

**RATING ACTION COMMENTARY**

Fitch Rates Adventist, CA's Series 2022 and 2022A Bonds 'A'; Revises Outlook to Negative

Wed 30 Nov, 2022 - 1:49 PM ET

Fitch Ratings - San Francisco - 30 Nov 2022: Fitch Ratings has assigned an 'A' long-term rating to Adventist Health's (Adventist) series 2022 and series 2022A bonds (issued by the California Health Facilities Financing Authority) and affirmed the system's other outstanding debt at 'A'.

Fitch has also affirmed the following ratings for Adventist:

--Long-term Issuer Default Rating (IDR) at 'A';

--Short-term CP note rating at 'F1+' (based on self-liquidity).

The Rating Outlook has been revised to Negative from Stable.

RATING ACTIONS**ENTITY / DEBT** ⚡**RATING** ⚡**PRIOR** ⚡

Adventist Health (CA)	LT IDR	A Rating Outlook Negative		A Rating Outlook Stable
	Affirmed			
Adventist Health (CA) /General Revenues/1 LT	LT	A Rating Outlook Negative		Affirmed A Rating Outlook Stable
Adventist Health (CA) /General Revenues/1 ST	ST	F1+	Affirmed	F1+

[VIEW ADDITIONAL RATING DETAILS](#)

The series 2022(taxable) and series 2022A bonds (tax-exempt) will be used to refinance Adventist's \$150 million line of credit balance, refinance \$150 million of outstanding CP (total program is currently \$350 million), refinance the series 2013 bonds, fund \$100 million of new money to support the system, and fund associated costs of issuance. There will be no reserve fund with the 2022 debt issuance. The new money financing portion will go primarily towards the construction, expansion, remodeling, renovation, and/or acquisition of certain health facilities.

SECURITY

The bonds are secured by a gross revenue pledge of the obligated group.

ANALYTICAL CONCLUSION

The Outlook revision to Negative from Stable reflects continued negative operational pressure, which resulted in a negative 6.5% operating margin and negative 1.6% operating EBITDA margin through the nine-months of fiscal 2022 ending Sept. 30, 2022 (unaudited).

Fitch's affirmation of Adventist's long-term rating at 'A' is primarily based on management's sharp focus on improving operations from current levels with an expectation to finish the 12-month year-end with a positive 0.7% operating EBITDA margin. Fitch recognizes that Adventist's recent performance has been affected by a series of unfavorable events including devastating wildfires in certain markets, the novel coronavirus, and now acute labor pressures affecting the entire healthcare industry. Together these factors have created adverse economic conditions for the system.

However, Adventist's credit strengths continue to include leading market positions throughout its three-state hospital footprint; an adequate liquidity position for the rating level; and a reasonable and accretive strategic plan.

Fitch views Adventist's strategic plan to improve operational performance as reasonable and expects it to drive improved results beginning in 4Q22. Over the next two years, Fitch anticipates the system to improve upon the most recent operating results (Sept. 30, 2022) and begin to make the operational journey to reestablish positive margins more closely resembling historical levels. Fitch anticipates fiscal 2023 to produce an operating EBITDA margin north of 3% and then continue to improve, reaching an approximate 6.4% operating EBITDA margin in fiscal 2025.

The rating and Outlook also reflect Fitch's expectations that Adventist's new management team (largely installed in early 2022) will make operational improvements and successfully execute upon its long-term strategy of growing in favorable markets, while closely evaluating underperforming markets. Fitch anticipates the organization's balance sheet resources will be stable at current levels and then improve over the medium to long term, which also supports an 'A' rating.

The 'F1+' short-term rating is applicable within Fitch's criteria and reflects both the linkage to Adventist's current 'A' rating and its strong liquidity levels compared with short-term puttable debt requirements providing sufficient coverage for the notes at just over 4x. Adventist also has a \$350 million syndicated line of credit available that can be drawn upon for general corporate purposes.

In an event of an unsuccessful rollover, the dealer will notify Adventist and the Issuing and Paying Agent (IPA) shall request payment for the full amount of the notes due. Adventist shall deliver funds to the IPA on the same day to be applied to the matured notes.

Based on Fitch's rating criteria relative to self-liquidity, Adventist's eligible cash and investments for same-day settlement comfortably exceeds Fitch's requirement to cover the maximum tender exposure on any given date.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Maintenance of Leading Market Positions; Growing in Accretive Markets

Adventist's revenue defensibility is midrange, with solid positions in multiple markets, all of which exhibit stable-to-favorable population growth trends and socioeconomic characteristics. Adventist is a multistate provider, with system operations in four states and inpatient hospital facilities located in three states: California, Oregon and Hawaii, (with one retirement facility in Washington), although the vast majority of facilities are located in California.

Adventist remains the largest provider in all of their major market regions, with respective market shares ranging from high single digits in highly fragmented (and sizable) markets, such as in Southern California and in certain segments of Northern California, to the highest share reaching approximately 61% in the greater Sacramento area market. It demonstrates good revenue defensibility in California, which is significant given the high financial barrier to entry with construction mandated to be seismically compliant, and therefore more expensive to build.

In each of the states where Adventist operates, the respective service areas generally exhibit stable population growth characteristics, with pockets of good population growth, high wealth and income levels, but also more rural markets that constrain its overall payor mix. Adventist has a comparatively constrained payor mix, with over 30% of their gross revenues coming from Medicaid (MediCal) and self-pay sources; this is somewhat mitigated due to California provider-fee funding delivered.

The payor mix is also heavily exposed to governmental payors with approximately 75% of system gross payor revenue coming from Medicare and Medicaid. However, Adventist benefits from supplemental reimbursement at its rural facilities, with Adventist operating the largest rural health clinic network in California.

Operating Risk: 'bbb'

Large Operating Loss in Fiscal 2022; Significant Improvement Expected in Fiscal 2023

The system's operating risk assessment is midrange with the expectation of adequate cost management opportunities to support improved performance going forward. As of the end of 3Q'22, Adventist recorded a significant \$254 million loss from operations, which resulted in a negative 6.5% operating margin and negative 1.6% operating EBITDA margin. This marks the fourth consecutive year the system will record a loss from operations. The fiscal 2022 decline in operating income is largely related to an acute increase in labor expenses, in addition to the carryover effect of prior unfavorable factors that have impacted the system's overall financial.

Fitch believes that Adventist has begun its operational turnaround, which will take place in the fourth quarter in fiscal 2022 and is supported by year-over-year volume increases and focused on curtailing certain expenses. By fiscal year-end (Dec. 31, 2022), management expects to generate a positive 0.7% operating EBITDA margin and observe continual improvement into the next fiscal year, which Fitch views favorably.

Financial Profile: 'a'

Satisfactory Balance Sheet Resources with Limited Debt Capacity

Adventist's unrestricted liquidity position remains satisfactory for the strong 'a' financial profile. Unrestricted cash totaled approximately \$2.1 billion through Sept. 30, 2022, which equated to approximately 140 day's cash on hand and 90% cash to debt. Current long-term debt is \$2.3 billion; on a proforma basis, long-term debt is expected to increase to approximately \$2.4 billion. Fitch believes the system has very limited debt capacity at the current rating level, but Adventist does not anticipate any significant new debt issuances over the near-term.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations affected this rating determination.

RATING SENSITIVITIES

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

--If operating EBITDA margins continue to remain low and at negative levels, coupled with the inability to meet projections close to or near a 3.6% operating EBITDA margin in fiscal 2023;

--If unrestricted liquidity materially declines below current levels, pressuring the key leverage metrics that support the rating;

--Any material unanticipated borrowings without a commensurate improvement in current levels of unrestricted cash and investments; Adventist has limited debt capacity at the current rating.

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

--Given the Negative Outlook and the need to significantly improve operating performance, a higher rating level over the two-year Outlook period would be unexpected and limited to only exceptionally positive impacts to Adventist's unrestricted liquidity position;

--Longer-term positive rating action will be contingent on Adventist fully achieving and/or exceeding its plan to return operational performance to historical levels.

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>.

CREDIT PROFILE

Adventist has 23 hospitals that are located in three states (Hawai'i, Oregon, and California) with its facilities enjoying the leading market position in the majority of its markets. Adventist has its largest presence throughout California, in the northern, northwest, central and southern regions. The system's total revenue in 2021 (last audited period) was approximately \$5.2 billion.

One of Adventist's main credit strengths is the size of its network with total operations spanning four states operating 370 clinics, which account for approximately 2.5 million clinic visits a year. The system's hospital presence is concentrated in California but geographically diversified, with no one facility comprising more than a small portion of system operating revenue. Management's future growth goal is for the system to be a \$10 billion organization (in total revenues) by 2030.

Adventist has a new executive leadership team in place led by Kerry Heinrich, President and CEO, who began the role earlier in 2022, and previously served on the system's board for seven years. Additionally, Adventist's CFO John Beaman began his role with the system in January 2022.

Revenue Defensibility

Historically, Adventist has been a major beneficiary of the California provider-fee program, and the net benefit is projected to be approximately \$266 million in 2022, which is consistent with the prior year's amount. If there is revenue impact variability in the amount that's remitted to Adventist it generally relates to the timing of CMS approval of the various components of the program. Notwithstanding beneficial provider-fee funding, the high level of Medicaid remains an inherent credit challenge and requires continued focus on operating efficiencies, which Adventist is committed to successfully managing.

Adventist has inpatient facilities operating in three states and maintains leading and solid market positions in each of its regions. A majority of the system's facilities are located in California and have market positions that range from high single digits to above 60% shares, respectively. As part of the system's long-term strategy to nearly double its size by the end of the decade, management is carefully reviewing performance in all markets and expects to add services in accretive, growing markets while prudently addressing operations in underperforming markets.

The Portland, OR market has recently exhibited some population growth and favorable unemployment and poverty levels, while Hawaii and California state-wide generally have flat population trends. In California and Hawai'i, unemployment levels are at and/or near state and national averages. As a rural provider in California, service area characteristics are somewhat distinct than from major population centers in the state and are reflected in the system's payor mix.

Operating Risk

Now that the system and economy are recovering from the pandemic coupled with a new management team in place, the system is evaluating all markets and focused on an improvement plan that should yield more than \$400 million in revenue enhancements and cost savings opportunities over the next 24-months.

Revenue enhancements are anticipated to come in part from positive negotiations related third party payor contracts, improved payor mix and patient volumes, a transformation of the system's revenue cycle management structure, and improvements in collections to reduce receivables, are among other initiatives. Cost savings will come principally from labor and productivity with reduced contract labor and an emphasis on recruiting new RNs and retaining RNs. Enterprise services savings are expected to include certain fixed cost reductions and insourcing of vendor contracts.

The system is expecting positive developments regarding outstanding settlement claims that should benefit its financial performance and that Fitch has factored into this analysis. Volumes have been trending positively (emergency department visits, outpatient surgeries, outpatient visits) for the system since 2021, which should continue to bolster revenues and contribute to future positive performance as expenses are managed prudently.

Fitch anticipates Adventist will continue to reinvest in itself and grow in size and scale over the next several years, toward a longer-term goal to be a \$10 billion healthcare company by 2030. This will be accomplished by further building provider sites, with organic growth in existing sites, newer geographic locations and through additional affiliations. Adventist has maintained a competitive average age of plant at 12.9 years with capital expenditures as a percentage of depreciation expense averaging approximately 88% over the past four fiscal years (FY2018-FY2021).

Future capital spending is anticipated to be a minimum of \$200 million per year going forward and ramp up to \$264 million in fiscal 2025, which excludes the new money series 2022A bonds. The additional capex represents a return to more normal capital investment for the system as the thesis of returning to historical operating performance becomes true.

Financial Profile

Through Fitch's base scenario, or Fitch's best estimate of the most likely scenario of financial performance over the next five years given our expectations for current economic conditions and operational performance, Fitch expects that Adventist will see gradual improvement in key metrics after the recent period of lower margins. Fitch expects gradual improvement to continue over the medium to long term, given the expectation of operational improvement, which should lead to balance sheet accretion. With the somewhat heightened capital spending over the next several years, cash to adjusted debt improves to between 110% and 120% by the outer years of the five-year scenario.

Fitch's stress scenario assumes an economic stress to reflect potential equity volatility understanding that the system is already in a period of acute operational stress. Despite the stress, Fitch's forward-looking analysis shows cash to adjusted debt at approximately 95% within three years but expects improvement similar to the base scenario in the out years of the five-year scenario analysis. Fitch's forward-looking portfolio sensitivity analysis is based on Adventist's specific asset allocation, with 42.8% in cash and fixed income, 34% in domestic and international equities and the remaining portion in hedge funds/alternative investments.

Fitch expects Adventist's financial and leverage profile to remain consistent with 'A' category metrics as it begins to recover from recent operational stresses and generates additional unrestricted liquidity to support planned capital spending. Key balance sheet and leverage metrics could improve further if actual capital spending or borrowing is lower than expected or if operations ramp up faster than anticipated.

Asymmetric Additional Risk Considerations

Adventist has good disclosure practices and provides a detailed MD&A along with audited materials. It does not have any unusual legal restrictions or operate under any unusual regulatory pressures. Adventist's debt and asset allocation are somewhat conservative for the sector, and it does not have a defined benefit plan liability. Neither days' cash on hand nor debt service coverage constitute an asymmetric risk.

Adventist's debt service coverage ratio 12-months through Sept. 30, 2022 (unaudited) is expected to be approximately 1.1x on a system-wide basis (MTI coverage is expected to be 1.5x), which is slightly above the 1.0x covenant threshold. Although close, management does not expect to trip this threshold. If Adventist were to violate this covenant threshold, which would be the first year of doing so, a consultant call-in would be required. This does not pose an asymmetric risk to the organization as the covenant requires two-consecutive years of violation before becoming a hard default.

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

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

FITCH RATINGS ANALYSTS

Michael Burger

Director

Primary Rating Analyst

+1 415 796 9960

michael.burger@fitchratings.com

Fitch Ratings, Inc.

One Post Street, Suite 900 San Francisco, CA 94104

Kevin Holloran

Senior Director

Secondary Rating Analyst

+1 512 813 5700

kevin.holloran@fitchratings.com

Eva Thein

Senior Director

Committee Chairperson

+1 212 908 0674

eva.thein@fitchratings.com

MEDIA CONTACTS**Sandro Scenga**

New York

+1 212 908 0278

sandro.scenga@thefitchgroup.com

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 \(pub. 18 Nov 2020\)](#)
(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)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

California Statewide Communities Development Authority

EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers.

Please read these limitations and disclaimers by following this link:

<https://www.fitchratings.com/understandingcreditratings>. In addition, the following <https://www.fitchratings.com/rating-definitions-document> details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at <https://www.fitchratings.com/site/regulatory>. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch

Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not

address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Copyright © 2022 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved.

[READ LESS](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance Healthcare and Pharma North America United States
