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CREDIT OPINION
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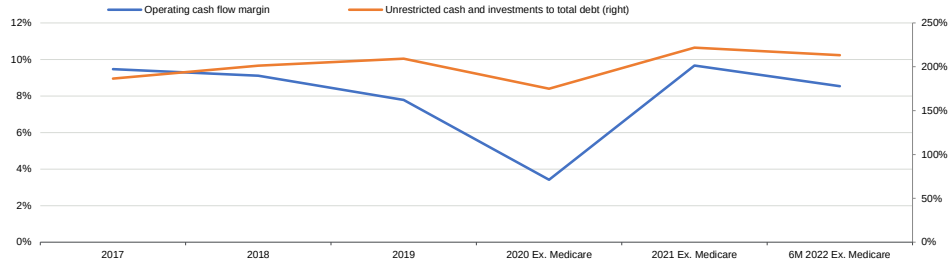
Rush University Med. Ctr. Oblig. Group, IL

Update to credit analysis

Summary

Rush System for Health (Rush, rated entity A1 stable) will benefit from its reputable academic medical center (AMC) and its ongoing expansion in the ambulatory arena, which will help support a solid market presence. Its fully integrated medical school and streamlined governance structure will provide Rush with greater flexibility than university-owned AMCs. Management will continue to focus on partnerships that diversify offerings in non-hospital settings. This, along with a soon-to-be opened neurology and oncology center, will provide good growth opportunities. With its major capital project near completion, days cash and cash to debt levels will be sustained at solid levels. Fiscal 2022 operating cash flow margins will benefit from recent CARES funds but future constraints from labor costs will likely result in some moderation compared to historical highs. 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
Manageable leverage, aided by solid cash levels and good, albeit moderating, margins



Cash to debt ratios for fiscal 2020, 2021 and 6 month interim period exclude Medicare advances and FICA funds.
Source: Moody's Investors Service

Credit strengths

» Solid market presence 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

» Senior management will continue to focus on asset-light opportunities, including partnerships as well as applied research

» Operating cash flow margins will likely remain solid, albeit more moderate (in the 8%-9% range) due to labor expenses and the opening of a new neurology/oncology ambulatory center

» Good cash metrics will be sustained as a major capital project nears completion; 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 payer

» Sector wide labor shortages and expenses will continue to constrain margins that have moderated in recent years

» Above average exposure to Medicaid will provide uncertainty especially in light of the state's history of budgetary constraints

» High reliance on 340B program will add risk in light of drug pricing scrutiny

» Despite its focus on market expansion via partnerships and affiliations, there remains potential for M&A in a highly consolidated market, which carries risk

Rating outlook

The stable outlook reflects an expectation that Rush will be able to sustain solid, albeit more moderate, operating cash flow margins as it opens a new ambulatory center amid rising labor expenses. The outlook also assumes the system will sustain good cash measures as elevated capital spending wanes.

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 payers amid competition

Factors that could lead to a downgrade

» Debt to cash or days cash measures decline

» Operating cash flow margins continue to moderate

» Loss of market share or revenue pressures associated with a challenging payer environment

» M&A that results in dilution of balance sheet or operating measures

Key indicators

Exhibit 2
Rush System for Health

	2017	2018	2019	2020	2021	6M 2022
Operating Revenue ($'000)	2,262,483	2,406,160	2,605,220	2,650,363	2,998,072	1,559,709
3 Year Operating Revenue CAGR (%)	4.9	4.9	6.4	5.4	7.6	N/A
Operating Cash Flow Margin (%)	9.5	9.1	7.8	3.4	9.7	8.5
PM: Medicare (%)	38.7	39.3	38.7	38.9	39.2	N/A
PM: Medicaid (%)	19.7	19.4	20.5	20.3	21.1	N/A
Days Cash on Hand	205	214	196	257	290	266
Unrestricted Cash and Investments to Total Debt (%)	186.5	201.2	209.4	185.2	243.3	227.6
Total Debt to Cash Flow (x)	2.3	2.3	2.3	5.6	2.2	1.9

Based on financial statements for Rush System for Health; fiscal year ending June 30; investment returns normalized at 5%. Cash ratios for fiscal 2020, 2021 and 6 month interim period include Medicare advances and FICA funds; days cash ratio for 6 month period calculated using annualized 6 month expenses.
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 2,800 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 fragmented, but also consolidated 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. Rush's market presence and growth will be aided by its position as an integrated AMC. 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 when its new ambulatory center dedicated to these specialties opens later this year.

Inpatient volume trends will continue to be soft with ongoing shifts to outpatient care and observation stays. However, as Rush expands non-hospital based services, such as its new strategically located outpatient centers, it will aid growth and improve its payer mix. Rush's streamlined governance structure will make it easier to expand services through partnerships and affiliations, such as Dispatch Health for acute at home services, Select Health for rehabilitation services and Lurie Childrens for pediatric care. Its partnership with R1, a revenue cycle management firm, will (alongside Rush's Epic system) continue to help boost Rush's performance.

On an individual facility basis, RUMC's inpatient and observation stay market share (3.9% as reported by management, across eight-counties) will likely remain close in line with other individual area AMCs. RCMC and ROPH are likely to retain leading positions in their respective local 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.

On a system-wide basis, however, Rush's share (6.1%) will be considerably below that of Advocate Aurora Health (18.3%), Northwestern Memorial HealthCare (15.6%) and Northshore-Edward-Elmhurst Health (13.7%), although in line with the University of Chicago Medical Center (5.1%). Based on the current payer 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. 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.

Medicaid (representing about 21% of revenues) will provide ongoing risk given potential state budgetary issues as well as expansion of Medicaid managed care plans, which represent the fastest growing source of revenues for Rush. The presence of Blue Cross Blue Shield of Illinois (part of Health Care Service Corporation), a leading commercial payer in Chicago, provides some uncertainty. However, Rush's clinically integrated network (CIN), which includes over 1,900 clinicians and also partners with non-acute care service providers, will help position the system.

Operating performance, balance sheet and capital plans: solid, albeit moderating OCF margins; good cash measures as capital project winds down

Following a very weak fiscal 2020 (3.4% operating cash flow (OCF) margin) due to the pandemic, Rush's fiscal 2021 OCF margin rebounded to about 9.7% aided by CARES funds of about $150 million. Although its OCF margin of about 8.5% for the six month interim period ended December 31, 2021 has been affected by sector wide labor shortages and expenses, fiscal 2022 will likely come in stronger due to about $61 million in additional CARES funds. Beyond fiscal 2022, management believes OCF margins will be sustained in the 8%-9% range, below previous expectations of 9%-10%, due to ongoing labor expenses, rising drug expenses as well as payer constraints and an ongoing shift to outpatient care. This compares to historical OCF margin highs of over 12%. As a percentage of total contribution margin, outpatient services rose from 49% to 57% between fiscal 2020 and 2021.

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 push back from manufacturers and commercial insurers on use of 340B pharmacies.

Rush's capital spending levels will come down (from the $1 billion level planned between fiscals 20-22) as the new 10 story neurosciences/oncology ambulatory facility on its main campus is expected to be completed in the fall of this year. This large capital project was partially funded with debt and philanthropy. However, beyond the new facility, capital needs will be largely self-funded.

Liquidity

Rush will maintain good days cash levels of over 200 days (249 days cash based on six month interims ended December 31, 2021). Management expects that absolute cash levels (excluding Medicare advances) will begin to rise following the completion of the ambulatory center project. Rush will also benefit from the presence of restricted cash, which was about $749 million at fiscal year end 2021.

Rush's investment allocation will have average risk, with about 45.8% allocated to fixed income or cash, 37.3% in traditional equities, 5.7% in private equity and the remainder in other investments in fiscal 2021.

Debt structure and debt covenants

Debt to cash flow will remain manageable (at about 2.5 times for the six month interim period). Highlighting Rush's ability to absorb a material (44% increase) in debt in 2020, cash to debt levels remain at 209%, in line with fiscal 2019's metric.

Debt structure

Rush's debt structure will remain relatively straightforward, limiting debt structure risk. About 90% of total gross debt is fixed rate.

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 $67.4 million as of June 30, 2021. At fiscal year end 2021, the swaps represented a combined $14 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 2021.

Pensions

Rush will carry a relatively modest combined unfunded pension liability for three separate plans of about $23.8 million based on fiscal 2021 (retirement pension plan underfunded by $85.1 million, supplemental plan underfunded by $4.4 million and pre-2015 retirement

plan, overfunded by $65.7 million). Combined with about $134 million in lease adjusted debt, cash to total adjusted debt was good at about 188.5% for fiscal 2021.

Legal security

All bonds are secured by a gross revenue pledge of the Rush Obligated Group, consisting 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

Environmental

No environmental issues are reflected in the assessment.

Social

A key social factor is labor shortages and rising expenses, which constrained margins even prior to the pandemic. Although Rush has a graduate nursing program, shortages are prevalent in the non-graduate nursing positions (as is the case nationally).

The system's exposure to government payers will remain above average, with over 60% of fiscal 2021 gross revenues derived from Medicaid (21.1%) and Medicare (39.2%).

Governance

The CEO of Rush, who succeeded the system's long-tenured CEO in 2019, will continue to bring a global background in medical school training. Senior 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 align resources across different entities. Management believes that this structure will well-position Rush for further expansion.

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