Fitch Downgrades Mary Washington Healthcare (f/k/a MediCorp Health System) (VA) to 'BBB+' Ratings
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Fitch Ratings-New York-11 July 2011: As part of its ongoing surveillance effort Fitch Ratings has downgraded to 'BBB+' from 'A-' the rating on the following outstanding bonds issued on behalf of Mary Washington Healthcare (MWHC):

--$73.9 million Industrial Development Authority of the City of Fredericksburg, Virginia hospital facilities revenue refunding bonds (MediCorp Health System Obligated Group), series 2007;
--$125 million Industrial Development Authority of Stafford County, Virginia revenue bonds (MediCorp Health System Obligated Group), series 2006;
--$65 million Industrial Development Authority of the City of Fredericksburg, Virginia revenue bonds (MediCorp Health System Obligated Group), series 2002B.

The Rating Outlook is Stable.

RATING RATIONALE
--The downgrade to 'BBB+' is the result of deterioration in MWHC's operating performance following the opening of Stafford Hospital (Stafford) in the spring of 2009, which experienced slower fill-up than had been expected. The competitive situation was further strained in 2010 by the opening of an HCA owned hospital in the system's primary service area.
--Following significant operating losses in 2009 and 2010 at Stafford, operating margins in both fiscal years 2009 and 2010 (fiscal year ending Dec. 31) fell to a thin 0.7%, falling short of even the 'BBB' category median of 1.9% and the operating EBITDA margins of 7.1% in 2009 and 7.7% in 2010 were closer to the 'BBB' median of 8.7%.
--Liquidity remains light at the lower end of the 'BBB' rating category with unrestricted cash and investment at March 31, 2011 of $147.6 million equal to 97.7 days cash on hand (DCOH), cushion ratio of 6.9x and cash equal to 53.3% of long term debt.
--Mary Washington Hospital(MWH)has lost its sole community provider status effective Jan. 14, 2011, which will have the effect of reducing revenues by $25 million on an annual basis. Management has taken steps to right size the organization in response to the expected lower level of revenues.
--Coverage of maximum annual debt service by EBITDA of 2.6x in fiscal 2010 was in line with the 'BBB' category median.
--The system still commands a dominant market share in the high 60% range for both hospitals combined in the PSA, despite the opening of the HCA facility seven miles from MWH, and the location of Stafford Hospital offers better emergency access and closer proximity to the higher population concentrations in south Prince William County.

KEY RATING DRIVERS
--Ability to absorb the loss of sole community status without further deterioration in operating results.
--Leveraging the location of Stafford Hospital to generate increased volumes.
--Maintaining liquidity metrics at the current level.

CREDIT SUMMARY
The downgrade to 'BBB+' follows two years of weak operating performance caused by the strain on system finances from the much slower than anticipated fill-up at the 100-bed Stafford Hospital, which opened in the spring of 2009. The reasons for constructing the facility at the greenfield Stafford site included the need to locate services closer to the higher population concentrations in south Prince William County, as well as addressing the difficulty of emergency access to MWH during certain times because of traffic congestion. While the opening of the 120-bed HCA hospital, Spotsylvania, six miles south from MWH may have contributed to lower volumes in 2010, the impact was not significant and MWH has maintained its dominance in the tertiary service lines.

After returning to historic operating results in fiscal 2008, operating results in 2009 and 2010 were impacted by the much greater than anticipated losses at the new Stafford facility as census failed to meet projections, as well as some loss of volumes at MWH. While operating losses at Stafford are diminishing as census is slowly building up, the $22 million and the $12.5 million Stafford operating loss in 2009 and 2010, respectively, resulted in system operating income reduced to $5 million in both years from $19.2 million in 2008, equal to a thin operating margin of 0.7%, lower than the 'BBB' category median of 1.9%. Operating EBITDA margins of 7.1% in 2009 and 7.7% in 2010 were closer to the 8.7% category median. For the three month interim period ended March 31, 2011, operating income was reported at $2.8 million, to an improved
operating margin of 1.6% and an 8.7% operating EBITDA margin. Coverage of maximum annual debt service (MADS) was 2.6 times (x) in fiscal 2010 and is reported at 2.7x for the first quarter of 2011, in line with the 'BBB' category median of 2.5x and MADS and MADS as percent of revenues is manageable at 3%.

Despite the increase in competitive pressures, MWHC has maintained its dominant market share estimated in the upper 60% range for both hospitals on a combined basis, of its eight county primary service area, located approximately half way between Richmond, VA and Washington D.C. The Stafford location places the system strategically closer to more populous market in the southern portion of Prince William County and the Stafford census has slowly increased from 23.3 patients in the first year of operation to 35.8 last year and 45 patients at March 31, 2011. Management has also focused on building up several tertiary services at MWH, such as cardiology, neurology and neurosurgery, and has partnered with University of Virginia Hospital for their cardiac surgery program and Children's Nationals Medical Center for pediatric service.

A significant issue facing the system is the loss of MWHC's sole community status, effective Jan. 14, 2011. While this is major concern, management began to prepare for the expected loss of approximately $25 million of revenues on an annual basis early last year with the help of outside consultants. Actions taken included benchmarking and a reduction of 300 FTE's, accomplished mainly through attrition. The budget for fiscal 2011, which includes the reduction to revenues from the loss of the sole community status, is for breakeven performance from operations. Management expects operations to improve over time as the system derives strategic benefits from the Stafford location and from the increased tertiary draw of MWH.

An additional credit concern is MWHC's light liquidity which was impacted by operating losses at Stafford in the last two years and the internal funding of capital needs. Unrestricted cash and investment at March 31, 2011 of $147.6 million equate to 97.7 days cash on hand (DCOH), cushion ratio of 6.9x and cash equal to 53.3% of long term debt, which are all below the 'BBB' category medians of 122.2 DCOH, 8.5x and 75.9. Management is planning a $30 million variable rate borrowing for later this summer, the proceeds of which would be used to repay a $10 million loan and to reimburse the system for funding of oncology projects at both campuses. The estimated $20 million of reimbursement will increase DCOH by approximately 10 days.

The Stable Rating Outlook reflects Fitch's belief that MWHC's operating profitability will stabilize as the system strategic initiatives result in stronger census at the Stafford location and MWH maintains its dominance in several tertiary lines. The inability to manage expenses to the reduced level of revenues due to the loss of the sole community status, with further negative impact on profitability and or liquidity would, however, introduce rating pressure.

MWHC is the parent of a group of health care related organizations including Mary Washington Hospital, a 442-licensed bed acute care hospital located in Fredericksburg, VA, and Stafford Hospital Center, a 100-bed acute care hospital located in Stafford, VA. Revenues for the system totaled approximately $707 million in 2010. MWHC covenants to provide audited annual financial statements and quarterly disclosure to bondholders via the NRMSIRs.

Contact:

Primary Analyst
Eva Thein
Senior Director
+1-212-908-0674
Fitch, Inc.
One State Street Plaza
New York, NY 10004

Secondary Analysts
Gary Sokolow
Director
+1-212-908-0651

Committee Chairperson
Carolyn Tain
Senior Director
+1-415-732-7576

Media Relations: Cindy Stoller, New York, Tel: +1 212 908 0526, Email: cindy.stoller@fitchratings.com.
Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria', dated Aug. 16, 2010;

For information on Build America Bonds, visit 'www.fitchratings.com/BABs'.

Applicable Criteria and Related Research:
Revenue-Supported Rating Criteria
Nonprofit Hospitals and Health Systems Rating Criteria

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