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Stanford Health Care

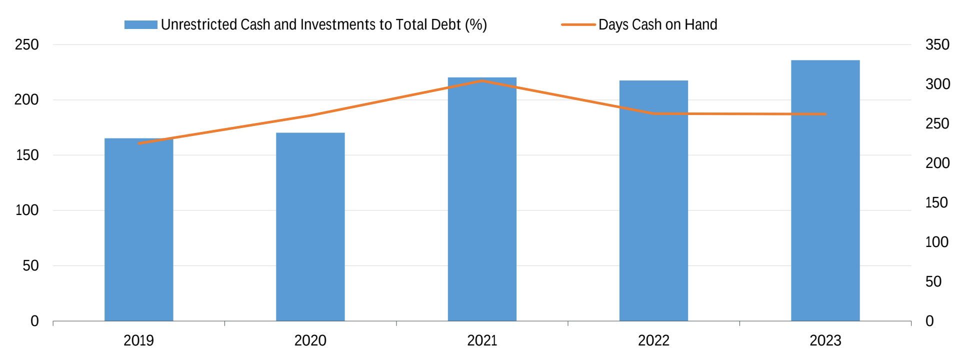
Update to credit analysis

Summary

Stanford Health Care's (Aa3 positive) credit profile is characterized by its clinical prominence and excellent patient demand, its location in an affluent and well insured market, and its status as a wholly owned subsidiary of Stanford University. Though patients come to it from across the US and even internationally, its location in an affluent and well insured market will help the organization maintain good revenue growth and generate operating surpluses despite industry pressures and rising costs. Stanford Health Care will continue spending approximately 2.0x depreciation expense for several years, keeping days cash in the mid-200 days.

On May 2, 2024 we revised SHC's outlook to positive from stable and affirmed the Aa3 long term rating.

Exhibit 1
Days cash to remain in the mid-200's, despite very high capital spending



Source: Moody's Ratings

Credit strengths

» Wholly owned subsidiary of Stanford University which imparts numerous benefits including fundraising and strong working relationships with the School of Medicine and Children's Hospital

» Strong brand and demand will enable robust utilization, particularly for higher acuity and higher reimbursing services; one of only two major academic medical centers in the Bay Area

» Revenue growth will remain strong due to favorable contracts, high case mix index, and volume growth owing to new capacity and strong demand

» Local service area will continue to be characterized by strong wealth levels and low rates of uninsured

Credit challenges

» Capital spending will remain elevated over the next several years, consuming the majority of cash flow

» High cost of living near primary locations creates challenges for staff

» Multiple Bay Area systems pursuing growth and various insurance strategies will drive the market's competitive landscape

» Liquidity will remain modest relative to peer institutions given that over half is managed by Stanford Management Company, which requires up to six-months advance notice of withdrawal of substantial funds

Rating outlook

The positive outlook reflects SHC's operational momentum and strong financial performance which will enable it to generate strong cash flow. Though capital spending will consume the majority of cash flow, strong financial performance will still allow it to reduce leverage and build absolute liquidity over the next several years.

Factors that could lead to an upgrade

» Durability of strong margins allowing debt to cash flow to remain near 2.0x

» Maintenance of very strong financial performance and liquidity with days cash in the mid-200's and cash to debt around 250%

» Short term ratings: not applicable

Factors that could lead to a downgrade

» Significantly higher capital spending contributing to weaker liquidity

» Materially dilutive acquisition

» Short term ratings: material reduction in coverage level of assets backing the self-liquidity program or downgrade of SHC's long term rating to A2 or lower

Key indicators

Exhibit 2
Stanford Health Care, CA

	2019	2020	2021	2022	2023
Operating Revenue ($'000)	5,390,002	5,501,117	6,726,200	7,314,237	7,752,847
3 Year Operating Revenue CAGR (%)	10.1	7.3	11.1	10.7	12.1
Operating Cash Flow Margin (%)	9.2	4.3	13.7	9.6	7.9
PM: Medicare (%)	41.8	42.6	42.1	43.0	44.8
PM: Medicaid (%)	12.8	13.1	14.0	14.7	14.7
Days Cash on Hand	225	260	304	263	262
Unrestricted Cash and Investments to Total Debt (%)	165.3	170.3	220.3	217.5	235.8
Total Debt to Cash Flow (x)	2.8	5.2	1.9	2.3	2.5

Based on audits for Stanford Health Care, fiscal year ended August 31
Transfers to Stanford University as operating expenses
Swap settlement payments reclassified to interest expense
Investment returns normalized at 5%
2020 includes Medicare advances in unrestricted cash accounting for about 10% of unrestricted cash balances (advances were fully repaid by FYE 2021)
Source: Moody's Ratings

Profile

Stanford Health Care is an academic medical center that is wholly owned subsidiary of Stanford University. It operates a hospital on the university campus in Palo Alto, one community hospital in the East Bay, and several outpatient centers throughout the Bay Area, in addition to numerous physician offices.

Detailed credit considerations

Market position

SHC will maintain an excellent market position with demand far exceeding capacity at the Palo Alto campus and very strong demand for outpatient services at other facilities throughout the service area. A new oncology joint venture with Sutter Health will expand SHC's presence to service areas where it will compete more directly with UCSF, though we believe there is sufficient demand to support both operations; the SHC/Sutter JV opens in 2026. SHC's strong reputation also makes it an attractive employer and partner for other businesses through a range of opportunities beyond direct patient care. These strengths are durable and will continue to undergird the organization's credit profile for years to come.

SHC's ownership by Stanford University (Aaa stable) imparts many strategic and credit benefits. SHC partners closely with Stanford's school of medicine and Lucile Salter Packard Children's Hospital (A1 stable), both of which have strong reputations and contribute to a strong research environment. Fundraising is an exceptional strength at Stanford and SHC benefits directly and indirectly from strong fundraising for the school of medicine by lowering the financial burden on the hospital (dean's tax) and through a portion of philanthropy that is used to support direct hospital initiatives.

Operating performance and liquidity

Financial performance will remain strong with SHC increasing cash flow from operations over the next several years. We expect SHC to maintain an approximately 9% OCF margin over a multi-year period, with revenue growth averaging 6% - 8% annually, aided by new capacity and strong demand. Though margins dipped in 2023, SHC has managed escalating labor, pharma, and other expenses better than most peer organizations over the last several years. Financial performance is currently very strong with a 12% OCF margin at Q2 2024.

Liquidity

SHC currently has about $5.8 billion of unrestricted cash and about 270 days cash on hand.

Aside from approximately $2.5 billion of cash, short term bond funds, and mutual funds, investments are managed in the university's merged pool. SHC can access a portion of the funds with up to six months' notice, but given the more aggressive nature of university investments, SHC's investment profile is more similar to that of a university than a typical hospital. Moreover, liquidity is modest for the rating category and compared to peer institutions; monthly liquidity as a percentage of total cash and investments is low at approximately 50% given the large share of investments not readily accessible by the hospital.

Leverage

SHC's capital appetite will remain robust and the majority of cash flow (at a normal OCF margin of about 9%) will be used for capital spending. The organization has identified over $3.5 billion of projects through 2027, though we note that spending in any given year is often lower than the long range forecast due to a variety of factors including final board approval, permitting, and other factors. Nevertheless, we expect SHC to sustain a capital spending ratio above 2.0x over a multi-year period, higher on a relative basis than most organizations over a multi-year period. Projects include a mix of refurbishment of existing space to add capacity, replacement and new construction, but there is no single project driving the majority of spending.

Absent new money debt, we expect debt to cash flow to sustainably improve to under 2.0x over the next several years.

Legal security

Bonds and notes are secured by a Gross Receivables pledge of Stanford Health Care and have a negative pledge subject to permitted encumbrances. Debt service coverage below 1.1x requires a consultant but does not trigger an event of default. There are no limitations on additional indebtedness, mergers or asset transfers.

Debt structure

Debt structure is about 87% fixed, 6% self-liquidity, and 7% put bonds. The Series 2021A has a four year put. Should SHC not be able to refinance the bonds, it has sufficient liquidity to retire them on the initial put date.

The self-liquidity program is comprised of $168 million of debt, evenly split between weekly VRDB's and VRDB's in a CP mode, and a $150 million taxable CP program and $200 million tax exempt CP program for cash management needs (there is no CP outstanding). Weekly maturities in the CP program are limited to $50 million.

SHC staggers the rolls of VRDBs in a CP mode and keeps the two tranches at least one month apart, although we include the full $84 million in our coverage calculations. Weekly maturities of CP or VRDBs in weekly mode will be limited to $134 million.

Assets supporting the program are Aaa rated 2a-7 money market funds, checking accounts at P-1 banks, US Treasuries and agency securities with maturities of two years or less, and longer dated treasuries. Coverage of the program is typically around 3.0x.

Debt-related derivatives

SHC terminated four swaps, reducing the notional amount outstanding to $338 million from about $570 million. The portfolio is diversified across three counterparties (Wells Fargo, Goldman Sachs, and Morgan Stanley). The mark-to-market value is about a $69 million liability to SHC, and no collateral is posted. Even when collateral posting has been required, it is manageable given SHC's cash position.

Pensions and OPEB

SHC terminated its defined benefit pension in Q2 2024. The unfunded liability was relatively small and SHC recorded a $52 million termination charge.

Operating lease exposure is average and the comprehensive debt position (inclusive of the unfunded pension liability and operating lease debt equivalents) is manageable.

ESG considerations

Stanford Health Care's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score

CIS-2

ESG considerations do not have a material impact on the current rating.

Source: Moody's Ratings

Stanford Health Care's ESG Credit Impact Score is neutral-to-Low (**CIS-2**). The hospital's strong reputation, good governance, and good wealth levels serve as mitigants to its ESG risks.

Exhibit 4
ESG issuer profile scores

ENVIRONMENTAL
E-3

SOCIAL
S-3

GOVERNANCE
G-2

Source: Moody's Ratings

Environmental

The E-IPS is moderately negative due to wildfire and water shortage risks. The university and healthcare enterprises have extensive risk management plans in place to addresses these and other risks. Stanford University has adopted a comprehensive sustainability initiative that includes a number of strategies across the enterprise including a longer-term goal of net zero greenhouse gas emissions.

Social

SHC's S-IPS is moderately negative, in line with national averages reflecting several factors including a growing reliance on government payors and the potential for issues regarding cost and access to healthcare to negatively impact hospital reimbursement and cash flow. Despite this risk, SHC has strong patient demand and significant scale to help offset some of these challenges. SHC's neutral customer relations score reflects its strong brand name, excellent clinical and research reputations and very high quality of care, resulting in strong patient demand and consistently high occupancy levels and very high case mix. Other social factors are in line with national averages including human capital, which we asses as moderately negative. SHC is located in a high cost area and many nurses and other workers commute long distances; competitive pay practices help mitigate this risk. Nurses are represented by a union which has held strikes.

Governance

SHC's G-IPS is overall neutral. Financial strategy and risk management is assessed as positive; management regularly conducts multi-year strategic and operational planning and has a track record of meeting or exceeding budget and has kept cost per adjusted discharge growth lower than average in recent years. Close collaboration with the university benefits SHC through investment management and fundraising through donations for major capital projects and through money raised to support medical education and research, which lowers the burden on the health system to support these activities. Stanford University is the sole corporate member of SHC and appoints its board of directors.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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