Catholic Medical Center, NH
Update to credit analysis following downgrade

Summary
Catholic Medical Center’s (CMC; Ba1 Negative) credit profile is characterized by its important role as the primary cardiac surgical service provider in the Manchester service area, offset by its relatively modest scale of operations and competitive market. While liquidity remains adequate, CMC’s weak operating performance has driven cash declines and reduced financial flexibility. Operating losses are largely driven by a heavy reliance of contract labor, elevated wages and inflationary pressures. Management has a number of strategic and operational improvement initiatives already underway to address operating challenges, but the pace of progress remains uncertain due to ongoing labor challenges as well as sluggish clinical demand trends. Management’s strategic initiatives will focus on revenue cycle management, as well as strategic growth focused on service contracts renegotiations, physician enterprises and expense reduction.

On August 22nd, we downgraded CMC’s rating to Ba1 negative from Baa3 negative.

Credit strengths
» Location in demographically favorable service area of Manchester, New Hampshire, characterized by low unemployment and high income levels
» Prominent acute inpatient cardiology service provider in the market with state regulatory protection
» Management’s performance improvement initiatives will provide support for expense reduction and revenue growth
» Largely fixed rate debt and minimal operating leases limit debt structure risks

Credit challenges
» Unabated cashflow losses will weaken liquidity and narrow the headroom of the cash to debt covenant for CMC’s bank debt (measured quarterly)
» Relatively modest scale and competitive market will present continued volume pressures
» Total adjusted debt will remain high due to large pension obligation

Rating outlook
The negative outlook reflects the likelihood that CMC’s liquidity will remain narrow to its bank debt covenant given ongoing cashflow losses and could further weaken before performance initiatives gain traction. Failure to sustain liquidity at current levels,
demonstrate financial improvement quarter to quarter in fiscal 2024 or an inability to effectively manage financial covenants will pressure the rating further.

**Factors that could lead to an upgrade**

- Material enterprise and market share growth
- Improved and durable cashflow rebuild resulting in substantial strengthening of margins and debt measures

**Factors that could lead to a downgrade**

- Further narrowing of the cash to debt covenant
- Inability to show quarter to quarter traction to durable margin recovery
- Inability to establish a competitive path forward

**Key indicators**

Exhibit 1
Catholic Medical Center, NH

<table>
<thead>
<tr>
<th>CATHOLIC MEDICAL CENTER, NH</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>Q3 2023 Annualized</th>
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<tbody>
<tr>
<td>Operating Revenue ($'000)</td>
<td>469,624</td>
<td>488,290</td>
<td>445,379</td>
<td>518,356</td>
<td>545,764</td>
<td>551,559</td>
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<tr>
<td>3 Year Operating Revenue CAGR (%)</td>
<td>10.4</td>
<td>6.9</td>
<td>0.6</td>
<td>3.3</td>
<td>3.8</td>
<td>N/A</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>4.8</td>
<td>2.7</td>
<td>-6.0</td>
<td>4.8</td>
<td>0.6</td>
<td>-3.9</td>
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<tr>
<td>PM: Medicare (%)</td>
<td>53.0</td>
<td>51.9</td>
<td>51.7</td>
<td>52.1</td>
<td>52.6</td>
<td>N/A</td>
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<tr>
<td>PM: Medicaid (%)</td>
<td>10.5</td>
<td>10.7</td>
<td>10.2</td>
<td>10.8</td>
<td>10.7</td>
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<td>Days Cash on Hand</td>
<td>161</td>
<td>130</td>
<td>209</td>
<td>188</td>
<td>114</td>
<td>98</td>
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<tr>
<td>Unrestricted Cash and Investments to Total Debt (%)</td>
<td>161.4</td>
<td>139.4</td>
<td>169.3</td>
<td>159.0</td>
<td>103.0</td>
<td>93.3</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>4.0</td>
<td>6.8</td>
<td>-9.8</td>
<td>6.1</td>
<td>23.5</td>
<td>-19.4</td>
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</table>

Based on audited financial statements for CMC Healthcare System, Inc.; fiscal year end September 30; investment returns smoothed at 5%.

*Source: Moody’s Investors Service*

**Profile**

Catholic Medical Center is a 330-bed acute care hospital in Manchester, NH offering tertiary services and specializing in cardiac care. In addition to CMC, the system includes an employed physician group and part ownership of an ambulatory surgical center.

**Detailed credit considerations**

**Market position: challenging labor and clinical market in a two-hospital town**

CMC’s market position as the sole provider for acute cardiology services in Manchester will continue to be a credit strength. Manchester is the largest city in New Hampshire, and benefits from low unemployment and high per capita income. Based on management reported data, CMC maintains 40% of the market share, with competitor, Elliot Hospital and local hospitals capturing the rest of the market.

Maintaining and growing clinical partnerships will be key to CMC’s ability to further capture market share and stabilizing volumes. In response to ongoing pressures from local competitors and its close proximity to Boston, CMC has proactively integrated the New England Heart and Vascular Institute (NEHVI) and the Transfer Center into the CMC Healthcare System, formed clinical relationships.

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with Dartmouth Health and joint ventures with the Bedford Ambulatory Surgery Center and ClearChoiceMD Urgent Care to bolster volumes and extend the system’s reach beyond its primary service area. CMC will maintain its clinical affiliation with the GraniteOne hospitals, although the parties mutually agreed to wind down GraniteOne after providing required notice in October 2022. These clinical affiliations will remain an important source of referrals for CMC.

**Operating performance and liquidity: weak volumes and high expenses will challenge operations and reduce liquidity**

CMC continues to focus on performance improvement plans, significant headwinds for labor and volumes will challenge its ability to gain traction. 2023 will mark a second consecutive year of weak operating performance for CMC, with the operating cash flow margin through Q3 2023 at -3.9%. CMC’s close proximity to Boston has presented challenges in terms of volume and staffing recovery efforts, and is expected to persist as an ongoing hurdle for overall operating performance. Management has outlined significant strategies aimed at reversing operating losses and driving improvements in cash flow, with a projected a $50 million impact by fiscal year end 2024. The initiatives focus on revenue cycle improvement, contract negotiations and expense reductions.

We expect improvements to be slow and should negative cash flows persist, CMC’s liquidity will decline, pressuring its headroom for the cash to debt covenant (0.6x:1 required) under the bank debt, potentially leading to a breach of the covenant during fiscal 2024. Failure to meet this covenant would result in an event of default. There is a cross default risk with the MTI debt. As of Q3 2023, there was still adequate headroom to the covenant, with cash to debt at 0.85:1.

**Liquidity**

CMC’s liquidity remains sufficient, after recent significant weakening due to the strained operating environment. At June 30, 2023, unaudited unrestricted cash and investments provided 98 days cash on hand. CMC maintains an average asset allocation with 45% equities, 17% fixed income and 38% cash at FYE 2022.

**Leverage: conservative debt structure but narrowing headroom to covenant poses risk**

CMC’s direct debt remains manageable relative to the system’s scale, at 30% debt to revenue, however, unabated cashflow losses will weaken liquidity and narrow the headroom of the cash to debt covenant for CMC’s bank debt. Capital spending will be light over the next several years as management addresses operating performance and cash flow and manages liquidity. Total adjusted debt will remain elevated, given the pension liability. Given ongoing declining operating cash flow, debt affordability will be further challenged.

**Debt structure, covenants and derivatives**

CMC maintains a conservative debt structure with 87% fixed rate debt.

CMC has one interest rate swap in place to hedge the variable rate risk associated with the Series 2015B bonds. This swap is a floating-to-fixed swap with TD bank with an initial notional amount of $8.65 million. CMC pays a fixed rate equal to 1.482% receives a 69.75% variable rate of the of the compounded SOFR rate. The fair value of the swap as of FYE 2022 was a positive $263 thousand to CMC.

Bonds are secured by a pledge of gross revenues of the obligated group, consisting of the hospital only, as well as a mortgage on certain real property including the hospital. Covenants include a debt service ratio of 1.2 times measured annually. Failure to meet this covenant will result in a consultant call-in. If the debt service ratio falls below 1.0 in any year subsequent to the consultant call, it would be considered an event of default. Bank covenants include cash to debt covenant of 0.60:1 measured quarterly. Failure to meet this covenant will result in an event of default.

**Pensions and OPEB**

CMC’s pension obligation will remain a key credit challenge. CMC has a frozen defined benefit pension plan, which was funded 73% relative to a projected benefit obligation of $250 million at FYE 2022, for a total $66 million unfunded liability.
ESG considerations

Catholic Medical Center, NH’s ESG Credit Impact Score is Highly Negative CIS-4

Exhibit 2
ESG Credit Impact Score

**CIS-4**
Highly Negative

For an issuer scored CIS-4 (Highly Negative), its ESG attributes are overall considered as having a discernible negative impact on the current rating. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-3.

Source: Moody’s Investors Service

Catholic Medical Center's (CMC) ESG credit impact score has significant impact on the current credit rating with potential for greater exposure over time. Consistent with the industry, CMC has elevated exposure to social risks, particularly related to human capital and demographics and societal trends, and governance risks of financial strategy and risk management, and management credibility and track record.

Exhibit 3
ESG Issuer Profile Scores

<table>
<thead>
<tr>
<th><strong>ENVIRONMENTAL</strong></th>
<th><strong>SOCIAL</strong></th>
<th><strong>GOVERNANCE</strong></th>
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</thead>
<tbody>
<tr>
<td><strong>E-2</strong> Neutral-to-Low</td>
<td><strong>S-4</strong> Highly Negative</td>
<td><strong>G-3</strong> Moderately Negative</td>
</tr>
</tbody>
</table>

Source: Moody’s Investors Service

**Environmental**
CMC has neutral to low environmental risks given its location in Manchester, New Hampshire.

**Social**
CMC is exposed to high social risk, largely driven by human capital and demographics and societal trends. CMC’s high demographic and societal risk is driven by high exposure to governmental payors (approximately 62% combined Medicare and Medicaid). This reliance exposes CMC to potential issues regarding cost and access to healthcare which may negatively impact hospital reimbursement and cash flow. Medical staff recruitment and retention present ongoing challenges that may be exacerbated by the industrywide labor shortage and proximity to Boston, Massachusetts contribute to high exposure to human capital risks. These risks are mitigated by CMC’s recruitment and labor expense reduction strategies.

**Governance**
CMC’s governance risk is moderate, reflecting financial strategy and risk management and management credibility and track record risks. Following consecutive years of weak financial performance, management has implemented several strategies to address operating challenges, however, the center has struggled to gain traction on improvement plans and as a result has not met budget. CMC is structured as a 501(c)(3) and is governed by a board, which consists of 15-members including the CEO.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.
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