

**CREDIT OPINION**

4 March 2020

 Rate this Research

**Contacts**

Diana Lee +1.212.553.4747  
 VP-Sr Credit Officer  
 diana.lee@moodys.com

Lisa Goldstein +1.212.553.4431  
 Associate Managing Director  
 lisa.goldstein@moodys.com

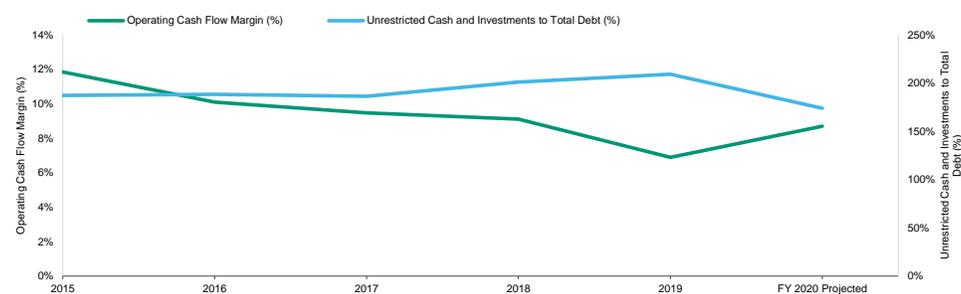
# Rush University Med. Ctr. Oblig. Group, IL

## Update to credit analysis

**Summary**

Rush System for Health (Rush, rated entity A1 stable) will benefit from its reputable academic medical center (AMC) and solid market presence. Rush's market position will be supported by the system's two community hospitals, and ongoing expansion in the ambulatory arena as well as through its clinically integrated network. With its fully integrated medical school and streamlined governance structure, Rush will enjoy greater flexibility than university-owned AMCs. New senior management will focus on partnerships and innovative applied research, which will likely help better position the system. Debt levels will increase materially amid a period of elevated capital spending but should remain manageable. Cash to debt metrics will decline, but should remain adequate for the rating assuming projects can be funded largely by improved cash flow and fundraising. Days cash levels will also hold steady and operating cash flow margins, though lower than historical periods, will likely return to solid levels. However, operating performance will remain reliant on 340B benefits, which provides some uncertainty in light of pricing scrutiny. Other ongoing challenges will include an intensely competitive, fragmented market, with multiple prominent AMCs and significantly larger systems nearby, as well as above average levels of Medicaid.

Exhibit 1

**Expected solid, albeit moderating, margins and cash should help offset rise in debt**


Source: Moody's Investors Service

**Credit strengths**

- » Solid inpatient market positions will be maintained by its AMC and two community hospitals, supported by ambulatory sites throughout the Chicago area
- » More flexible AMC structure, integration of health sciences programs and streamlined governance structure will help support ongoing operating efficiencies and growth

- » New senior management will provide greater focus on partnerships as well as applied research opportunities
- » Solid operating cash flow margins in the 9% to 10% range will likely be attained and sustained following compression as Rush focuses on cost savings and revenue initiatives
- » Although debt levels will rise and cash to debt measures will moderate somewhat, significant restricted cash will help bolster balance sheet

### Credit challenges

- » Chicago area market will continue to be highly competitive and dynamic, with multiple AMCs and much larger health systems as well as the presence of a major commercial payor; it is too early to see if larger scale and geographic reach will be critical
- » Management will face challenges as it improves internal cash flow to achieve forecasted cash to debt and days cash measures; this will involve reducing working capital needs
- » Growth in salary and other expenses will continue to constrain margins that have moderated in recent years
- » Above average exposure to Medicaid, which provides greater uncertainty in light of the state's budgetary challenges; high income reliance on 340B program will add risk
- » Despite its focus on market expansion via partnerships and its CIN, there remains potential for M&A in a highly consolidated market

### Rating outlook

The stable outlook reflects an expectation that despite higher debt levels, Rush will be able to maintain solid cash to debt and days cash measures aided by reduced working capital needs and fundraising. The outlook also reflects a return to good operating cash flow margins following moderation due to higher expenses and one-time items.

### Factors that could lead to an upgrade

- » Material sustained improvement in cash to debt and days cash measures
- » Stronger volume trends and market share
- » Sustained improvement in absolute operating cash flow levels as well as margins
- » Maintenance of good positioning with payors amid competition

### Factors that could lead to a downgrade

- » Debt to cash or days cash measures are not sustained at solid levels as forecast due in part to inability to reduce working capital needs
- » Operating margins do not recover as expected or are sustained at moderate lower levels
- » Loss of market share or rate pressures associated with a challenging payor environment
- » M&A results in dilution of balance sheet or operating 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.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

### Rush University Medical Center Obligated Group

	2015	2016	2017	2018	2019
Operating Revenue (\$'000)	2,081,608	2,159,894	2,262,483	2,406,160	2,605,220
3 Year Operating Revenue CAGR (%)	6.2	5.9	4.9	4.9	6.4
Operating Cash Flow Margin (%)	11.9	10.1	9.5	9.1	6.9
PM: Medicare (%)	36.8	38.1	38.7	39.3	38.7
PM: Medicaid (%)	20.3	19.9	19.7	19.4	20.5
Days Cash on Hand	224	216	205	214	194
Unrestricted Cash and Investments to Total Debt (%)	187.4	188.5	186.5	201.2	209.4
Total Debt to Cash Flow (x)	2.0	2.2	2.3	2.3	2.5

Based on financial statements for Rush System for Health; fiscal year ending June 30; investment returns normalized at 6% prior to fiscal 2015 and 5% in fiscal 2015 and beyond  
Source: Moody's Investors Service

## Profile

Rush University Medical Center (RUMC) is part of a three-hospital system in an eight-county area surrounding and including the city of Chicago. The system is comprised of 660-bed RUMC, an academic medical center in the city of Chicago with a health sciences university that has more than 2,500 students; 210-bed Rush Copley Medical Center (RCMC) in Aurora, IL; and 127-bed Rush Oak Park Hospital (ROPH) in Oak Park, IL, as well as the various subsidiaries and joint ventures of these entities.

## Detailed credit considerations

### Market position: AMC with solid position within very competitive market

Rush will continue to operate in an intensely competitive and highly fractured market, as the Chicago area includes four other academic medical centers (AMCs) as well as larger health systems. All players will continue to implement strategies to gain inpatient and outpatient market share and prepare for new payment methodologies. That said, Rush's individual facilities will likely retain solid market positions, aided by its standing as an integrated academic health system. This includes RUMC and its health sciences university (comprised of its medical school, nursing school and other programs), both engaged in significant levels of clinical research. RUMC offers a broad array of tertiary and quaternary services and is clinically renowned in a number specialties, including orthopedics, neurosciences and cancer care. Rush plans to bolster its presence in neuroscience and oncology with a new ambulatory center dedicated to these specialties. RCMC and ROPH will also face local competition, but are likely to retain leading positions in their respective service areas. RCMC's service area, which is around Aurora, will benefit from a growing Kendall County. ROPH's service area, in Oak Park, is just west of downtown Chicago.

Across its eight-county market, we expect the system to at least maintain inpatient market share of about 5.1% (based on recent data reported by management). As a system, Rush's inpatient share is in line with the [University of Chicago Medical Center](#) (A1 stable). But it is considerably smaller than large systems such as [Advocate Aurora Health](#) (Aa3 positive), AMITA Health (part of [Ascension Health Alliance](#) and [Adventist Health System](#), both Aa2 stable), and [Northwestern Memorial HealthCare](#) (Aa2 stable). Based on the current payor environment, with limited narrow network and population based products, it is too early to tell if bigger inpatient scale and geographic reach will be critical.

As seen in the first half of fiscal 2020, with inpatient admissions down by about 7% (following improved trends in fiscal 2019), ongoing shifts to outpatient care and observation stays will likely result in moderation of inpatient admissions growth. Overall demand will be aided by ongoing clinical integration opportunities at RCMC, physician recruitment, as well as several newer outpatient centers. The system will also be well-poised to expand services through partnerships and potential new affiliations, aided by its streamlined governance structure (see below). A recent partnership with R1, a revenue cycle management firm, will (alongside Rush's Epic system) help boost Rush's performance.

Medicaid will provide ongoing risk given potential state budgetary issues as well as ongoing expansion of Medicaid managed care plans. The presence of Blue Cross Blue Shield of Illinois (part of [Health Care Service Corporation](#), A1 stable), a leading commercial payor in Chicago, provides some uncertainty. However, Rush will approach a challenging payor environment with various strategic initiatives. Rush's clinically integrated network (CIN), which includes about 1,850 clinicians and also partners with non-acute care service providers, will help better position the system. Although Rush is focused on partnerships, and there are fewer independent community hospitals remaining in the area, mergers with other acute care providers cannot be ruled out.

**Operating performance, balance sheet and capital plans: likely to return to solid OCF margins; with material new debt, good balance sheet measures will require less working capital**

Management anticipates that fiscal 2020 operating cash flow (OCF) margins will be around 8.7% upon successful execution of a \$25 million cost-cutting program; this compares to 6 month interim OCF margins of about 7.2%. The ratings reflect an assumption that OCF margins will recover and be sustained in the 9% to 10% range although margins have trended down from highs of over 12% over the past several years.

Higher salary expenses associated with a very competitive market and rising drug expenses will continue to constrain margins as they did in fiscal 2019. Even after excluding one-time items, fiscal 2019 OCF margins were below budget, coming in at around 8.6% (compared to budgeted 9.7%). Fiscal 2019 one-time items included a pension settlement (\$23 million) and severance costs (about \$13 million) related to an early retirement program (ERP).

Rush will also continue to receive meaningful net income from the 340B federal drug discount program. The sustainability of this income will be less certain because of potential changes to specialty drug pricing as well as commercial insurer and PBM restrictions in use of 340B pharmacies.

Beyond the cost initiatives targeted for the second half of 2020, Rush will continue to manage expense growth with improved labor productivity and operational efficiencies. Rush's fiscal 2019's ERP will result in annual salary expense savings.

Rush's capital spending plans over the next several years will be substantial, totaling over \$1 billion over three years (fiscal 20-22); this compares to about \$188 million spent in fiscal 2019. The largest project will involve construction of the new 10 story neurosciences/ oncology ambulatory facility on its main campus, which is scheduled to open in June 2022.

**LIQUIDITY**

The A1 rating assumes that Rush will maintain good liquidity levels, with days cash in the 200 day range (194 days at fiscal year end 2019). Rush expects to substantially fund higher capital spend with improved internally generated cash flow, investment income and philanthropy. Management plans to put taxable bond proceeds (of about \$270 million) on its balance sheet. Its forecast assumes Rush will substantially maintain this absolute level of unrestricted cash despite elevated capital spend through 2022. Thereafter, when its capital spending ratio falls back to about 1.0 times, management expects cash levels to rise.

As a result, despite a material increase in gross debt (of about 44%), Rush's cash to debt metrics will be less favorable but will remain manageable at the current rating. The ratings assume cash to debt will not fall below forecasted levels of about 174% in fiscal 2020 (down from about 209% in fiscal 2019).

Based on expectations of improved cash flow in the second half of 2020 (and benefiting from a smoothed investment income of 5% on unrestricted cash), debt to cash flow will increase to a still manageable 2.8 times in fiscal 2020 (up from 2.4 times in fiscal 2019).

In order to meet these forecasts, along with achieving investment gains and fundraising goals, management will focus on reducing its working capital needs. This will be challenging because working capital needs (since 2015) have resulted in cash flow from operations on the statement of cash flows to be significantly lower than operating cash flow as measured from the income statement. Rush will continue to benefit from the presence of restricted cash, which was about \$610 million at fiscal year end 2019.

Rush's investment allocation will have average risk, with about 43% allocated to fixed income or cash and the remainder in equities (36.2%), hedge funds (3.5%), private equity (5.5%) or other investments.

## Debt structure and debt covenants

### DEBT STRUCTURE

Rush's debt structure will remain relatively straightforward, limiting debt structure risk. Following this transaction, which will refinance the Series 2011 variable rate bank debt, about 90% of total gross debt will be fixed rate debt.

Rush will have ample covenant cushion over the coming year. If historical debt service coverage falls below 1.1 times, it would require a consultant call-in. Issuance of additional debt would require: (1) minimum pro-forma debt service coverage of 1.10 times; or (2) minimum historical debt service coverage of 1.1 times.

### DEBT-RELATED DERIVATIVES

Rush will continue to have moderate exposure to swaps, with two floating-to-fixed interest rate swaps, one with Morgan Stanley Capital Services and one with Citibank; the combined notional amount was about \$74.5 million as of June 30, 2019. At fiscal year end 2019, the swaps represented a combined \$14.8 million liability to Rush. At the A1 rating level, Rush would be required to post collateral if the combined market value exceeded negative \$30 million or one swap agreement exceeded negative \$15 million; no collateral posting was required for fiscal 2019.

### PENSIONS AND OPEB

Rush's unfunded pension liability, which was about \$41.8 million in fiscal 2019, will add a modest level of indirect debt. Combined with about \$151 million in lease adjusted debt, cash to total adjusted debt was good at about 160% at fiscal year end 2019 but is forecast to moderate to about 143% in fiscal 2020.

## Legal security

All bonds are secured by a gross revenue pledge of the RUSH Obligated Group. Concurrent with this transaction, the obligated group will consist of Rush System for Health (the system parent), Rush University Medical Center, Copley Memorial Hospital, Rush Copley Medical Center, Rush Copley Foundation, Copley Ventures, Rush Oak Park Hospital, and Rush Copley Medical Group NFP.

## ESG considerations

A recent transition of new senior management, including new CEOs at both the system and RUMC, will provide some uncertainty. The system's new CEO, however, who was previously the Dean of Rush Medical College, will bring new perspective to Rush, having a global background in medical school training programs. Management will focus on partnerships and investment returns, such as those related to applied research. Rush will continue to benefit from a streamlined single parent governance structure, which includes a smaller and more focused parent board, instituted in 2017. This more nimble structure will enable Rush to create further efficiencies by aligning resources across different entities. Management believes that with this structure, Rush will be well positioned for further expansion.

The system's exposure to government payors will remain above average, with about 59% of fiscal 2019 gross revenues derived from Medicaid (20.5%) and Medicare (38.7%).

No environmental issues are reflected in the assessment.

© 2020 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND/OR ITS CREDIT RATINGS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY MOODY'S (COLLECTIVELY, "PUBLICATIONS") MAY INCLUDE SUCH CURRENT OPINIONS. MOODY'S INVESTORS SERVICE DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S INVESTORS SERVICE CREDIT RATINGS. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS, NON-CREDIT ASSESSMENTS ("ASSESSMENTS"), AND OTHER OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. AND/OR ITS AFFILIATES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from \$1,000 to approximately \$2,700,000. MCO and Moody's investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody.com](http://www.moody.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1213572