FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms CommonSpirit (CO) IDR at 'A-'; Outlook Stable

Thu 20 Feb, 2025 - 5:24 PM ET

Fitch Ratings - Austin - 20 Feb 2025: Fitch has affirmed CommonSpirit Health's Issuer Default Rating (IDR) at 'A-' and on approximately $19.7 billion of debt issued by or on behalf of CommonSpirit Health at 'A-'. The ratings include prior debt issued by Dignity Health and Catholic Health Initiatives (CHI).

The Rating Outlook is Stable.

Fitch has also affirmed the Short-Term rating on CHI bonds backed by the system's self-liquidity at 'F1', including on the series 2004C variable rate demand bonds and CHI's CP notes. The 'F1' short-term rating correlates to the 'A-' long-term rating and to a higher implied short-term rating given the issuer's revenue defensibility assessment and a liquidity ratio that exceeds 1.75x.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
CommonSpirit Health (CO)	LT IDR	A-	Affirmed	A-
Catholic Health Initiatives (CO) /General Revenues/1 LT	LT	A-	Affirmed	A-
CommonSpirit Health (CO) /General Revenues/1 LT	LT	A-	Affirmed	A-
Dignity Health (CA) /General Revenues/1 LT	LT	A-	Affirmed	A-
Catholic Health Initiatives (CO) /Self-Liquidity/1 ST	ST	F1	Affirmed	F1

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VIEW ADDITIONAL RATING DETAILS

While some of CommonSpirit's financial metrics suggest rating in a lower category per Fitch criteria, Fitch believes its substantial size, diversity and national scale convey rating strength beyond the face value of these metrics.

CommonSpirit Health improved profitability in fiscal 2024 by reducing the external contract labor use and increasing volumes, and implementing productivity initiatives, following notable operational challenges in the prior two years. CommonSpirit, like many healthcare systems, has faced stubbornly persistent operational challenges despite meaningful progress.

Ongoing operational challenges include lower acuity levels, labor scarcity and high wage inflation. CommonSpirit realized all its initial merger-driven operational goals, but operational challenges still impacted fiscal 2024 operating results, although these results improved markedly over fiscal 2022 and fiscal 2023.

The system incurred total operational losses of $581 million in fiscal 2024 (audited results through June 30, 2024), following a $1.4 billion loss in fiscal 2023. This led to an operating margin loss of 1.5% and an operating EBITDA margin of 4.2%, which though improved, remains weak. Due to operational challenges, the planned return to a better-than-break-even operating margin on an annual basis is unlikely before fiscal 2026. However, Fitch Ratings sees this as a delay in, not a rejection of, CommonSpirit's multiyear journey to operational profitability and balance sheet accretion.

Fitch believes CommonSpirit is positioned to build on prior gains. The first six months of fiscal 2025 (unaudited six-month results through Dec. 31, 2024) show an operating loss of just $196 million, reflecting improvements in its operating margin loss to 1.0% and its operating EBITDA margin of 4.5%.

While operating results have not been as robust as expected, Fitch expects that CommonSpirit will generate a consistent operating EBITDA margin of about 6% or higher in the long term, with a positive operating margin achieved by fiscal 2027, or perhaps as early as 2026. Fitch expects operating EBITDA margins below 6% over the next one to two years due to current industry headwinds, but recognizes CommonSpirit's recent progress. Sustaining these improvements according to management's timeline will be crucial for maintaining the current rating and Rating Outlook.

Capital spending is expected to reflect operational performance but is expected to remain at or above annual depreciation levels. The spending will support CommonSpirit's long-term mission as the sector shifts to more outpatient access points.

A break-even operating income margin would result in an operating EBITDA margin of approximately 6% and operating EBITDA cash flow of about $2.5 billion, demonstrating CommonSpirit's significant size and scale.

SECURITY

The bonds are a joint and several obligations under CommonSpirit's master trust indenture (MTI) and are secured by a gross revenue pledge of the obligated group (OG).

KEY RATING DRIVERS

Revenue Defensibility - 'bbb'

Extensive Size and Revenue Diversity

CommonSpirit's revenue defensibility is assessed as midrange, which is the highest assessment absent significant taxing authority to support bond repayment or operations. This assessment is supported by its broad revenue composition across different services and markets. It has a combined payor mix in fiscal 2024, with 22.9% of gross revenues from combined Medicaid and self-pay, contributing to the midrange assessment. CommonSpirit has not experienced a significant shift in payor mix but, like most in the sector, is pursuing rate increases from commercial payors due rising staffing and overall costs.

CommonSpirit garners a leading or a near-leading market share in many of its key markets, most of which are competitive with strong regional providers. The system has focused on growth and expansion in Colorado, Arizona and the Pacific Northwest in recent years, and remains focused on stabilizing its Texas (South) operations.

Fitch expects CommonSpirit to continue reviewing its asset portfolio after reorganizing into fewer geographical regions last year. System assets are being evaluated on the long-term potential for a full continuum of care model and the relative contribution of each market.

Markets with limited paths to financial sustainability or market essentiality will, in the context of CommonSpirit's mission, may need to be considered for alternate models or partnerships to improve operating results, while still honoring community impact. Notably, CommonSpirit spent $4.2 billion in community benefits in fiscal 2024. Fitch does not expect any significant asset divestiture at this time.

Fitch believes CommonSpirit should be able to leverage its higher-performing assets and find a sustainable balance between profitability and support of its mission. New geographies and new capabilities have also been added (e.g. Steward Health Care's Utah care sites last year) to an already extensive list of pre- and post-acute service offerings.

Operating Risk - 'bbb'

Improved Operational Results in Fiscal 2024 and Beyond; Financial Results Expected to Continue to Improve

CommonSpirit improved its performance amid sector-wide operational pressures in fiscal 2024, reducing its operating margin loss to 1.5% and achieving an operating EBITDA margin of 4.2%. As of the second quarter of fiscal 2025 (unaudited financial results through Dec. 31, 2024), CommonSpirit's operations improved further, with a YTD operating margin loss of only 1.0% and an operating EBITDA margin of 4.5%. These results were driven by volume growth, reduced average length of stay and productivity (labor) initiatives.

CommonSpirit is actively pursuing labor standardization, organizational design changes, and other value capture initiatives in its revenue cycle, supply chain and ancillary services, which Fitch expects to result in operational improvements in fiscal 2025, 2026, and beyond. Despite these initiatives, operational losses may persist through calendar 2025, but Fitch expects to see a gradual strengthening of operating EBITDA margin. Fitch expects positive operating margins will begin to be realized in fiscal 2026, with full-year results surpassing break-even in 2027.

Capital spending averaged $1.35 billion over the past three fiscal years. Fitch projects this will increase to around $2.0 billion on average over the next five years as margins and EBITDA improve, and CommonSpirit invests in growth opportunities.

Fitch views CommonSpirit's intended capital spending as generally aggressive and considers it unlikely that spending will occur at planned levels. Instead, spending will likely be achieved at a slower pace, gradually improving unrestricted liquidity and creating additional spending flexibility. Fitch expects lower spending levels in the earlier years, followed by an increase as operations improve.

Financial Profile - 'bbb'

Liquidity Level, with Gradual Improvement Expected

Unrestricted cash and investments were $15.6 billion at fiscal YE 2024. Long-term debt at fiscal YE 2024 was $20.6 billion, inclusive of short-term/long-term debt, as well as short-term/long-term operating lease liabilities, resulting in cash to debt of 75%, which is highly consistent with levels in prior year. Days cash on hand was strong at 155 days as of fiscal YE 2024 and was around the same level in YTD fiscal 2025.

Unrestricted liquidity, not including any impact from improved operations, should grow in fiscal 2025 due to several liquidity infusions, including, among other things, continued FEMA settlements, employee retention credits, and payment on delinquent payor accounts. The exact amount and timing are yet to be determined, but are likely to range from $0.5 billion on the lower end to $1.0+ billion on the higher end. In addition, CommonSpirit is focused on building on its record annual philanthropy and fundraising, which reached $314 million in fiscal 2024.

CommonSpirit's fiscal 2024 pension funding increased and is at a total funding level of 87% on a projected benefit obligation (PBO) basis. Fitch considers only the portion of a defined benefit (DB) pension funded below 80% as a debt equivalent, which was as much as $2.4 billion a few years ago. As a result, cash-to-debt and cash-to-adjusted debt ratios are the same.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations were applied in this rating determination.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- If CommonSpirit is unable to adhere to stated improvement initiatives or misses key financial milestones in fiscal 2025 and 2026, a negative Outlook or a downgrade is possible;

-- If cash-to-debt levels do not gradually improve and are not expected to be sustained above 80%, negative action is likely;

-- Higher levels of capital spending that require significant additional cash or debt commitments without commensurate EBITDA growth could lead to a negative rating action.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Sustained operating EBITDA margins of 8% or above;

-- Generation of more robust cash flow that allows for a continuous level of capital reinvestment to remain competitive;

-- Sustained cash-to-adjusted debt expectations of 100% while maintaining a midrange (or better) operating risk assessment.

PROFILE

CommonSpirit is the largest Catholic healthcare system in the U.S. This integrated system operates 157 hospitals (including 20 hospitals operated through unconsolidated joint ventures) and more than 2,300 care sites across 24 states. CommonSpirit has 25,000 affiliated physicians and practitioners, with more than 6,000 of those providers employed, and 20 million annual patient encounters.

In fiscal 2024 (audited results through June 30, 2024), the system had combined revenue of approximately $37 billion. In addition to hospitals, the system offers a wide range of care in its individual market divisions, including micro hospitals, imaging centers, urgent care centers, specialty clinics, virtual care, and home health and hospice services.

Sources of Information

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

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer’s available public disclosure.

APPLICABLE CRITERIA

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 12 Nov 2024) (including rating assumption sensitivity)

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 10 Jan 2025) (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), v2.0.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

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