

Fitch Affirms East Texas Medical Center's (TX) Revs at 'BBB'; Outlook Revised to Negative

Written by Australian Business

CHICAGO--([BUSINESS WIRE](#))--Fitch Ratings has affirmed the 'BBB' rating on the following revenue bonds issued on behalf of East Texas Medical Center (ETMC):

--\$35.8 million Wood County Central Hospital District hospital revenue bonds, series 2011;

--\$265.9 million Tyler Health Facilities Development Corporation hospital revenue bonds, series 2007A.

The Rating Outlook is revised to Negative from Stable.

SECURITY

The bonds are secured by a pledge of gross revenues of the obligated group, a first mortgage lien on certain property and debt service reserve funds on the series 2007 and 2011 bonds.

KEY RATING DRIVERS

REVENUE COMPRESSION A CONCERN: The Outlook revision to Negative reflects Fitch's concern with ETMC's unexpected decline in profitability through the 10 months ended Aug 31st and the challenge ETMC may face in getting back to positive operating performance in 2014. Through the 10-month interim period ended Aug. 31, 2013, ETMC posted a \$10.4 million loss from operations which translates to a negative 1.3% operating margin and 7.4% operating EBITDA margin. In fiscal 2012, ETMC posted operating and operating EBITDA margins of 1.3% and 9.6%, respectively.

LIQUIDITY REMAINS LIGHT: ETMC's liquidity metrics remain light for the rating level,

but moderating capital needs in 2014 and beyond should allow for balance sheet replenishment so long as it meets its operating cash flow targets. ETMC had \$208.8 million in unrestricted cash at Aug. 31, 2013, equal to 84.7 days of cash on hand (DCOH) and 50.1% cash to debt. ETMC is budgeting for more moderate capital expenditures of \$45 million in fiscal 2014, and Fitch expects total unrestricted cash to improve slightly as cash flow is projected to exceed spending.

COVERAGE REMAINS ADEQUATE: ETMC's coverage and leverage metrics continue to reflect a manageable debt burden, though erosion in profitability has negatively impacted metrics. While coverage of maximum annual debt service (MADS) by EBITDA slipped to 1.8x and debt to EBITDA increased to 5.2x, against Fitch's 'BBB' category medians of 3.1x and 3.8x, respectively, Fitch expects ETMC to finish fiscal 2013 with slightly improved coverage, and ETMC is projecting 2.3x coverage for fiscal 2014.

MARKET CHALLENGES PERSIST: Inpatient volume declines (for the third straight year), increased competition within Smith County, and ongoing reimbursement pressures from all payors will continue to challenge ETMC's operating performance in 2014. As a result, Fitch believes ETMC will need to rely on expense reductions and operating efficiencies rather than revenue growth to reach its fiscal 2014 targets.

RATING SENSITIVITIES

CASH FLOW IMPROVEMENT: ETMC expects to improve its operating margin in fiscal 2014 to approximately 1.5% via a robust expense management effort and reduced capital spending needs. While Fitch expects ETMC to improve profitability in 2014, negative rating pressure is likely if current operating losses continue over the next 12-24 months.

CREDIT PROFILE

ETMC is an integrated health system servicing the east and northeastern regions of Texas. The system consists of 15 acute care affiliates and several other entities with approximately 1,000 staffed acute care beds. Total revenues were \$942.1 million in fiscal 2012. ETMC covenants to provide bondholders with annual audited financial information to the Municipal Securities Rulemaking Board's EMMA system within 150 days of fiscal

year end and quarterly financial statements within 45 days of fiscal quarter end.

REVENUE PRESSURES PERSIST

The Outlook revision to Negative reflects Fitch's concern with ETMC's negative trend in profitability, coupled with the challenges it faces in improving its performance. ETMC expects to finish fiscal 2013 with a slight operating loss of over \$5 million, which is well below expectations. The largest factors in this years' performance have been ongoing clinical volume declines, reimbursement pressures from both commercial and government payors, as well as continued competition for patient volumes within Tyler and Smith County.

MARKET CHALLENGES

While the competitive landscape is unchanged, competition remains robust for the clinical volumes within Smith County, ETMC's largest contributing county. While Fitch notes that ETMC has recently aligned some key physicians in cardiology and orthopedics which should bolster volumes and help preserve market share, it will continue to be challenged by reimbursement pressures from its commercial and government payors.

Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Nonprofit Hospitals and Health Systems Rating Criteria', dated May 20, 2013.

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U.S. Nonprofit Hospitals and Health Systems Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=708361

Additional Disclosure

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