

# RatingsDirect®

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## Ballad Health, Tennessee; Joint Criteria; System

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# Ballad Health, Tennessee; Joint Criteria; System

## Credit Profile

<b>Mountain States Health Alliance ICR</b>		
<i>Long Term Rating</i>	A-/Stable	Current
<b>Sullivan Cnty Hlth Ed &amp; Hsg Fac Brd, Tennessee</b>		
Wellmont Hlth Sys, Tennessee		
<b>Ser 2006C</b>		
<i>Long Term Rating</i>	A-/Stable	Current

### Rationale

S&P Global Ratings' long-term rating and underlying rating (SPUR) on various outstanding bonds issued for Ballad Health, Tenn. is 'A-'. The outlook is stable.

The rating reflects our opinion of the organization's strong enterprise profile, with a solid business position covering a wide geographic region, robust size and scale, and experienced management team. While the integration plans continue, we recognize there have been some challenges, including normal operating pressures and softer-than-expected business volume that has contributed to slower revenue growth than originally projected. As such, the operating performance in fiscal 2018 (as per S&P Global Ratings calculation), was relatively breakeven with a slight \$428,000 deficit (negative 0.02% operating margin), but rebounded in fiscal 2019, with a positive \$27.7 million gain (1.3% operating margin) as management offsets the revenue loss with expense reductions and efficiencies. Liquidity remains consistent with the current rating and mitigates, to some extent, the continued operating and industry challenges. However, we would expect improved operating results in fiscal 2020 and beyond as the benefits from integration accelerate, providing the expected cost savings identified at the onset of the merger.

The rating also continues to reflect a negative holistic adjustment on Ballad Health that reflects the softer operating results, continued integration of two sizable health systems and the complexities associated with operating within the Certificate of Public Advantage (COPA) and cooperative agreement (CA).

Given the merger of the two entities forming Ballad Health (Mountain States Health Alliance and Wellmont Health), the financial reporting consists of an audited balance sheet as of June 30, 2018; while the audited income statement results at the same period reflect only five months of operations ending June 30. As such, our ratios for fiscal 2018 reflect the audited balance sheet data and 12 month unaudited income statement results ending June 30 prepared by Ballad Health management.

S&P Global Ratings has reviewed the latest available financial data, which has informed our assessment of the rating. We intend to meet with the full management team sometime over the next several months to delve deeper into Ballad Health's strategies, including the system's plan to further enhance services and signature clinical programs, potential consolidation and cost savings analysis, and detailed capital plans over the next several years. As such, following our

meeting with Ballad Health, we plan to publish a full research update on our view of the credit rating on the organization and potential credit impact, if any, based on our discussion and additional information received.

The rating reflects our assessment of Ballad Health's:

- Excellent business position, with a leading market share at 63% in its primary service area with generally stable demographics;
- Generally solid balance-sheet metrics with strong liquidity and continued moderation of leverage metrics; and
- Management team with proven turnaround and integration skills.

In our view, partially offsetting rating factors include our assessment of Ballad Health's:

- Modest operating results the past two fiscal years (2019 and 2018), although operations improved and were positive in fiscal 2019 despite some declines in utilization;
- Challenged payor mix with a heavy reliance on governmental payors;
- Challenges associated with integration and realizing the benefits and cost savings initiatives over time; and
- Ability to comply with terms of the COPA and CA (defined above) and the high number of performance metrics.

Other credit factors include an ongoing lawsuit, which is now in the appellate phase following a ruling against Ballad Health. On Dec. 18, 2018, a jury ruled in favor of Highlands Physician Incorporated in a dispute with Wellmont Health System. The dispute originated in 2016, prior to the merger with Mountain States Health Alliance and the formation of Ballad Health. The jury verdict was for a sum of \$58 million. Ballad Health is actively appealing the verdict.

Management believes there were numerous errors and issues that occurred during the trial, and remains confident the decision will be overturned. Ballad Health established a reserve of \$10 million (in fiscal year 2018) related to this litigation. We will continue to monitor future developments and incorporate the potential credit impact, if any, as more details unfold. However, we believe Ballad Health maintains a solid liquidity position and we would not expect a material dilution to key ratios.

## **Outlook**

The stable outlook reflects the system's leading market position, and our expectation that operating results will improve over the next several years as integration efforts take hold and greater cost savings are realized. The outlook also reflects our expectation that the system will retain its financial strength and business position while it implements COPA guidelines. Additional debt is not expected and therefore not factored into the rating.

### **Downside scenario**

We could revise the outlook to negative or lower the rating if operating results are not consistent with expectations, resulting in a weakening of the financial profile to levels more consistent with a lower rating. These could include, but are not limited to future cash flow and balance-sheet metrics decreasing due to operating pressure, driving down margins and liquidity below projected levels; an increase in debt, and investment market declines pressuring unrestricted reserves. We will also continue to assess the impact of any issues related to operating under the COPA.

## Upside scenario

While we do not anticipate it during the two-year outlook period, a higher rating is possible if Ballad Health successfully integrates the two health systems as planned while staying in compliance with COPA guidelines, sustains strong cash flow, improves unrestricted reserves to levels commensurate with a higher rating, and does not issue additional debt, as debt metrics are slightly elevated for the rating level.

(For table figures, see our full analysis on Ballad published Nov. 4, 2019, on RatingsDirect.)

**Table 1**

<b>Ballad Health , Tennessee Enterprise Statistics</b>				
	<b>--Fiscal year ended June 30--</b>			
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
PSA population	736,606	736,606	N.A.	N.A.
PSA market share (%)	63.2	63	N.A.	N.A.
Inpatient admissions	90,217	95,477	91,274	86,358
Equivalent inpatient admissions	247,096	249,095	211,125	199,380
Emergency visits	432,394	449,412	442,025	443,292
Inpatient surgeries	20,948	21,540	20,297	20,058
Outpatient surgeries	51,677	52,433	50,068	50,466
Medicare case mix index	1.6300	1.6100	1.6300	1.6350
FTE employees	13,564	14,247	13,495	13,474
Active physicians	1,623	1,402	N.A.	N.A.
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	47.2	47.4	44.4	N.A.
Medicaid (%)	10.7	10.5	11.4	N.A.
Commercial/Blues (%)	36.6	38.5	40.8	N.A.

N/A--Not applicable. N.A.--Not available. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions.

**Table 2**

<b>Ballad Health , Tennessee Financial Statistics</b>					
	<b>--Fiscal year ended June 30--</b>			<b>Medians for 'A-' rated health care system</b>	<b>Medians for 'BBB+' rated health care system</b>
	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2018</b>
<b>Financial performance</b>					
Net patient revenue (\$000s)	2,044,986	2,018,458	1,913,760	2,010,148	1,853,921
Total operating revenue (\$000s)	2,104,126	2,077,163	1,973,440	MNR	MNR
Total operating expenses (\$000s)	2,076,381	2,077,591	1,931,528	MNR	MNR
Operating income (\$000s)	27,745	(428)	41,912	MNR	MNR
Operating margin (%)	1.32	(0.02)	2.12	1.00	0.10
Net nonoperating income (\$000s)	33,774	10,844	42,151	MNR	MNR
Excess income (\$000s)	61,519	10,416	84,063	MNR	MNR
Excess margin (%)	2.88	0.50	4.17	2.50	1.00
Operating EBIDA margin (%)	10.43	9.01	11.68	7.80	5.00

Table 2

	--Fiscal year ended June 30--			Medians for 'A-' rated health care system	Medians for 'BBB+' rated health care system
	2019	2018	2017	2018	2018
	EBIDA margin (%)	11.84	9.49	13.53	8.30
Net available for debt service (\$000s)	253,137	198,094	272,726	215,399	120,844
Maximum annual debt service (\$000s)	85,339	85,339	85,339	MNR	MNR
Maximum annual debt service coverage (x)	2.97	2.32	3.20	3.20	2.80
Operating lease-adjusted coverage (x)	2.54	1.99	2.68	2.40	2.30
<b>Liquidity and financial flexibility</b>					
Unrestricted reserves (\$000s)	1,395,573	1,290,788	1,304,993	1,122,312	704,582
Unrestricted days' cash on hand	263.0	242.8	264.3	135.20	152.90
Unrestricted reserves/total long-term debt (%)	105.9	96.2	96.4	96.20	148.80
Unrestricted reserves/contingent liabilities (%)	388.0	344.6	377.8	565.50	553.90
Average age of plant (years)	13.8	13.1	13.7	13.10	11.00
Capital expenditures/depreciation and amortization (%)	98.2	N.A.	N.A.	159.00	89.40
<b>Debt and liabilities</b>					
Total long-term debt (\$000s)	1,317,279	1,341,729	1,353,310	MNR	MNR
Long-term debt/capitalization (%)	44.0	45.9	46.2	45.90	36.80
Contingent liabilities (\$000s)	359,665	374,561	345,430	MNR	MNR
Contingent liabilities/total long-term debt (%)	27.3	27.9	25.5	19.30	31.80
Debt burden (%)	3.99	4.09	4.23	2.40	2.10
Defined-benefit plan funded status (%)	N.A.	N.A.	N.A.	80.60	79.70
<b>N/A--Not applicable. N.A.--Not available. MNR--Median not reported.</b>					

Given the merger of the two entities forming Ballad Health (Mountain States Health Alliance and Wellmont Health), the financial reporting consists of an audited balance sheet as of June 30, 2018; while the audited income statement results at the same period reflect only five months of operations ending June 30. As such, our ratios for fiscal 2018 reflect the audited balance sheet data and 12 month unaudited income statement results ending June 30 prepared by Ballad Health management. The fiscal 2019 data is audited. Fiscal 2017 financial data was based on an internal compilation provided by Ballad Health management.

This report does not constitute a rating action.

## Credit Snapshot

- Security pledge: Securing the bonds is a gross revenue pledge of the obligated group, which includes the parent Ballad Health, MSHA, Wellmont, and a majority of the hospital facilities.
- Organization description: Ballad Health was formed Feb. 1, 2018 and operates 19 hospitals in Tennessee, Virginia, Kentucky, and North Carolina. In addition, Ballad operates at multiple non-acute care sites throughout the service area, providing ambulatory surgery, diagnostic and testing, among other things.
- Financial reporting: Given the merger of the two entities forming Ballad Health (Mountain States Health Alliance and Wellmont Health), the financial reporting consists of an audited balance sheet as of June 30, 2018; while the audited income statement results at the same period reflect only five months of operations ending June 30. As such, our ratios for fiscal 2018 reflect the audited balance sheet data and 12 month unaudited income statement results ending June 30 prepared by Ballad Health management. The fiscal 2019 data is audited. Fiscal 2017 financial data was based on an internal compilation provided by Ballad Health management.

## Ratings Detail (As Of November 4, 2019)

Mountain States Health Alliance (MBIA) (National)		
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Current
<b>Greenville Hlth and Ed Facs Brd, Tennessee</b>		
Ballad Hlth, Tennessee		
Greenville Hlth & Ed Fac Brd (Ballad Health) Hosp		
<i>Long Term Rating</i>	A-/Stable	Current
Greenville Hlth & Ed Fac Brd (Ballad Hlth) Hosp Ser 2018B		
<i>Long Term Rating</i>	AA/A-1+	Current
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Current
<b>Sullivan Cnty Hlth Ed &amp; Hsg Fac Brd, Tennessee</b>		
Wellmont Hlth Sys, Tennessee		
<b>Ser 2011</b>		
<i>Long Term Rating</i>	A-/Stable	Current
<b>The Hlth &amp; Educl Facs Brd of the City of Johnson City, Tennessee</b>		
Mountain States Hlth Alliance, Tennessee		
Johnson City Hlth & Ed Fac Brd (Mountain States Health Alliance) (MBIA) (National)		
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Current
<b>Johnson City Hlth &amp; Ed Fac Brd (Mountain States Health Alliance), Series 2007B-1</b>		
<i>Unenhanced Rating</i>	A-(SPUR)/Stable	Current
<i>Long Term Rating</i>	AA/A-1+	Current
<b>Series 2010 A&amp;B, 2006A and 2009A</b>		
<i>Long Term Rating</i>	A-/Stable	Current
<b>Series 2012A</b>		
<i>Long Term Rating</i>	A-/Stable	Current

**Ratings Detail (As Of November 4, 2019) (cont.)**

Many issues are enhanced by bond insurance.

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