FITCH UPGRADES AURORA HEALTH CARE (WI) REVS TO 'A+'; OUTLOOK REVISED TO STABLE

Fitch Ratings-Chicago-18 November 2016: Fitch Ratings has upgraded the rating on approximately $1.3 billion in Wisconsin Health and Educational facilities Authority Bonds issued on behalf of Aurora Health Care (AHC), to 'A+' from 'A'.

The Rating Outlook is revised to Stable from Positive.

SECURITY
The bonds are secured by a limited pledge of gross revenues and a first mortgage lien on Aurora St. Luke's Medical Center. A debt service reserve fund provides additional security on the series 2009 and 2010 bonds.

KEY RATING DRIVERS

BETTER OPERATING PERFORMANCE MAINTAINED: The upgrade to 'A+' reflects sustained operating profitability through interim 2016, which reflects strong cash flow ahead of historical levels. AHC generated a healthy 13.6% operating EBITDA margin through the six-month interim period ended June 30, 2016, following the 15.5% generated in the same period prior year. While some softening is expected, cash flow is expected to remain above median levels going forward, driven by steady leading market position, growing clinical volumes as well as the significant completion of information system updates and related costs.

BALANCE SHEET IMPROVEMENT: The upgrade to 'A+' also reflects an expectation of further liquidity growth, bringing AHC's cash to debt and cushion ratios nearer to Fitch's 'A' category medians of 19.4 times (x) and 148.6% cash to debt. At June 30, 2016, AHC had $1.8 billion in unrestricted liquidity, equal to 147 days of cash on hand (DCOH), 14x cushion ratio, and 115.2% cash to debt. AHC's balance sheet has consistently improved year-over-year (y-o-y), with additional incremental growth expected over the near to medium term.

LIMITED OPERATING RISK: The rating also reflects AHC's favorable operating risk profile resulting from its leading market share position and large base of employed physicians which allows for greater variance when compared to Fitch's 'A' category median financial ratios. AHC's leading market role, geographic reach, and alignment with area providers via the 'About Health' network, have all supported good physician recruitment, healthy volumes, and favorable payor contracts.

MANAGEABLE LEVERAGE: While AHC's overall debt burden remains somewhat elevated, its leverage has consistently moderated and is expected to continue to do so. Coverage of maximum annual debt service (MADS) by EBITDA was robust at 5.6x in interim 2016, and is expected to remain in line with Fitch's 'A' category median of 4.5x going forward. Capital needs near $200 million annually will be cash flow funded, with no additional debt currently planned.

RATING SENSITIVITIES
IMPROVING LIQUIDITY: The upgrade to 'A+' incorporates Fitch's expectation that Aurora Health Care will sustain solid cash flow that will lead to further improvement in liquidity. There is only marginal room at the higher 'A+' rating level for unexpected deterioration in liquidity metrics or material increases in leverage.

CREDIT PROFILE

AHC is an integrated healthcare system consisting of 14 acute care hospitals and one behavioral health hospital (3,162 licensed beds), approximately 1,730 employed physicians, 160 clinic sites, and approximately 70 retail pharmacies located in the eastern third of Wisconsin. In 2015 (fiscal year ended Dec. 31), AHC had total operating revenues of $4.9 billion.

Fitch's analysis is based on the consolidated system. Through June 30, 2016, total revenue of the Obligated Group was $1.8 billion million, representing approximately 71% of the consolidated total revenue of the system. At June 30, 2016, the total assets of the obligated group represented 84% of consolidated assets.

STEADY OPERATING RESULTS

Despite its large base of employed physicians, AHC has been able to generate operating and operating EBITDA margins which are currently very favorable for the rating category. Performance has been supported by healthy clinical volumes, particularly at its relatively new Grafton and Summit hospitals. Further, AHC continues to incrementally increase its market share position in Southeast Wisconsin, to 39.7% through September 2016 from 37.6% in 2012. Its participation within the 'About Health' network of providers is also viewed favorably.

As a result of strong cash flow, AHC has consistently grown unrestricted liquidity by an impressive 46% from 2012 through 2015 (13.5% compound annual growth rate [CAGR]) against revenue growth of nearly 20% over the same time frame. Continued healthy operating performance is expected to bring AHC's liquidity metrics more in line with Fitch's 'A' category medians within the next 12-18 months. With an 8.4% operating margin (equal to $211.2 million in income) through the six-month interim period, operating cash flow is expected to remain well ahead of capital outlays near $200 million with enough surplus to generate further balance sheet growth over the near term.

DEBT PROFILE

AHC has approximately $1.6 billion in total long-term debt, of which $1.3 billion are bonds. Long-term debt mix is relatively conservative, with approximately 63% fixed to 36% variable. Its liquidity support providers for its VRDBs are sufficiently diverse, with three counterparties providing LOC agreements now extending into 2018. AHC's put exposure is manageable with cash to demand debt of 395.4% as of June 30, 2015.

AHC has a meaningful amount of capital leases outstanding, with $71 million in expense in 2015. AHC also has a frozen defined benefit pension plan, a $1.4 billion obligation which was 91% funded at fiscal year-end 2015. It terminated its one swap in August 2016, and has no other derivative instruments outstanding.

DISCLOSURE

AHC covenants to provide annual and quarterly disclosure for the first three quarters of each fiscal year through the Municipal Securities Rulemaking Board's EMMA system. The content of AHC's quarterly disclosure is viewed favorably and includes a management discussion, a balance sheet, an income statement, a cash flow statement, and utilization statistics. Fitch views AHC's timely and comprehensive disclosure as best practice.

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Applicable Criteria
Revenue-Supported Rating Criteria (pub. 16 Jun 2014)
https://www.fitchratings.com/site/re/750012
U.S. Nonprofit Hospitals and Health Systems Rating Criteria (pub. 09 Jun 2015)
https://www.fitchratings.com/site/re/866807