



Fitch Rates Rush System for Health's Series 2020 Bonds 'AA-'; 'AA-' IDR Affirmed; Outlook Stable

Fitch Ratings - Chicago - 26 February 2020:

Fitch Ratings has assigned a 'AA-' rating to \$300 million of Series 2020 taxable fixed rate revenue bonds to be issued by Rush System for Health (RUSH). Fitch also affirmed RUSH's 'AA-' Issuer Default Rating (IDR) and the 'AA-' ratings on approximately \$457 million of series 2015A&B fixed rate revenue bonds issued by the Illinois Finance Authority on behalf of RUSH.

The Rating Outlook is Stable.

Proceeds from the series 2020 bonds will be used to refund \$27 million of series 2011 variable rate direct purchase debt, provide funds for RUSH's capital spending program, cash reimburse for roughly \$48 million of prior capex, and pay the costs of issuance.

SECURITY

Bond payments are secured by a pledge of the gross revenues of the obligated group. The obligated group includes the vast majority of RUSH operating assets, including the Rush University Medical Center (RUMC) flagship academic medical center (AMC) and the two community hospitals: Rush Oak Park Hospital (ROPH) and Rush Copley Medical Center (RCMC).

ANALYTICAL CONCLUSION

The 'AA-' IDR reflects Fitch's expectation that RUSH will maintain strong capital-related ratios through the five-year cycle in Fitch's forward-looking scenario analysis stress case, in the context of the system's midrange revenue defensibility and strong operating risk profile assessments. While operating in a competitive metropolitan area, RUSH has a broad reach for high-acuity services as a leading AMC. The Stable Outlook considers Fitch's anticipation that RUSH will sustain an operating EBITDA margin consistent with a strong assessment, despite moderate softening in fiscal 2019.

KEY RATING DRIVERS

Revenue Defensibility:: 'bbb'

AMC with Broad Reach in Very Competitive Market

RUSH's revenue defensibility is midrange. The system operates in a market with a number of competing AMCs, as well as other health system's with tertiary services. RUSH's payor mix is sound and the service area economy is stable.

Operating Risk:: 'a'

Track-Record of Strong Results; Compressed Margins in Fiscal 2019

RUSH's operating risk profile is strong. The system is expected to maintain an operating EBITDA margin above 9%, although the operating EBITDA margin was compressed somewhat in fiscal 2019. Capital spending plans are considered to be elevated and manageable.

Financial Profile:: 'aa'

Strong Capital-Related Ratios Through the Cycle

RUSH's financial profile is strong. Capital-related ratios remain strong in Fitch's forward-looking scenario analysis, including in the stress case.

Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with RUSH's rating.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Negative Rating Action:

--Unexpected continued compression of operating EBITDA margins, leading to an operating risk profile more consistent with a midrange assessment;

--Unanticipated material increase in net debt beyond the Series 2020 bonds resulting in weaker capital-related ratios.

Developments That May, Individually or Collectively, Lead to Positive Rating Action:

--Sustained reversion to stronger operating EBITDA margins;

--Material liquidity growth leading to considerably stronger capital-related ratios.

CREDIT PROFILE

RUSH owns three hospitals: RUMC, the AMC flagship located in Chicago (just west of the Loop); ROPH in Oak Park, IL; and RCMC in Aurora, IL. Additional operations include a medical group with over 700 employed physicians, a rehabilitation and skilled nursing facility, multiple ambulatory facilities in the metro area, a freestanding ED in the western suburbs, research facilities, a medical-centered university with more than 2,700 students and growing (all graduate), and a graduate medical education program. RUSH is unique among AMCs in that the hospital founded the university and both entities are under a common governance and management structure. While patient services account for the vast majority of RUSH's operations, tuition/educational programs and research accounted for approximately 8% of fiscal 2019 total operating revenue.

RUSH recorded just over \$2.6 billion in audited operating revenue in fiscal 2019 (June 30 year-end). RUSH is a part of the Illinois Medical District along with the University of Illinois Hospital & Health Sciences (UI Health), the John H. Stroger, Jr Hospital (a member of the Cook County Health and Hospitals System), the Jesse Brown VA Medical Center, and other healthcare entities.

Revenue Defensibility

RUSH's payor mix is midrange. Combined Medicaid and self-pay accounted for nearly 24% of gross revenue in fiscal 2019, just below the midrange threshold of 25%. If it were to weaken moderately so that combined Medicaid and self-pay were expected to exceed 25%, RUSH's payor mix assessment could be revised to moderately weak. Illinois expanded Medicaid under the Affordable Care Act (ACA).

RUSH's market position is moderately weak. RUSH's service area is very competitive and covers the broad Chicago eight-county metro area. In that region, the leading individual hospitals are Northwestern Memorial Hospital (the flagship of Northwestern Medicine), Advocate Christ Medical Center (a member of AA rated Advocate Aurora Health, AAH), RUMC, the University of Chicago Medical Center (the flagship of AA- rated University of Chicago Medicine), and AAH's Lutheran General Hospital. Of the eight-county service area, no individual hospital captures more than 5% share of combined inpatient admissions and observation stays. The leading systems in the market include AAH (17.7% share), AMITA Health (15.7% share), Northwestern Medicine (12.0% share), Trinity Health (rated 'AA-', 5.5% share), and RUSH (5.4% share), followed by eight additional systems that capture between 2% and 5% share each.

In addition to RUMC, Northwestern Memorial, and UCMC, additional AMC competitors include the University of Illinois Hospital & Health Sciences (UI Health, like RUMC, is a part of the Illinois Medical District) and Loyola Medicine (a member of Trinity Health).

Due to the unique and highly fragmented market, with the inclusion of multiple AMCs and health systems with tertiary level services, Fitch considers RUSH's market position to be comparatively weaker relative to industry

peers operating in less competitive areas.

Positively, RCMC and ROPH have distinct market share leads in their respective local markets. In the service area around Aurora, IL, in the western suburbs, RCMC captures 36.0% inpatient market share, with no competitor capturing more than 17% share. In the service area around Oak Park, ROPH captures 21.5% share with no competitor capturing more than 14%.

RUSH exhibits strong quality indicators, which, in Fitch's opinion, bolster its overall revenue defensibility. For example, RUMC was ranked by Vizient as the best AMC in the country in the 2019 quality and accountability study (and RUMC has been ranked in the top five every year since 2013).

RUSH's service area economy is stable. As a major metro area, Chicago benefits from a diversified economy. Population trends in Cook County are stagnant to moderately declining, although Kane County (where RCMC is located) is growing. The median household income level in Cook County is just above the national average and well above average in Kane County. The unemployment rate in the Chicago-Naperville-Elgin metropolitan statistical area is just below the national average. Fitch does not expect RUSH's payor mix to change materially in the coming years.

Operating Risk

RUSH's operating cost flexibility is strong, despite somewhat softer margins in fiscal 2019. The system's operating EBITDA margin averaged nearly 10% between fiscal 2015 and fiscal 2019, although moderated to 7.8% in audited fiscal 2019 (June 30 year-end; fiscal 2019 results exclude pension settlement expense of roughly \$23 million). Margins compressed in fiscal 2019 due largely to above inflationary growth in supply costs (tracking an industry-wide trend) and labor and benefit costs (including \$13 million in one-time early retirement severance costs).

Fitch notes that patient activity trends were not factors in the moderated results. Despite generally flat inpatient volumes for the Chicago area market, RUSH continued to experience volume gains in key areas, such as inpatient admissions (up 4.2% in fiscal 2019 over fiscal 2018), inpatient surgeries (up 6.2%), outpatient surgeries (up 11.9%), and outpatient visits (up 5.3%). Fitch notes inpatient admissions increased in part as the result of a shift away from observation stays, which declined 10% in fiscal 2019 (combined inpatient admissions and observations were essentially unchanged, up less than 0.1% in fiscal 2019).

Operating results remain somewhat compressed in interim fiscal 2020, as RUSH's operating EBITDA margin measured 7.2% through six-months fiscal 2020 (as of Dec. 31, 2019), compared with 8.0% for the same period fiscal 2019 (the interim fiscal 2019 period excludes pension settlement expense). Counter to fiscal 2019, the interim fiscal 2020 period experienced a decline in inpatient admissions (down 7.1%) but big gains in observations (up 12.3%), while other volumes continue to trend up. Management notes that much of the decline in profitability in interim fiscal 2020 is due to non-recurring items, including defined benefit (DB) pension plan accounting change. Nevertheless, management is implementing a roughly \$25 million improvement effort, which includes new and expanded service lines, integration of imaging services, documentation and coding improvements, expansion of 340B pricing to RCMC, and expense savings such as reduced overtime and consultant costs and supply chain savings. As a result of these efforts, management expects the full-year operating EBITDA margin to approach 9% despite the softer years through the first six months. Over the longer-term, while Fitch does not necessarily expect RUSH to sustain an operating EBITDA margin in the 10%-plus range as it has historically, a margin in the 9% range or better should be maintained.

RUSH's capital spending requirements are manageably elevated. The system has nearly \$1.3 billion of capex planned between fiscal 2020 and fiscal 2024, translating to an average annual capital spending ratio of about 1.5x (spending is front-loaded, as the capital spending ratio will average approximately 2.0x between 2020 and 2022). Ongoing and future capital is focused on ambulatory development, highlighted by the Joan and Paul Rubschlager Building, an estimated \$430 million-\$450 million center on the RUMC campus (expected to open by summer 2022). RUSH's average age of plant measured 12.6 years at FYE 2019 and its capital spending ratio averaged 1.3x over the last five years.

Financial Profile

RUSH's financial profile is strong. Capital-related ratios are strong through the cycle, including in the stress case of Fitch's forward-looking scenario analysis, given the system's midrange revenue defensibility and strong operating risk profile assessments.

RUSH has approximately \$945 million of pro forma debt outstanding, including the series 2020 revenue bonds. Pro forma unrestricted cash and investments measure over \$1.3 billion. The series 2020 plan of finance includes an estimated \$48 million of cash reimbursement for prior capex.

Debt equivalents are manageable. RUSH's DB pension plan was 96% funded FYE 2019 relative to a projected benefit obligation (PBO) of nearly \$1.1 billion (Fitch only includes the portion of FASB DB pensions that are below 80% funded in the calculation of adjusted debt). RUSH's operating lease expense measured nearly \$38 million in fiscal 2019, translating to a debt equivalent of almost \$190 million (based on 5x lease expense method). Consequently, RUSH's pro forma adjusted debt (direct debt plus underfunded DB pension below 80% funded plus operating leases) is approximately \$1.1 billion. Pro forma net adjusted debt (adjusted debt minus unrestricted cash and investments) is favorably negative at roughly negative \$200 million. Favorably, Fitch expects net adjusted debt to remain negative in virtually every year of the stress case of the scenario analysis.

Based on fiscal 2019 results, RUSH's net adjusted debt-to-adjusted EBITDA was a favorably negative 1.3x and cash-to-adjusted debt about 150%. Through the five-year cycle in the stress case (which assumes normal economic recession followed by a recovery and then stability), net adjusted debt-to-adjusted EBITDA is 0x or favorably negative in every year while cash-to-adjusted exceeds 120% by year five.

Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with RUSH's rating.

RUSH's long-serving CEO, Dr. Larry Goodman, retired in 2019. New senior executives include: Dr. Ranga Krishnan, who is now CEO of the Rush System for Health since spring 2019 after having served as the Dean of the Rush Medical College since 2015; Dr. Omar Lateef, who is now CEO of RUMC since spring 2019 after having served as the Chief Medical Officer since 2015; and Dr. Sherine Gabriel, who joined in February 2019 as the President of Rush University, after having served as the Dean of the Rutgers Robert Wood Johnson Medical School and CEO of Robert Wood Johnson Medical Group.

RUSH's unrestricted cash and investments measured \$1.3 billion at FYE 2019. Cash on hand measured roughly 195 days and does not pose an asymmetric risk. In addition to unrestricted liquidity, RUSH's restricted

cash is considerable and continues to grow; as of FYE 2019, restricted net assets measured nearly \$840 million (up from just under \$780 million at FYE 2018). While restricted net assets are not included in calculation of RUSH's liquidity or capital-related ratios, they do bolster the system's balance sheet strength.

Pro forma, RUSH has about \$945 million of debt, including the planned Series 2020 bonds and expected refunding of the series 2011 variable rate private placement debt. The pro forma debt mix is roughly 94% fixed rate and 6% variable rate. Pro forma maximum annual debt service (MADS) is \$61.4 million (based on smoothing debt service; actual pro forma debt service includes a \$300 million bullet in 2050). Pro forma smoothed MADS coverage is 4.2x and does not pose an asymmetric risk. RUSH does not have additional new money debt plans over the next five years beyond the Series 2020 bonds.

RUSH's financial covenants include minimum MADS coverage of 1.20x, minimum historical debt service coverage of 1.10x, and minimum cash on hand of 65 days.

RUSH has two fixed payor swaps, with a notional amount of approximately \$75 million at FYE 2019. The net termination value of the swaps was a negative \$14.8 million to RUSH at FYE 2019 (no collateral was posted at year-end). The swaps expire in November 2035.

SUMMARY OF FINANCIAL ADJUSTMENTS

In fiscal 2018, the proceeds from the sale of property and equipment is so high (nearly \$80 million) that it dilutes RUSH's net five-year average capital spending ratio (because Fitch nets the sale of property & equipment to calculate net additions to PP&E). So, acquisition of property and equipment is removed from the calculation of net additions to PP&E in fiscal 2018 to create a more accurate reflection of RUSH's capital spending ratio.

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

RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
Rush System for Health (IL)	LT IDR AA- ● Affirmed	AA- ●
Rush System for Health (IL) /General Revenues/1 LT	LT AA- ● Affirmed	AA- ●

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Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 07 Nov 2019)
U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 27 Nov 2019)

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