RATING ACTION COMMENTARY

Fitch Affirms Rush System for Health (IL) at 'AA-'; Outlook Stable

Mon 13 Feb, 2023 - 2:55 PM ET

Fitch Ratings - Chicago - 13 Feb 2023: Fitch Ratings has affirmed Rush System for Health's (RUSH) Issuer Default Rating (IDR) at 'AA-'. Fitch has also affirmed at 'AA-' the ratings on tax-exempt revenue bonds issued by the Illinois Finance Authority on behalf of RUSH and taxable revenue bonds issued directly by RUSH.

The Rating Outlook is Stable.

Analytical Conclusion

The 'AA-' IDR reflects RUSH's strong financial profile despite ongoing macro labor and inflationary pressures, as RUSH has maintained generally sound operating metrics and strong capital-related ratios. While operating in a competitive metropolitan area, RUSH has a broad reach for high-acuity services as a leading academic medical center (AMC).

The Stable Outlook considers Fitch's anticipation that notwithstanding the ongoing macro pressures, RUSH's operations will remain profitable over time, although recognize that metrics will likely be more modest in fiscal 2023. Capital-related ratios should remain strong in the forward-looking scenario analysis, including in a stress case.

RATING ACTIONS

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SECURITY

Bond payments are secured by a pledge of the gross revenues of the obligated group (OG). The OG includes the vast majority of RUSH operating assets, including the Rush University Medical Center (RUMC) flagship AMC and the two
community hospitals, Rush Oak Park Hospital (ROPH) and Rush Copley Medical Center (RCMC). RUSH’s financial covenants include minimum maximum annual debt service (MADS) coverage of 1.20x, minimum historical debt service coverage of 1.10x, and minimum cash on hand of 65 days.

**KEY RATING DRIVERS**

**Revenue Defensibility - 'bbb'**

**AMC with Broad Reach in Competitive Market**

Due to the high degree of competition in the Chicago area, with the inclusion of multiple AMCs and large health systems with tertiary level services, Fitch considers RUSH's market position to be comparatively weaker relative to AMC industry peers operating in less competitive areas. Positively, RCMC has a distinct market share lead of its local market around Aurora, IL, and ROPH is the leader (when combined with RUMC) in its market around Oak Park. RUSH's university operations benefit from strong enrollment demand and student quality.

The broader service area economy is considered to be generally stable. As a major metro area, Chicago benefits from a diversified economy. RUSH's combined gross Medicaid/self-pay is in the 23%-24% range (23.6% in fiscal 2022), just below Fitch's 25% threshold for a midrange assessment. Illinois expanded Medicaid under the ACA. RUSH has experienced a shift of about two percentage points over the last two years from commercial to Medicare.

**Operating Risk - 'a'**

**Track-Record of Strong Results Despite Pandemic and Macro Pressures**

RUSH has a track-record of good operating margins. Excluding fiscal 2020, when the challenges of the pandemic were particularly acute, the system's operating margin and operating EBITDA margin averaged 3.0% and 9.2%, respectively, between fiscal years 2016 and 2022 (including an 8.4% operating EBITDA margin in fiscal 2022). Sound margins were sustained in fiscal 2022 despite pronounced labor and inflationary pressures.

Looking forward, while labor pressures are expected to continue, management expects RUSH to remain profitable and Fitch's strong operating risk assessment factors in our belief that over the long-term the system should sustain an operating EBITDA margin at least in the 8% range. Nevertheless, near-term pressures persist, as management budgeted a more modest 7.0% operating EBITDA margin for fiscal 2023. Indeed, the first half of fiscal 2023 has been challenged with a 4.7% operating EBITDA margin (compared to 6.1% budgeted for the period).

Management reports that interim 2023 continues to be hampered by inflation and labor challenges, as well as investments to increase access and one-time preparation expenses related to the new Joan and Paul Rubschlager Building (which includes RUSH's new cancer center).

Management is implementing a number of strategic initiatives to drive margin improvement, including revenue opportunities with the recently opened Rubschlager Building, continued ambulatory growth and RUSH's new partnerships with CVS. RUSH is also implementing expense management tools, highlighted by efforts to sustain employee retention and minimize contract labor.

Capex is manageable. The capital spending ratio averaged approximately 1.4x between fiscal years 2018 and 2022. The average age of plant measured 13 years at FYE 2022. The capital spending ratio is expected to be elevated in fiscal 2023 at about 2.7x as the system completed the Rubschlager Building. Thereafter, capex should moderate to a routine pace. RUSH does not have additional debt plans in the near term.
Financial Profile - ‘aa’

Strong Capital-Related Ratios Should be Sustained

RUSH’s capital-related metrics remain strong in Fitch’s forward-looking scenario analysis. At FYE 2022, the system had just over $1.0 billion of debt and unrestricted liquidity exceeded $1.8 billion (excluding Medicare advances), translating to cash-to-adjusted debt of nearly 180%. At FYE 2022, RUSH’s defined benefit pension was 95% funded (relative to a projected benefit obligation of just over $915 million), which does not give rise to a debt equivalent under Fitch’s calculation of adjusted debt.

RUSH’s net adjusted debt-to-adjusted EBITDA was favorably negative at -5.7x in fiscal 2022. Cash on hand of was approximately 230 days and smoothed MADS coverage was 4.7x in fiscal 2022, and therefore not asymmetric risks. In Fitch’s forward-looking scenario analysis stress case, net adjusted debt-to-adjusted EBITDA remains favorably negative in all five years and cash-to-adjusted debt does not fall below 140% in any year and approaches 180% by year five.

Asymmetric Additional Risk Considerations

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

Only approximately 5% of RUSH’s debt is variable rate.

In addition to unrestricted liquidity, RUSH’s restricted cash is considerable, measuring about $900 million at FYE 2022. While these restricted assets are not included in calculating liquidity, they do bolster balance sheet strength.

RATING SENSITIVITIES

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

--Sustained operating EBITDA margin compression expected to remain below 8%, leading to a weaker operating risk assessment;

--Unanticipated material increase in net debt resulting in notably weaker capital-related ratios.

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

--Long-term reversion to stronger operating EBITDA margin sustained above 10%;

--Material liquidity growth leading to considerably stronger cash-to-adjusted debt in excess of 250%, even in a downside scenario.

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.

PROFILE
RUSH owns three hospitals: RUMC, the AMC flagship in Chicago; ROPH in Oak Park; and RCMC in Aurora. Additional operations include a large multidisciplinary medical group, a rehabilitation facility, multiple ambulatory facilities in the metro area, a freestanding emergency department in the western suburbs, research, a medical-centered university with nearly 2,900 enrolled students in fall 2022 (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 operations, tuition/educational programs and research accounted for approximately 8% of total operating revenue in fiscal 2022.

RUSH recorded nearly $3.2 billion in operating revenue in audited fiscal 2022. 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), and the Jesse Brown VA.

In fall 2022, a RUMC subsidiary formed a joint venture (JV) with Select and closed on a $75 million five-year debt to finance the construction of a five-story specialty hospital. The operating JV is 73.5% Select and 26.5% RUMC subsidiary (the ownership of the building is 50/50). RUSH has provided a guarantee on the debt until certain conditions are met (RUSH’s debt would measure about $1.1 billion if the guarantee were included).

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.

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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), v2.0.0 (1)

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