FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Stanford Health Care, CA Revs at 'AA'; Outlook Stable

Fri 17 Mar, 2023 - 10:35 AM ET

Fitch Ratings - Austin - 17 Mar 2023: Fitch Ratings has affirmed the 'AA' Issuer Default Rating (IDR) and the 'AA' long-term rating on approximately $2.04 billion of Stanford Hospital and Clinics (dba Stanford Health Care's [SHC]) outstanding California Health Facilities Financing Authority (CHFFA) revenue bonds and self-issued taxable bond series. Fitch has also affirmed the 'AA'/'F1+' rating on $168.2 million in bonds (2008B series) that are supported by SHC's self-liquidity and the 'F1+' rating on $150.0 million authorized series 2021 SHC Taxable Commercial Paper (CP) Notes.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Stanford Hospital and Clinics (CA)	LT IDR Affirmed	AA Rating Outlook Stable	AA Rating Outlook Stable

Stanford Hospital and Clinics (CA) /General Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Stanford Hospital and Clinics (CA) /Self-Liquidity/1 ST	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

The 'AA' rating reflects SHC's resilient operating performance and very strong financial profile, within the context of a midrange revenue defensibility and very strong operating risk profile assessment.

While some of SHC's capital-related ratios fall below Fitch's 'AA' rated peers, the 'AA' rating continues to be supported by SHC's extensive clinical reach in the greater San Francisco and Central Valley regions, and its nationwide/worldwide destination position for extremely high-acuity services. SHC's highly favorable service area characteristics and very close relationship with Stanford University, rated 'AAA', further support the rating.

SHC's operating and operating EBITDA margins moderated only slightly in fiscal 2022, after a significant fiscal 2021 gain, and are expected to remain consistently strong, and near historic levels going forward. Moreover, capital needs are expected to remain manageable in the coming years as the system addresses campus renovation/renewal efforts on its 300 Pasteur facility and addresses some few remaining seismic items. Strong credit characteristics are balanced by a high degree of competition in the greater San Francisco and Central Valley region.

The 'F1+' rating reflects SHC's long-term credit quality, together with its ability to cover the maximum potential liquidity demands presented by its taxable CP and weekly variable-rate demand (VRDB) programs with cash and highly liquid, highly rated investments.

SECURITY

Currently, a drop below 1.1x MADS is an event of default; however, a revised MTI is expected to spring into effect as SHC issues more debt or as more existing debt is refinanced, provided more than 50% of bondholders consent. The new MTI is expected to will change the base of the annual rate covenant to Annual Debt Service (ADS) rather than Maximum Annual Debt

Service (MADS) and require a consultant's report as the remedy for Income Available for Debt Service covering less than 1.10x ADSs.

KEY RATING DRIVERS

Revenue Defensibility - 'bbb'

Solid Position in Competitive Market with Favorable Demographics

SHC has an excellent market position as the sole level 1 trauma center between San Francisco and San Jose, CA; an expansive service line of high acuity clinical services across the Central Valley and the Western region; and a nationally/internationally recognized brand. Additionally, SHC is the primary adult academic teaching hospital for Stanford University (AAA rated). SHC's clinical strength is reflected in both its healthy clinical volume growth, and its solid fundraising activity.

Operating Risk - 'aa'

Solid Performance Beyond 2021, Manageable Capital Plans

SHC's operating EBITDA and EBITDA margins were very strong at 15.2% and 16.3%, respectively, as of fiscal YE21 (Aug. 31), and remained very strong in fiscal 2022 at 11.6% and 13.2%, respectively. SHC's recovery and subsequent sustainability was driven in large part by sizable growth in clinical volume and related net patient revenue and recognition of federal CARES Act funds totaling $410 million in fiscal 2021. More recently in fiscal 2022, SHC avoided the worst of the sector-wide salary/wage/benefit expense increases, and managed to produce an exceptional 11.6% operating EBITDA margin, and a 13.2% EBITDA margin, inclusive of $215 million in federal stimulus revenues.

Most recently, through the three-month interim period ended Nov. 30, 2022, SHC is still generating a strong 9.6% operating EBITDA margin, and a 13.9% EBITDA margin. Looking forward, Fitch assumes that SHC will be able to produce operating EBITDA margins in a similar range consistent with pre-pandemic historical performance.

Future capital needs are manageable, with spending focused on the renewal of their 300 Pasteur inpatient buildings and some remaining seismic needs.

Financial Profile - 'aa'

SHC's financial profile continued to be stable during a volatile fiscal 2022, and capital-related ratios remain resilient through Fitch's forward-looking scenario analysis. As of FYE Aug 31, 2022, total adjusted debt of $2.56 billion (which includes $261 million in operating lease liability) is manageable against SHC's $4.94 billion in unrestricted liquidity. With a 99% funded (actuarial benefit obligation, or ABO basis) defined benefit pension obligation and all operating leases reported on balance sheet, SHC currently carries no debt equivalents. There are no additional new debt plans at this time over the outlook period.

Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with SHC's rating.

RATING SENSITIVITIES

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

--Weaker financial performance or significant additional borrowing that brings cash to adjusted debt to below 120% for a prolonged period, could place pressure on the rating;

--Failure to maintain operating EBIDA margins at or above 9% could result in a lower assessment of operating risk, which in turn could place pressure on the 'AA' rating.

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

--Given marginally thinner leverage metrics for the 'AA' rating, positive rating action is unlikely over the two-year Outlook period.

--Over a longer period, positive rating movement would require continued improvement in balance sheet and leverage metrics, including cash and investments sustained at or above 200% of adjusted debt.

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.

PROFILE

Stanford Health Care (SHC) is a principal teaching affiliate of Stanford University's School of Medicine. SHC, together with Lucile Salter Packard Children's Hospital (rated AA-), operates clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research. SHC's close relationship with Stanford University and its School of Medicine generates certain reputational and clinical benefits that are unique in the service area and important for recruitment. SHC operates a 604 licensed-bed tertiary, quaternary and specialty hospital, as well as the primary, specialty and subspecialty clinics in which the medical faculty of the School of Medicine provide clinical services. SHC is also the sole corporate member of the 242 licensed-bed Stanford Health Care Tri-Valley, located in the East Bay.

The main Stanford hospital is located on the campus of Stanford University, adjacent to the School of Medicine in Palo Alto, CA.

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

Kevin Holloran
Senior Director
Primary Rating Analyst

+1 512 813 5700
kevin.holloran@fitchratings.com
Fitch Ratings, Inc.
2600 Via Fortuna, Suite 330 Austin, TX 78746

Michael Burger
Director
Secondary Rating Analyst
+1 415 796 9960
michael.burger@fitchratings.com

Emily Wadhwani
Senior Director
Committee Chairperson
+1 312 368 3347
emily.wadhwani@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

Stanford Health Care (CA)	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

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