Fitch Upgrades Mercy Regional Health Center (KS) Revs to 'A+': Outlook Stable

Ratings  Endorsement Policy
15 Dec 2014 1:40 PM (EST)

Fitch Ratings-New York-15 December 2014: Fitch Ratings has upgraded to 'A+' from 'A-' the rating on $22,995,000 of series 2013 hospital refunding revenue bonds issued by the City of Manhattan, KS on behalf of Mercy Regional Health Center (MRHC).

The Rating Outlook is Stable.

SECURITY

The bonds are secured by a pledge of gross revenues of the obligated group and a security of the main hospital campus through a lease arrangement with the city of Manhattan.

KEY RATING DRIVERS

DRAMATIC FINANCIAL IMPROVEMENT: The upgrade to 'A+' from 'A-' is driven by considerable changes in MRHC's financial profile from a combination of one-time items and solid core financial performance despite its small revenue base, producing an overall credit profile more consistent with an 'A+' rating.

OWNERSHIP TRANSFER: In February 2014, Via Christi Health (VCH), a subsidiary of Ascension Health (revenue bonds rated 'AA+'; Stable Outlook) became the sole member of MRHC through an ownership transfer agreement with Memorial Hospital Association, which previously held 50% ownership. Prior to this transaction, VCH held 50% control of MRHC and managed the organization under a management agreement since 1996 (updated and executed in 2010). While the bonds remain obligated on MRHC's credit only and MRHC already benefitted from the size and scale of VCH's operating platform, the full consolidation into VCH (and Ascension Health) is viewed positively.

MATERIAL BALANCE SHEET STRENGTHENING: As part of the transaction, VCH forgave $5.4 million in loans to MRHC and transferred $15.5 million in cash (included in unrestricted liquidity). Combined with receipts from one-time asset sales and strong cash flows, unrestricted cash and investments more than doubled over three years. Additionally, total long-term debt decreased over 20% with approximately 35% decline in maximum annual debt service (MADS). All key debt and liquidity metrics at September 30, 2014 well exceeded Fitch's 'A' medians.

SOLID OPERATING PERFORMANCE: After a negative operating margin in fiscal 2008 (June 30 year-end), profitability has been robust, driven by a change in leadership at MRHC and additional oversight provided by VCH. MRHC's operating and operating EBITDA margins exceeded Fitch's 'A' medians for the past five fiscal years.

SMALL REVENUE BASE: Fitch's main concern remains MRHC's small revenue base which exposes the organization to more operating volatility. However, its historically stable operating and financial performance, leading market share, and ownership structure mitigate concerns.

MANAGEABLE CAPITAL NEEDS: Aside from the renovation of the North Tower estimated to cost $15 million over a two year period, capital plans are modest and limited to routine maintenance and updates. No new debt is anticipated.

RATING SENSITIVITIES

STABILITY EXPECTED: Fitch expects MRHC to continue producing sound financial results and execute the North Tower construction project on time and within budget, and believes there is some cushion for volatility at the 'A+' rating.

CREDIT PROFILE

MRHC owns and operates a 150-licensed bed hospital and other health care facilities in Manhattan, KS. MRHC's main campus is operated under a lease from the city of Manhattan. The length of the lease is tied to the amortization of the bonds and the lease payment is composed mostly of the bond payments. Fitch reviewed the consolidated results of Mercy Regional Health Center, Inc., which includes non-obligated entities that accounted for approximately 11% of operating revenues in fiscal 2014.
Ownership Transfer

On February 27, 2014, Via Christi Health, a subsidiary of Ascension Health became the sole member of MRHC through a membership transfer agreement with Memorial Hospital Association. As a result of the transfer, VCH acquired full ownership of MRHC (from 50% controlling interest previously). As MRHC was previously managed by VCH via a management agreement, MRHC management reported no significant changes to the day-to-day operations or the local governance of the hospital. MRHC will be renamed Via Christi Hospital on April 24, 2015. Fitch also notes that VCH is a subsidiary of and is within the obligated group of Ascension Health. MRHC expects the series 2013 bonds to remain outstanding in its current form with MRHC as the sole member of the obligated group.

Material Balance Sheet Strengthening

As part of the transaction, VCH forgave $5.4 million in loans to MRHC and transferred $15.5 million in cash through an asset transfer. A net of $20.9 million balance sheet improvement was immediately recognized in fiscal 2014. Combined with one-time asset sales and strong cash flows, unrestricted cash and investments grew to $93.6 million at Sept. 30, 2014 from to $45.9 million at Sept. 30, 2011. Further supported by a decline in debt, Liquidity metrics of 390.2 days cash on hand, 43.1x cushion ratio, and 351.1% cash to debt are excellent and improved from 193.3 days, 21.1x cushion ratio, and 113.6% cash to debt three years ago.

Solid Profitability

Consistent and strong profitability continued, reflecting good cost control, strategic growth plans, and payor mix. Fiscal 2014 was a particularly strong year, with operating and operating EBITDA margins of 13.4% and 18.8%, respectively. Results include $8.2 million in other operating revenues received for the sale of MRHC's Sunset Campus to Kansas State University. Excluding these funds, profitability remains solid with operating and operating EBITDA margins of 6.2% and 12%, respectively, against Fitch's 'A' medians of 2.5% and 9.5%.

Strong financial performance is also supported by MRHC's positive competitive position. MRHC has a dominant market share in Manhattan as the only acute care hospital in the city, and maintains a leading 27.9% market share in a larger eight-county service area. While there is competition, it is manageable and MRHC is well positioned to compete. MRHC added 13 physicians in the last year, purchased and began operating a da Vinci robot, and is expanding its cardiology, orthopedic, and rehabilitation services, which should further its competitive position regionally.

Small Revenue Base

Fitch's largest credit concerns continues to be MRHC's small revenue base for the rating category (MRHC's revenue size of $106.3 million on a consolidated basis in fiscal 2014 makes it one of the smallest Fitch rated 'A' category hospitals) and execution on renovation of the North Tower on its main campus, and relocation of certain services from its old campus. However, MRHC's solid liquidity position, relationship with VCH and Ascension Health, and overall strong financial profile mitigates some of the concerns around MRHC's small revenue base.

Manageable Capital Plans

The renovation of the North Tower (to be renamed the Outpatient Pavilion) is estimated to cost $15 million and will be funded by internal equity. The project is expected to break ground in spring 2015, and the funds will be spent over two years. Aside from the campus consolidation project, capital spending is minimal, representing routine maintenance and updates. A total of $13 million is budgeted for fiscal 2015.

DEBT PROFILE

At Sept. 30, 2014, MRHC had $26.7 million in long-term debt outstanding producing a maximum annual debt service (MADS) of $2.2 million. All debt is fixed. The low debt burden reflects the $5.5 million loan forgiveness from VCH in 2014 and represents a decline in MADS from $3.4 million at the time of Fitch's last review two years ago. Debt metrics are solid, with 10.3x MADS Coverage in fiscal 2014, (6.5x excluding the one-time gain from sale) and a low 2% of MADS as a percentage of revenues.

DISCLOSURE

Disclosure will be made within 120 days of fiscal year end and within 45 days of the end of the first three quarters and 60 days after the end of the fourth quarter to the Municipal Securities Rulemaking Board's EMMA system.

Fitch notes that MRHC's audited financial information is now consolidated into Ascension Health's statements. Unaudited interim financial statements are provided based on MRHC's credit only.

Contact: