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Ratings

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CommonSpirit Health, Illinois; Hospital; Joint Criteria; System

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US$2678.048 mil taxable fixed rate rev bnds ser 2019 due 07/01/2049		
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US$1054.815 mil tax exempt fixed rate rev bnds (CommonSpirit Health) ser 2019A-2 due 07/01/2049		
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US$579.39 mil tax exempt fixed rate rev bnds (Dignity Health) ser 2019A-1 due 07/01/2049		
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US$81.535 mil tax exempt rev bnds (CommonSpirit Health) ser 2019A-2 due 07/01/2049		
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US$74.595 mil tax exempt rev bnds (Dignity Hlth) ser 2019A-1 due 07/01/2049		
Long Term Rating	BBB+/Stable	New

Rationale

S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'BBB+' from 'A' on all debt issued for Dignity Health, Calif. (various issuers). The outlook is stable. At the same time, S&P Global Ratings revised its outlook to stable from positive and affirmed its 'BBB+' rating on all debt issued for Catholic Health Initiatives, Colo. (CHI; various issuers). S&P Global Ratings also assigned its 'BBB+' long-term rating and stable outlook to the following series

of bonds issued by various entities for Dignity Health and for CommonSpirit Health (CommonSpirit), Ill., which is the newly combined name of the aligned ministries of CHI and Dignity Health:

Obligor: CommonSpirit Health

- $2.68 billion series 2019 taxable fixed-rate bonds, issued by CommonSpirit Health;
- $1.05 billion series 2019A-2 fixed-rate bonds, $132 million series 2019B-1 six-year put bonds, and $216 million series 2019B-2 seven-year put bonds, all issued by the Colorado Health Facilities Authority;
- $218 million series 2019A-2 fixed-rate bonds, $89 million series 2019B-1 five-year put bonds, $88 million series 2019B-2 six-year put bonds, and $139 million series 2019B-3 seven-year put bonds, all issued by the Washington Health Care Facilities Authority;
- $106 million series 2019A-2 fixed-rate bonds, issued by the Kentucky Economic Development Finance Authority; and
- $82 million series 2019A-2 fixed-rate bonds, issued by The Health, Educational and Housing Facility Board of the City of Chattanooga, Tenn.

Obligor: Dignity Health:

- $579 million series 2019A-1 fixed-rate bonds, issued by the Colorado Health Facilities Authority;
- $92 million series 2019A-1 fixed-rate bonds, issued by the Washington Health Care Facilities Authority;
- $75 million series 2019A-1 fixed-rate bonds, issued by the Kentucky Economic Development Finance Authority; and
- $198 million series 2019A-1 fixed-rate bonds, issued by The Health, Educational and Housing Facility Board of the City of Chattanooga.

The ratings on CHI and Dignity Health are fully harmonized with CommonSpirit under the new master trust indenture (MTI) that will be established with the 2019 plan of finance.

S&P Global Ratings also affirmed its 'A-2' short-term ratings on CHI debt where applicable, including the commercial paper (CP) rating and the short-term component of dual ratings backed by CHI's self-liquidity. The self-liquidity program remains unchanged other than the amount of debt supported by self-liquidity will decline postfinancing as a portion of the CP will be refinanced with long-term debt. S&P Global Ratings will continue to monitor the self-liquidity program on a monthly basis.

S&P Global Ratings also affirmed its 'BBB+' long-term rating on Kentucky Economic Development Finance Authority's debt originally issued for Sylvania Franciscan Health's obligated group (SFH). In 2015, CHI absorbed SFH's outstanding debt and secured it through CHI's capital obligation document (COD), and as a result, the debt originally rated based on SFH is now rated based on CHI.

S&P Global Ratings also affirmed its 'BBB+' long-term rating on Louisville & Jefferson County Metro Government, Ky.'s series 2012 bonds issued for Louisville Medical Center Laundry. The bonds are supported by a pool of revenue streams from user institutions that use a share of the laundry services provided by Louisville Medical Center (LMC; the general manager). The rating reflects the credit quality of the two lowest-rated institutions in the pool, which are CHI

(BBB+/Stable) and the University of Louisville Hospital (bbb+). For a larger discussion of these bonds and other participants, please see our article published Feb. 1, 2019, on RatingsDirect.

S&P Global Ratings also affirmed its 'BBB+' long-term rating on the LMC water and steam plant series 2012A and series 2016 bonds issued by Louisville & Jefferson County Metro Government. The bonds are supported by a user contract for the steam and water plant between LMC (the general manager) and five primary users. The rating reflects the credit quality of the two lowest-rated institutions in the pool, which are CHI (BBB+/Stable) and the University of Louisville Hospital (bbb+). For a larger discussion of these bonds and other participants, please see our article published Feb. 1, 2019, on RatingsDirect.

Finally, S&P Global Ratings affirmed its 'AA/A-1' rating on certain series of Dignity Health's variable-rate demand bonds (VRDBs), based on the application of our joint criteria. S&P Global Ratings also lowered its rating to 'AA-/A-1' from 'AA/A-1' on various other series of Dignity Health's VRDBs, based on the application of our joint criteria and, in particular, the lowering of the Dignity Health SPUR. The long-term component of the joint criteria ratings is based jointly on the SPUR on Dignity Health, and the long-term rating of each of the individual letter-of-credit (LOC) banks, while the short-term components are based solely on our rating on the LOC banks.

CommonSpirit Health was formed on Feb. 1, 2019, through the combination of Dignity Health and CHI. As part of the system's initial and current pro forma plan of finance, it intends to amend and consolidate CHI's COD and Dignity's MTI into a new MTI for CommonSpirit Health. As a result, all of the legacy debt of CHI and Dignity Health outstanding postsale and the bonds issued with this financing will be on parity with the CommonSpirit MTI. Pursuant to our Group Rating Methodology criteria, we consider both historical CHI and historical Dignity Health as core to CommonSpirit. The rating actions taken as part of this analysis reflect this treatment. Total pro forma long-term debt of CommonSpirit is approximately $14 billion.

The plan of finance is expected by management to provide $6.3 billion of bond proceeds (including net premium), the majority of which will be used for current refundings and advanced refundings of multiple series of bonds issued on behalf of Dignity Health and CHI. A portion of CHI's CP program will also be refinanced, although the program will remain outstanding for potential future use. While all existing ratings are being maintained for now, the ratings on the various series being fully refunded will be withdrawn after the refundings are completed. Approximately $600 million of net new debt is included in the $6.3 billion, and CommonSpirit intends to use the funds for reimbursement of prior capital expenditures and the funds are available to support future capital investments.

The 'BBB+' rating assignment on CommonSpirit's debt reflects a very strong enterprise profile offset by a financial profile that we consider adequate based on pro forma historical financials of the new system. The very strong enterprise profile reflects CommonSpirit's exceptionally broad geographic and financial dispersion, with 142 hospitals and more than 700 clinical sites across 21 states, making it one of the largest health systems in the country. While the system is large in scale, we believe these enterprise strengths are tempered by a financial profile that is weighed down by a legacy of very weak and underperforming assets in some of the system's key markets, especially at a few of the CHI entities. The adequate financial profile also incorporates our view that pro forma debt leverage is high for the rating, although adequate overall, and pro forma unrestricted reserves are consistent with the rating category. In our view, these characteristics are offset by an income statement that remains vulnerable and dependent on special

revenue (i.e., provider fees and disproportionate share revenue, or DSH). We view the current plan of finance favorably, as it replaces a significant amount of existing short-term debt with long-term committed capital, and also provides near- and long-term savings and cash flow relief. Moreover, the plan moves the overall debt mix to a more conservative profile through declines in variable-rate and direct purchase exposure.

The newly formed system has no overlapping markets, so some of the traditional synergies created from such combinations are not possible for CommonSpirit. Nevertheless, we do recognize that there are ample synergies that can still be achieved as a result of the alignment of the two large ministries and are in process of being executed by management. As with any large merger or acquisition, execution risks are abundant. While our discussions with management point to an aligned leadership team keenly focused on execution of common goals and driving swift integration of the two systems, we believe execution risks exist, especially given historical issues at legacy CHI assets that are still being addressed. Consequently, our rating also reflects a one-notch negative rating adjustment pursuant to our criteria. The 'BBB+' rating more accurately reflects our view of heightened execution risks during the initial integration of the new system. We view this as a risk particularly because CommonSpirit is not starting from a position of strength from a financial performance standpoint due to common industry pressures as well as the weight of a few key underperforming markets.

The 'BBB+' ratings reflect our view of the following credit strengths:

- Significant scale and leverage opportunities for CommonSpirit as one of the largest health care systems in the country, with 142 hospitals and more than 700 clinical sites in 21 states generating approximately $30 billion in annual revenue;
- Adequate pro forma maximum annual debt service (MADS) coverage driven by healthy but potentially volatile nonoperating income;
- A strong management team anchored by some key executives that helped in the initial turnaround of Dignity Health, when it was known as Catholic Healthcare West;
- Management's healthy funding of its legacy defined benefit plans; and
- Management's planned operational improvements, which are targeted to yield $2 billion of benefit to cash flow over the next three to five years.

Key credit risks include our view of:

- A wide range of complex, tedious efforts to integrate all operational aspects of two systems that were very large on their own, including technology, policies and procedures, clinical quality metrics, and supply chain, among many others;
- The inherent managerial challenges associated with meshing the cultures and operating mindsets of two large organizations, while rectifying some market issues that have long persisted;
- Heavy reliance on special funding sources including DSH and provider fees;
- Very weak pro forma operating and operating EBIDA margins; and
- Lingering underperformance and uncertain path to resolutions in the system's Kentucky and Texas markets, both of which have been a drain on earnings and operationally problematic in recent years.

Outlook

The stable outlook reflects our expectation that CommonSpirit will gradually improve its financial profile after initial growing pains in the first year of integration while at least maintaining its current balance sheet profile. Our outlook also incorporates our view of management's development of a comprehensive plan of improvement and integration including the near-term savings expected to be generated by this plan of finance, offset by the potential for further write-offs in certain markets and large capital spending expected in the Texas market.

Downside scenario

We believe that CommonSpirit has some cushion at the 'BBB+' rating to withstand unexpected challenges that surface in the first one to two years of the combined organization. A negative outlook or lower rating would be premised on operating results that materially miss management's targets. A dislocation of the investment markets that negatively affects investment income, which pro forma coverage relies heavily upon, could also prompt a negative outlook. We think the balance sheet is appropriate for the rating, but not overly robust. Therefore, a material increase in debt without demonstrated progress on improving underlying operations would also be cause for potential rating pressure.

Upside scenario

A positive outlook or upgrade would be premised largely on CommonSpirit achieving a trend of stable and consistent operating margins and EBIDA in line with 'A' category medians, while incrementally improving the balance sheet. In our view, the enterprise profile is already strong enough to support a much higher rating, leaving future rating direction largely dependent on execution toward much stronger operating performance.

Enterprise Profile--Very Strong

Management and governance

CommonSpirit is led by the office of the CEO, which comprises the two CEOs from the legacy Dignity Health and CHI organizations. Responsibilities and decision making authority are split between the CEOs, with Lloyd Dean, the former CEO of Dignity Health, responsible for all operations including clinical, financial, and human resources. Kevin Lofton, the former CEO of CHI, has responsibility over other key areas including advocacy, compliance, philanthropy, information technology, and mission. They both share responsibility for strategy. We understand that the board selected this model to accelerate integration so that responsibilities could be shared and to maintain continuity of the various strategies in flight at the legacy organizations. While well intentioned, we do believe this is an unproven model that comes with some challenges when leading the integration of a new organization. In our view, despite the attempt to clearly define the role of each of the CEOs, important decisions will likely require consensus at least informally. Inherently, this has the potential to create delays at a time when the organization already faces many operating challenges, including broad industry trends that are disrupting the entire sector. The legacy rating of Dignity Health was strongly influenced by our view of that system's strong managerial culture and broad success functioning in difficult markets, and one of the key challenges for the CommonSpirit team is to incorporate that success while both rectifying many legacy issues and working through the difficulties of a potentially arduous integration process.

CommonSpirit has established an Office of Transformation and Integration, which reports to the Office of the CEO. In

addition, CommonSpirit's chief financial officer, Dan Morissette, is closely involved in the leadership and accountability of these efforts. This body consists of a team of leaders across the organization led by the chief strategy officer and the chief administrative officer, who have been tasked with leading the multiple workstreams aimed at performance improvement and integration. This structure was established to promote accountability and to ensure that progress is being made toward the nearly $2 billion of merger- and transformation-related synergies that CommonSpirit is pursuing.

CommonSpirit prioritized the establishment of its operating model and placement of its leadership positions and all key executive positions were filled relatively quickly with individuals from the historical organizations. The only exception is the chief information officer role, which is currently held on an interim basis while a national search is underway for a long-term hire.

The board of stewardship trustees of CommonSpirit is initially composed of 14 members, including six from historical CHI, six from historical Dignity Health, and the two CEOs who serve as ex officio members. The board is self-perpetuating, and the initial term of all members expires in June 2022. Within the first 12 months, an additional independent board member with no affiliation to either legacy organization will be appointed. Going forward, the board will be appointed without regard to prior affiliation, which we view as a positive, encouraging systemwide decision-making consistent with CommonSpirit management's goal of managing the system as a single organization.

The Kentucky market

In the Kentucky market, CHI's legacy footprint has reduced significantly and at a large cost in write-offs over the recent past. The initial vision of establishing a statewide integrated operation with the University of Louisville Hospital (ULH) under the KentuckyOne brand was not successful. In many ways, the unwinding of the Kentucky One venture, with its exceptionally large write-offs in fiscal 2017 and fiscal 2018, highlights our view that legacy CHI organization credit risks will still saddle the new organization. The most recent announcement that the University of Louisville will not purchase the remaining portions of KentuckyOne is one more delay in getting this issue resolved. Management reports talks with additional buyers are underway, and some additional write-offs are expected, but these should not exceed $50 million.

Effective July 1, 2017, operations of ULH were returned to the University of Louisville, and CHI incurred a noncash charge of $318 million, which is shown as a change in net assets not affecting income in fiscal 2018. Following the UMC deconsolidation, CHI made the determination to sell the bulk of its remaining Louisville operation--largely Jewish Hospital and St Mary's Healthcare Inc. CHI felt that it no longer made sense to retain these assets, as the organization lacked sufficient scale to be profitable without the university hospital. CHI acquired the remaining noncontrolling interest of these entities and related assets for $150 million in fiscal 2018. As a result of the planned sale, the bulk of the remaining Louisville operation, which had a total revenue base of approximately $712 million in fiscal 2018, was classified as a discontinued operation. Management recognized an impairment charge of $272 million in fiscal 2018 (on top of the $318 million deconsolidation charge noted above), which was also shown in changes in net assets. Finally, in June 2018, CHI recognized an additional $105.5 million of charges in discontinued operations and $11.8 million in charges in continuing operations to adjust the remaining KentuckyOne assets' property and equipment values to their fair value net of cost to sell. While the majority of the charges relate to internal estimates of the expected write-down on sale, S&P Global Ratings believes the portion of the charges that relates to operations of these

assets in fiscal 2017 and fiscal 2018 is properly shown in operating income, and we have made that adjustment to our overall financials.

CommonSpirit has experienced some challenges in selling the remaining Louisville assets. Most recently, the University of Louisville, which now operates ULH, withdrew its bid to acquire the facilities. While the remaining KentuckyOne assets are classified as discontinued operations, we note that they continue to lose money, with a negative 8.2% operating EBIDA margin for the year-to-date period. We have also factored this into our operating income calculations. We believe that continuing to operate these facilities and identifying an appropriate buyer present sizable challenges for the CommonSpirit management team, particularly as it must do so as it simultaneously works through its plan of integration.

Following the sale of the Louisville facilities, CommonSpirit's largest remaining asset in Kentucky will be the St. Joseph Health system, based in Lexington. The system has a revenue base of over $1 billion, and operates well, with an 8.5% operating EBIDA margin for fiscal 2018.

The Texas market

Houston is one of the most populated and fastest-growing cities in the country. CHI invested significantly in this market beginning in 2013 and has grown to include 15 hospitals that generated $1.6 billion in net patient service revenue for the 12-month period ended June 30, 2018. In our view, this has been a key underperforming market for CHI, consistently missing budgeted targets and experiencing limited cash flow despite the strong regional demographics. In fiscal 2018, $88 million in EBITDA was generated from the Texas region.

The Texas market includes the Baylor St. Luke's Medical Center (BSLMC), which is located in the heart of the Texas Medical Center in Houston. BSLMC is part of a joint venture with the Baylor College of Medicine (Baylor), although it consolidates into the CommonSpirit pro forma financials, as it is controlled by CommonSpirit. We note that BSLMC has historically been best known for its cardiac program and is affiliated with the Texas Heart Institute (which is within BSLMC). That program has struggled, though, and in 2018 it experienced issues that resulted in the Centers for Medicare & Medicaid Services (CMS) decertifying the storied heart transplant program. In addition to the interruption in service, these events created notably bad publicity for the organization. At the same time, many of its most significant competitors within the Texas Medical Center have recently completed or will soon complete major new additions to their facilities. We believe this is a threat to BSLMC's historical business position in this market, particularly given the recent high-profile operating and clinical quality problems. Management has indicated that key leaders in this market have been replaced and that CMS and BSLMC have resolved the conditional findings that CMS cited. BSLMC has reapplied to have its heart transplant program recertified, which management expects should occur by the end of calendar 2019.

BSLMC is facing a capital project that could be as large as $1 billion, with roughly one-third to come from Baylor. The project to rebuild its flagship facility and relocate major portions of it on a nearby campus have been pending for some time, but clarity around certain project specifications is lacking. The target date for completion is slated for 2023. In our view, planning and execution of this project is one of the significant challenges facing CommonSpirit's new leadership team.

Table 1

CommonSpirit Health, Illinois Enterprise Statistics			
	--Nine months ended March 31--	--Fiscal year ended June 30--	
	2019	2018	2017
PSA population	N.A.	N.A.	N.A.
PSA market share (%)	N.A.	N.A.	N.A.
Inpatient admissions	625,951	852,756	872,001
Equivalent inpatient admissions	1,227,661	1,663,852	1,692,459
Emergency visits	2,616,582	3,458,317	3,518,062
Inpatient surgeries	171,734	238,951	248,690
Outpatient surgeries	263,970	355,618	368,217
Medicare case mix index	N.A.	N.A.	N.A.
FTE employees	125,940	126,815	134,171
Active physicians	22,000	21,494	20,573
Based on net/gross revenues	Gross	Gross	Gross
Medicare (%)	44.0	44.0	42.0
Medicaid (%)	21.0	21.0	22.0
Commercial/Blues (%)	28.0	29.0	30.0

N.A.--Not available. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions.

Financial Profile--Adequate

The financial profile of CommonSpirit is derived from a pro forma of historical results of the legacy organizations. CommonSpirit has issued a nine-month consolidated pro forma financial statement for fiscal year 2019 that is presented assuming that the ministries came together effective July 1, 2018, such that nine months of operations are shown for both legacy organizations, thereby improving comparability. The figures in table 2 for fiscal 2018 and fiscal 2017 are based on a compilation of CHI's and Dignity Health's individual audits prepared by S&P Global Ratings as part of its analysis. We note that the interim results for fiscal 2019 do not include the effect of the expected accounting treatment, which will be purchase accounting as an acquisition of Dignity Health by CHI. We expect that there will be an adjustment in the fiscal 2019 audit to reflect the fair value of assets acquired (estimated by management at $1 billion-$2 billion), which management estimates will result in an increase to net assets and thereby a favorable effect on debt to capitalization, all else equal. Conversely, we understand that an approximately $85 million to $110 million impairment charge associated with the North Dakota and Arkansas markets may also be booked in the year-end results. We expect these adjustments to be included within the fiscal 2019 audit. That audit, which will include 12 months of CHI's performance and five months of Dignity Health's performance, is also expected by management to include a pro forma presentation for the combined entity for the full 12-month period as if they were combined since July 1, 2018. Audited information for CommonSpirit's financial results are not yet available. The fiscal 2019 audit will be the new organization's first audit.

Financial performance

We consider CommonSpirit Health's pro forma financial performance as vulnerable, as the combined organizations generated a loss from operations in the year-to-date period, break-even results in fiscal 2018, and a significant loss in

fiscal 2017, as calculated by S&P Global Ratings. The most notable adjustment made in our income calculations is the inclusion of the losses from discontinued operations as a part of operating income, consistent with our historical treatment of CHI's results. We also note that the recognition of California's provider fee revenue creates some unevenness year over year. Specifically, 2018's results include a retroactive portion of revenue related to 2017, thus inflating 2018's results somewhat while depressing 2017's margin.

We also note that the income statement is supported by substantial special funding sources, including DSH and provider fee payments, the latter of which are largely driven by Dignity Health's California operations. Roughly 30% of CommonSpirit's net patient revenue is derived from its California facilities, though the individual markets are quite distinct. Despite the thin operating margins and operating EBIDA margins, we note that CommonSpirit has generated healthy returns on its sizable investment portfolio, resulting in pro forma MADS coverage that is adequate for the rating. Our pro forma MADS incorporates the plan of finance and includes both CHI's legacy debt secured by its COD and Dignity Health's legacy debt secured by its MTI. Both organizations have small amounts of debt not secured under either the COD or MTI. We have included those obligations in our debt figures as well. MADS of $825 million also smooths out several bullet payments, the first of which is in 2023. We fully expect that as CommonSpirit further refines its capital structure during the next few years that it will restructure upcoming bullet maturities.

We expect that CommonSpirit's financial performance will likely decline initially, before ultimately improving. Management is targeting an EBITDA margin of 5.0% in fiscal year 2019. Initially, we believe that dis-synergies such as severance costs and consulting costs will weigh on cash flow and margins. However, beyond that we do expect upside if management successfully executes on the performance improvement initiatives it has defined and is in the process of executing. Management has laid out a targeted $2 billion of savings goals during the next three to five years. About one half of the target relates to synergies that CommonSpirit expects to achieve as a result of the ministry alignment that it believes would not have been possible for either CHI or Dignity Health on an independent basis. The other half relates to transformation initiatives, some of which were already underway at the legacy organizations. With regard to the merger-related synergies, some would argue that both organizations already had sufficient scale as a source of leverage with payers and suppliers. While we agree to an extent, we also feel that meaningful savings are realistic as a result of the doubling of size of the organization, through re-bidding contracts and a consolidation of certain services or suppliers to one versus multiple service/supply companies. Moreover, we understand there is opportunity through eliminating duplicative functions and structures as well as through establishing common staffing standards across the system and closing the gap where inefficiencies exist relative to benchmarks on outcomes and processes. This plan of finance also provides meaningful cash flow savings during the initial period of integration. While we view these targets favorably, we also think management will have to make other meaningful changes to address underperforming markets, which could involve divestitures similar to recent activities in the Kentucky market. Management indicates that there are no other divestitures planned in the near term.

Liquidity and financial flexibility

CommonSpirit's balance sheet is very much in line with expectations for the rating and helps support our view of the overall financial profile. Total pro forma unrestricted reserves of $11.6 billion at March 31, 2019, results in a healthy 153 pro forma days' cash on hand and 83% of total pro forma debt. Despite modest capital spending of less than 100% of depreciation during the last few years, both legacy organizations have invested considerably in their plants, resulting

in a good average age of plant of less than 10 years.

Management projects capital spending to be roughly 80%-90% of depreciation through fiscal 2021 as it focuses on building balance sheet strength. However, given the size of the system and the fluid nature of building the strategy of the combined ministries, we think it is realistic that capital investment could change as the organization evaluates its portfolio and assesses strategic needs and possible divestitures or perhaps other partnerships. We understand that the system does not currently plan to make any wholesale changes to merge the entire system on to one common electronic medical record (EMR), so we don't anticipate a massive EMR overhaul. Its internal targets state a minimum of 150 days' cash on hand and cash to debt approaching 100% by 2021. At Feb. 28, 2019, the combined operating investment portfolio was quite liquid, with 68% of funds ($7.4 billion) available within 30 days.

CHI and Dignity Health maintain their individual legacy capital investment pools governed by their historical investment policies and guidelines and managed by the existing asset managers. We understand that the board's investment committee has approved this to remain in effect while the treasury department completes a holistic review of the program including desired mix, risk tolerance, and liquidity needs for the coming years. However, the CommonSpirit board has oversight over all of the legacy programs. The organization's treasurer is Lisa Zuckerman, who had been Dignity Health's long-time treasurer.

Debt and contingent liabilities

We expect the 2019 plan of finance may be the first of several issuances that CommonSpirit will likely pursue during the next few years as it optimizes the capital structure of the combined organization. Neither CHI nor Dignity Health has accessed the public markets during the past few years, given the affiliation had been pending for some time. As a result, both have been relying on shorter-term debt to address puts and renewals in recent years. The 2019 bonds, collectively, are expected by management to provide $6.3 billion of capital (including net premium) the majority of which will be used to refinance existing debt. New net debt of $600 million is expected to be generated for new capital for the company, which will reimburse the organization for prior capital expenditures.

On a pro forma basis, CommonSpirit will have approximately $14 billion of long-term debt outstanding, about a $600 million increase. The compilation of the organization's historical long-term debt shows a lower figure of less than $12 billion of long-term debt because it excludes the current portion. Given the short nature of some of the recent obligations, the accounting treatment classifies a relatively large portion of CommonSpirit's debt as current. We recognize this classification and note that this issuance is only a modest increase in actual total debt, with a commensurate increase in unrestricted reserves. Pro forma debt to capitalization (excluding any potential increase in net assets associated with accounting treatment of the combination of CHI and Dignity Health) is 49%. Management's projections call for a gradual decline in leverage with a goal of 45%.

We view the expediency of the issuance favorably, as it does reduce the risk of the portfolio by increasing long-term fixed-rate committed capital in place of short-term obligations. Moreover, the financing is expected by management to yield considerable near-term cash flow savings for CommonSpirit, which we believe will be important particularly in the near term, as we expect generation of cash flow to be muted until integration savings materialize.

Following the completion of the 2019 plan of finance, CommonSpirit will have de-risked its debt portfolio materially by refinancing a large portion of its contingent liability debt. S&P Global Ratings estimates that contingent liability debt

will decrease to about $3 billion postfinancing, which will primarily consist of the remaining self-liquidity backed debt, VRDBs, direct placements, and CHI's CP program. We understand that as part of the plan of finance, management will seek consent from all banks to agree to a common set of standards and covenants across all legacy direct placement deals.

Both CHI and Dignity Health have defined benefit pension plans. On a combined basis, although the plan assets are roughly $2 billion less than the projected benefit obligations, we believe the plans are well funded at approximately 81% based on the data reported in both organization's latest audits (period ended June 30, 2018).

Table 2

CommonSpirit Health, Illinois Financial Statistics

	--Nine months ended March 31--	--Fiscal year ended June 30--			
	2019*	**2018§**	**2017§**	**Health care system A- 2017**	**Health care system BBB+ 2017**
Financial performance†					
Net patient revenue ($000s)	19,895,000	26,819,737	25,535,154	1,967,303	1,602,943
Total operating revenue ($000s)	21,521,000	29,142,005	27,749,424	MNR	MNR
Total operating expenses ($000s)	21,866,000	29,138,801	28,805,433	MNR	MNR
Operating income ($000s)	(345,000)	3,204	(1,056,009)	MNR	MNR
Operating margin (%)	(1.60)	0.01	(3.81)	2.00	(1.80)
Net nonoperating income ($000s)	522,000	787,590	797,239	MNR	MNR
Excess income ($000s)	177,000	790,794	(258,770)	MNR	MNR
Excess margin (%)	0.80	2.64	(0.91)	4.10	0.30
Operating EBIDA margin (%)	5.03	6.70	3.10	8.80	4.00
EBIDA margin (%)	7.28	9.16	5.80	11.00	5.50
Net available for debt service ($000s)	1,605,000	2,740,749	1,657,073	174,352	111,119
Pro forma maximum annual debt service ($000s)	825,000	825,000	825,000	MNR	MNR
Pro forma maximum annual debt service coverage (x)	2.59	3.32	2.01	3.20	2.80
Pro forma operating lease-adjusted coverage (x)	2.00	2.45	1.65	2.50	2.30
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	11,018,000	12,134,525	11,638,266	883,401	638,819
Unrestricted days' cash on hand	145.0	160.0	155.2	149.30	156.20
Unrestricted reserves/total long-term debt (%)	103.9	102.9	98.4	88.20	141.90
Unrestricted reserves/contingent liabilities (%)	N.A.	235.2	239.5	643.90	535.40
Average age of plant (years)	N.A.	9.8	9.7	13.30	10.50
Capital expenditures/depreciation and amortization (%)	104.4	89.3	93.6	173.30	87.70
Debt and liabilities‡					
Total long-term debt ($000s)	10,600,000	11,787,835	11,828,449	MNR	MNR

Table 2

CommonSpirit Health, Illinois Financial Statistics (cont.)

	--Nine months ended March 31--	--Fiscal year ended June 30--			
	2019*	**2018§**	**2017§**	**Health care system A- 2017**	**Health care system BBB+ 2017**
Long-term debt/capitalization (%)	42.1	44.5	45.9	46.20	35.30
Contingent liabilities ($000s)	N.A.	5,159,068	4,859,803	MNR	MNR
Contingent liabilities/total long-term debt (%)	N.A.	43.8	41.1	18.60	31.20
Pro forma debt burden (%)	2.81	2.76	2.89	2.70	2.20
Defined-benefit plan funded status (%)	N.A.	81.51	76.41	80.00	77.40
Other miscellaneous statistics					
Total net special funding ($000s)**	805,125	1,196,221	N.A.	MNR	MNR
Pro forma balance sheet ratios					
Unrestricted reserves ($000s)	11,618,000			MNR	MNR
Total long-term debt ($000s)§§	13,939,000			MNR	MNR
Unrestricted days' cash on hand	152.9			MNR	MNR
Unrestricted reserves/total long-term debt (%)	83.4			MNR	MNR
Long-term debt/capitalization (%)	48.9			MNR	MNR

N.A.--Not available. MNR--Median not reported. *Fiscal 2019 results based on consolidated financial statements prepared by CommonSpirit Health assuming that the ministry alignment occurred on July 1, 2018. §Compilation of the individual audits of CHI and Dignity Health as prepared by S&P Global Ratings. †S&P Global Ratings' financial performance calculations include the net impact of discontinued operations as part of operating income. ‡Historical long-term debt excludes current portion. **DSH and provider fees (net of expense). §§Assumes net increase of $600 million of debt.

Credit Snapshot

- Organization description: CommonSpirit Health was formed through the combination of Dignity Health and Catholic Health Initiatives on Feb. 1, 2019. The organization is one of the largest health care systems in the country, with 142 hospitals and more than 700 clinical locations across 21 states.
- Group status: Prior to the consolidation of CHI's COD and Dignity Health's MTI into a new MTI and single credit group, both organizations remained separately obligated on their existing debt obligations. However, pursuant to S&P's Global Ratings' Group Rating Methodology, we consider both core to CommonSpirit Health, and have therefore aligned our ratings on both legacy organizations prior to the effectuation of the new MTI. Upon closing of the 2019 plan of finance, the CommonSpirit MTI will be in effect and will secure the 2019 bonds issued for CommonSpirit as well as the historical debt originally issued under CHI's COD and Dignity Health's MTI.
- Security: On the effective date following the issuance of the 2019 bonds, amendments to the historical CHI COD and Dignity Health MTI will be effectuated and a single, new MTI will be formed for CommonSpirit Health. At that time, the bonds issued as part of this plan of finance and those obligations that were originally issued under CHI's COD and Dignity Health's MTI will be secured under the CommonSpirit MTI, making all joint/several obligations. There is some debt outside of the new MTI that were not obligations of either historical governing bond documents, but they are nominal. We have, however, included that debt and related debt service in all our cited metrics and analysis. The CommonSpirit MTI creates an obligated group that includes the vast majority of the entities of CommonSpirit. Specifically, the obligated group will comprise 92% and 89% of total revenue and assets, respectively, of the combined system. The security for the bonds is a pledge of gross revenue of the obligated group. The MTI also has a provision creating restricted affiliates of the obligated group. Members of the obligated group can direct restricted affiliates to transfer funds to enable the obligated group to comply with provisions of the MTI. Initially, BSLMC is the only restricted affiliate. The CommonSpirit MTI is also expected by management to feature a rate covenant of 1.1x historical actual debt service coverage and an event of default should historical coverage be below 1.0x after one year. Also, an additional bonds test is expected to exist at 1.1x historical pro forma coverage.
- Swaps: Under the plan of finance no new swaps will be entered into, but the swaps of the historical organizations will remain outstanding. CHI is party to 15 floating-to-fixed swaps, multiple total return swaps and one basis swap. There are eight counterparties: Bayerische Landesbank, JPMorgan Chase Bank N.A., UBS AG, Morgan Stanley, Piper Jaffrey, Bank of America/Merrill Lynch, Barclay's, and BMO Capital. Dignity Health has 16 floating to fixed rate swaps, one total return swap and five fixed-to-floating risk participation agreements, with J.P. Morgan, Sumitomo, Barclays, and Deutsche Bank as counterparties for the swaps. As of March 31, 2019, the total notional amount of the swap portfolio is $3.1 billion with a negative mark to market of $389 million, net of collateral posted by CHI of $208 million in accordance with its swap agreements. Dignity Health has no collateral posting requirements under its swap agreements. While CommonSpirit's swap portfolio is large, we do not view it as a risk to the rating at the current time given the pro forma changes to increase the overall fixed-rate debt percentage while reducing contingent liability exposure. Our view is further supported by CommonSpirit's considerable and liquid unrestricted reserve balances versus the swap exposure.

Ratings Detail (As Of July 15, 2019)		
Catholic Health Initiatives taxable bnds		
Long Term Rating	BBB+/Stable	Outlook Revised

Ratings Detail (As Of July 15, 2019) (cont.)		
Catholic Health Initiatives taxable bnds ser 2017A due 10/01/2027		
Long Term Rating	BBB+/Stable	Outlook Revised
Catholic Health Initiatives taxable bnds ser 2018A due 07/31/2028		
Long Term Rating	BBB+/Stable	Outlook Revised
Catholic Health Initiatives US$900.mil taxable hosp CP nts ser A&B		
Short Term Rating	A-2	Affirmed
Dignity Hlth rev bnds		
Long Term Rating	BBB+/Stable	Downgraded
Dignity Hlth (Dignity Hlth) SYSTEM		
Long Term Rating	BBB+/Stable	Downgraded
Arizona Hlth Facs Auth, Arizona		
Dignity Hlth, California		
Arizona Hlth Facs Auth (Dignity Hlth) JOINTCRIT		
Long Term Rating	AA/A-1	Affirmed
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Arizona Hlth Facs Auth (Dignity Hlth) JOINTCRIT		
Long Term Rating	AA/A-1	Affirmed
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Arizona Hlth Fac Auth (Dignity Health)		
Long Term Rating	BBB+/Stable	Downgraded
Arizona Hlth Fac Auth (Dignity Health) hosp VRDO ser 2008B		
Long Term Rating	AA-/A-1	Downgraded
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Arizona Hlth Fac Auth (Dignity Health) hosp VRDO ser 2009F		
Long Term Rating	AA-/A-1	Downgraded
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Arizona Hlth Fac Auth (Dignity Health) (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Breckenridge, Minnesota		
Catholic Health Initiatives, Colorado		
Breckenridge (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
California Hlth Facs Fincg Auth, California		
Dignity Hlth, California		
California Hlth Facs Fincg Auth (Dignity Hlth) JOINTCRIT		
Long Term Rating	AA/A-1	Affirmed
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Facs Fincg Auth (Dignity Hlth) JOINTCRIT		
Long Term Rating	AA-/A-1	Downgraded
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Facs Fincg Auth (Dignity Hlth) JOINTCRIT		
Long Term Rating	AA-/A-1	Downgraded

Ratings Detail (As Of July 15, 2019) (cont.)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Facs Fincg Auth (Dignity Hlth) SYSTEM		
Long Term Rating	BBB+/Stable	Downgraded
California Hlth Facs Fin Auth (Dignity Health)		
Long Term Rating	BBB+/Stable	Downgraded
California Hlth Facs Fin Auth (Dignity Health) (AMBAC)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Facs Fin Auth (Dignity Health) (MBIA) (National)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Facs Fin Auth (Dignity Hlth) VRDO hosp rev bnds ser 2004K		
Long Term Rating	AA-/A-1	Downgraded
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Hlth Fac Fin Auth (Dignity Healtht) (MBIA) (National)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Statewide Communities Dev Auth, California		
Dignity Hlth, California		
California Statewide Communities Dev Auth (Dignity Health) (BHAC) (SEC MKT)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
California Statewide Comntys Dev Auth (Dignity Health) (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Downgraded
Chattanooga Hlth, Educl & Hsg Fac Brd, Tennessee		
Catholic Health Initiatives, Colorado		
Chattanooga Hlth Ed & Hsg Fac Brd (Catholic Hlth Initiatives)		
Long Term Rating	BBB+/A-2/Stable	Outlook Revised
Chattanooga Hlth Ed & Hsg Fac Brd (Catholic Hlth Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Colorado Hlth Fac Auth, Colorado		
Catholic Health Initiatives, Colorado		
Colorado Hlth Fac Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Colorado Hlth Fac Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Unenhanced Rating	NR(SPUR)	Current
Colorado Hlth Fac Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Unenhanced Rating	NR(SPUR)	Current
Colorado Hlth Fac Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Colorado Hlth Fac Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised
Colorado Hlth Fac Auth (Catholic Health Initiatives) (AGM)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Colorado Hlth Fac Auth (Catholic Health Initiatives) (BHAC) (SEC MKT)		

Ratings Detail (As Of July 15, 2019) (cont.)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Colorado Hlth Fac Auth (Catholic Health Initiatives) (FGIC)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth, Kentucky		
Catholic Health Initiatives, Colorado		
Kentucky Econ Dev Fin Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/A-2/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised
Kentucky Econ Dev Fin Auth, Kentucky		
Sylvania Franciscan Hlth Oblig Grp, Ohio		
Kentucky Econ Dev Fin Auth (Sylvania Franciscan Health Obligated Group)		
Long Term Rating	BBB+/Stable	Affirmed
Louisville & Jefferson Cnty Metro Govt, Kentucky		
Catholic Health Initiatives, Colorado		
Louisville & Jefferson Cnty Metro Govt (Catholic Hlth Initiatives) rev rfdg bnds		
Long Term Rating	BBB+/Stable	Outlook Revised
Louisville & Jefferson Cnty Metro Govt, Kentucky		
Louisville Med Ctr, Kentucky		
Louisville & Jefferson Cnty Metro Govt (Louisville Med Ctr) rfdg rev bnds (Louisville Med Ctr, Inc. Steam & Chilled Wtr Plant Proj)		
Long Term Rating	BBB+/Stable	Affirmed
Louisville & Jefferson Cnty Metro Govt, Kentucky		
Louisville Med Ctr Laundry, Kentucky		
Louisville & Jefferson Cnty Metro Govt (Louisville Med Ctr Laundry) rfdg rev bnds (Louisville Med Ctr, Inc. Laundry Fac Proj)		
Long Term Rating	BBB+/Stable	Affirmed
Maricopa Cnty Indl Dev Auth, Arizona		
Dignity Hlth, California		
Maricopa Cnty Indl Dev Auth (Dignity Health)		
Long Term Rating	BBB+/Stable	Downgraded
Montgomery Cnty, Ohio		
Catholic Health Initiatives, Colorado		
Montgomery Cnty (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Montgomery County (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Short Term Rating	NR	Current

Ratings Detail (As Of July 15, 2019) (cont.)		
Montgomery County (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Umatilla Cnty Hosp Fac Auth, Oregon		
Catholic Health Initiatives, Colorado		
Umatilla Cnty Hosp Fac Auth (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Washington Hlth Care Fac Auth, Washington		
Catholic Health Initiatives, Colorado		
Washington Health Care Facilities Authority (Catholic Health Initiatives)		
Long Term Rating	BBB+/Stable	Outlook Revised
Washington Hlth Care Fac Auth (Catholic Health Initiatives)		
Unenhanced Rating	BBB+(SPUR)/Stable	Outlook Revised
Washington Hlth Care Fac Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised
Washington Hlth Care Fac Auth (Catholic Health Initiatives) SYSTEM		
Long Term Rating	BBB+/Stable	Outlook Revised

Many issues are enhanced by bond insurance.

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