver, CO) formed the NJH-SJH Center for Outpatient Health LLC, which is a Colorado limited liability company. The net income/loss of the combined clinical operations is shared 25% with NJH and 75% with SCL. NJH is obligated to make payments under the Installment Sale Contract to pay the debt service on the bonds which are guaranteed by SCL Health.

Financial Profile

The 'F1+' short-term rating is supported by the adequacy of SCL Health's highly liquid resources available to fund any remarketed puts on the $111 million series 2016BD weekly VRDBs and also corresponds to SCL Health's 'AA-' long-term rating.

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

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Sisters of Charity of Leavenworth Health System, Inc. (CO)	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

ENTITY/DEBT	RATING			PRIOR
• NJH-SJH Center for Outpatient Health LLC/General	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 18 Nov 2020) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

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

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Colorado Health Facilities Authority (CO)	EU Endorsed, UK Endorsed

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