

CHICAGO--([BUSINESS WIRE](#))--Fitch Ratings has assigned an 'AA-' rating to the following Colorado Health Facilities Authority revenue bonds issued on behalf of Sisters of Charity of Leavenworth Health System (SCLHS):

--\$300 million series 2013A.

The bonds are expected to price the week of Oct. 28 via negotiated sale. Proceeds will reimburse SCLHS for prior capital expenditures associated with its Exempla St. Joseph's replacement hospital and pay costs of issuance.

In addition, Fitch affirms the 'AA-' rating on approximately \$1.1 billion in revenue bonds issued by the California Health Facilities Financing Authority (CA), Colorado Health Facilities Authority (CO), Kansas Development Finance Authority (KS), and Montana Facility Finance Authority (MT), on behalf of SCLHS. An additional \$125.9 million in direct placement debt is not rated by Fitch.

The Rating Outlook is Stable.

SECURITY

The bonds are an unsecured obligation of the SCLHS corporate parent (the sole member of the obligated group).

KEY RATING DRIVERS

STABLE BALANCE SHEET: The series 2013A bonds will reimburse SCLHS for prior capital expenditures related to its Exempla St. Joseph Hospital in Denver replacement facility. On a pro forma basis, SCLHS will bolster its unrestricted liquidity by nearly \$70

million with no increase to maximum annual debt service (MADS) requirements. On a pro forma basis, cash to debt and cushion ratio were 113.8% and 16.8x, respectively, as of June 30, 2013.

SIGNIFICANT DEBT BURDEN: Total debt will equal approximately \$1.6 billion post issuance, equal to 44% of capitalization and 4.1x EBITDA, both unfavorable to Fitch's 'AA' category medians of 32.7% and 2.9x, respectively. Still, capital needs are expected to decline to below \$200 million in 2015 following completion of the St. Joseph's Hospital project in December 2014.

SUSTAINED OPERATING PERFORMANCE: SCLHS maintained steady operating cash flow levels in fiscal 2012 with a 1.4% operating margin and 12.3% operating EBITDA margin. Through the six-month interim period ended June 30, 2013 it generated operating and operating EBITDA margins of 2.0% and 12.1% respectively. Coverage of pro forma MADS was 2.5x in 2012 and 2.6x in interim 2013, and a marked improvement from 2.0x coverage in 2010.

DIVERSE REVENUE BASE: A key credit strength is SCLHS' geographic diversity. Following the transfer of the St. John's facility in California, SCLHS will have a portfolio of nine hospitals in six distinct markets. Further, SCLHS has pursued strategic partnerships within certain markets which are expected to both bolster its market position, and be accretive to overall system operating performance.

RATING SENSITIVITIES

CAPITAL PLAN FUNDING: In order to preserve liquidity, SCLHS will require sustained operating results over the next 12-18 months to fund the remaining costs associated with the St. Joseph's replacement facility, as well as the one-time costs associated with opening and moving to the new site in December 2014. Failure to do so could result in negative rating action.

CREDIT PROFILE

SCLHS is a large, multi-state health care system operating nine acute care hospitals, four safety net clinics, a children's mental health center, and over 190 ambulatory service centers across the four states of Kansas, Montana, Colorado and California. In fiscal 2012 (year end Dec. 31), SCLHS reported total revenues of approximately \$2.2 billion. Fitch analysis is based on the consolidated entity, and Fitch reclassifies certain financial statement items for analytical purposes.

The sole obligated group member is SCLHS as corporate parent, with nine hospitals comprising the restricted affiliates group. Covenant tests include the OG and the restricted affiliates, which accounted for 97.4% of total revenues and had 315 days cash on hand (DCOH) against the consolidated system's 334 DCOH for 2012. Debt service coverage for the OG and affiliates was 3.5x against a consolidated 3.1x.

BALANCE SHEET STRENGTH

The series 2013A bonds will reimburse SCLHS for capital expenditures on the Exempla St Joseph's replacement hospital in Denver which is expected to open in Dec 2014. Separately, SCLHS expects to cash defease roughly \$220 million of debt associated with Exempla JOA. Thus, SCLHS' pro-forma unrestricted liquidity of \$1.8 billion at June 30, 2013 equates to 316 DCOH against Fitch's 'AA' median of 254.3 DCOH. Overall, pro forma debt ratios remain consistent for the rating level, and despite significant capital spending expected through 2014, SCLHS' balance sheet is expected to remain robust.

Fitch views positively that SCLHS' defined benefit pension plan remains well funded at 86.5% at Dec. 31, 2012. In addition, it has started the process to convert its smaller pension with Lutheran Medical Center to a church plan over the next few years, which would eliminate its ERISA requirement risks.

PRO FORMA DEBT BURDEN

Still, SCLHS' overall debt burden remains sizeable, and pro forma coverage is somewhat light for the category at 3.6x by EBITDA at June 30, 2013. The series 2013A bonds are expected to be issued as fixed rate, with MADS of \$107.5 million.

Since the series 2013A bonds are not new money, post-issuance SCLHS will have approximately \$1.6 billion in debt outstanding, of which \$199 million are variable-rate demand bonds (VRDBs) supported by standby bond purchase agreements (SBPAs). The next renewal date is Nov. 26, 2014 for those SBPAs issued by JP Morgan Chase on \$147.3 million in VRDBs. No additional debt is anticipated, and Fitch believes there is limited capacity for additional debt at the current rating level.

SIGNIFICANT CAPITAL NEEDS

Capital expenditures will remain significant through 2014 as major projects are completed, including the Saint Joseph replacement hospital in Denver and the St. Mary's bed tower in Grand Junction. For 2014 capital expenditures will be between \$312 million and \$420 million. As only \$312 million has been committed, SCLHS will need to continue producing solid operating EBITDA to preserve its balance sheet.

SCLHS has undertaken several strategic initiatives to achieve systemwide performance improvement, focusing on improving its revenue cycle, realigning its portfolio of hospitals, and more efficient and effective clinical performance. Effective April 1, 2013, SCLHS sold its Providence (Kansas City) and Saint John (Leavenworth) hospitals to Prime Healthcare for \$56.7 million, which was used to redeem associated debt and reimburse SCLHS for prior expenditures. And in September 2013, SCLHS signed a definitive agreement to transfer its Saint John's Health Center (Santa Monica) to Providence Health with an expected close by Dec. 31. Finally, a joint operating agreement is underway with National Jewish, which is expected to be accretive to the system overall.

SCLHS has begun to realize some results from improvement efforts, as demonstrated by significant improvement in operating EBITDA to 12.3% in 2013 from 8.5% in 2010. Fitch expects steady operating EBITDA levels through 2015 as its capital needs start to wane, which should also allow for balance sheet preservation.

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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