FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Stanford Health Care, CA Revs at 'AA'; Outlook Stable

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Fitch Ratings - Chicago - 23 Mar 2022: Fitch Ratings has affirmed the 'AA' rating on approximately $2 billion of SHC's outstanding California Health Facilities Financing Authority (CHFFA) revenue bonds and its 'AA'/'F1+' rating on $168.2 million in bonds that are supported by SHC's self-liquidity.

Fitch has also affirmed the 'F1+' rating on $150 million authorized ($0 outstanding) series 2021A SHC Taxable Commercial Paper (CP) Notes. The Rating Outlook is Stable.

SECURITY

Under an amended master trust indenture, the bonds are secured by a pledge of gross revenues of the obligated group. Stanford Health Care (SHC) is the only obligated group member. SHC introduced an amendment to its MTI in the 2020 offering, which among other changes, would replace the revenue pledge with a receivables pledge once majority bondholder consent is secured.

ANALYTICAL CONCLUSION

The 'AA' rating reflects SHC's resilient operating performance and improving financial profile, within the context of a midrange revenue defensibility and 'aa' operating risk profile assessment. While SHC's capital-related ratios fall below Fitch's 'AA' rated peers, the 'AA' rating continues to be supported by SHC's extensive clinical reach in greater San Francisco and central valley region, and its destination position for high-acuity services. SHC's highly favorable service area characteristics and very close relationship with Stanford University, rated 'AAA' further support the rating.

SHC's operating and operating EBITDA margins rebounded significantly in fiscal 2021 and are expected to remain comfortably healthy near historical levels going forward. Moreover, capital needs are expected to remain manageable in the coming years as the system addresses campus renovation/renewal efforts in its 300 Pasteur facility and addresses remaining seismic items. Strong credit characteristics are balanced by a high degree of competition in the greater San Francisco and Central Valley region.

The 'F1+' rating reflects SHC's long-term credit quality, together with its ability to cover the maximum potential liquidity demands presented by its taxable CP and weekly variable-rate demand (VRDB) programs with cash and highly liquid, highly rated investments.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Solid Position in Competitive Market with Favorable Demographics

SHC has midrange revenue defensibility, reflecting its strong position as the sole level 1 trauma center between San Francisco and San Jose, CA; its expanding service line growth for higher acuity clinical services across the central valley and the western region; a nationally recognized brand; and its position as the primary adult academic teaching hospital for Stanford University. SHC's clinical strength is reflected in both its healthy clinical volume growth yoy, and its solid fundraising activity.

Operating Risk: 'aa'

Solid Performance Beyond 2021, Manageable Capital Plans

Following some margin compression through the height of the pandemic, operating EBITDA and EBITDA margins rebounded to 15.2% and 16.3%, respectively, as of fiscal YE21 (Aug. 31). This recovery was driven in large part by sizeable growth in clinical volume and related net patient revenue, and federal CARES Act funds totaling $406 million. Through the three-month interim period ended Nov. 30, 2021, SHC generated a somewhat more normalized 13.3% operating EBITDA and a 14.8% EBITDA margin.

Post-2021 operating EBITDA is expected to remain steady. Future capital needs are manageable, with spending focused on the renovation of the 300 Pasteur inpatient building and any remaining seismic needs. Of note, management reports its cost-per-adjusted discharge, despite inflationary pressures, has remained relatively level due to ongoing efficiency efforts.

Financial Profile: 'aa'

SHC's financial profile improved in 2021, and capital-related ratios remain resilient through Fitch's scenario analysis.

Total adjusted debt of $2.6 billion (which includes $312 million in operating lease liability) is manageable against SHC's $5.07 billion in unrestricted liquidity. With a 101% funded (actuarial benefit obligation, or ABO basis) defined benefit pension obligation and all operating leases reported on balance sheet, SHC currently carries no debt equivalents. There are no additional debt plans at this time.

Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with SHC's rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Given somewhat thinner leverage metrics for the 'AA' rating, positive rating action is unlikely at this time. Over a longer period, positive rating movement would require continued improvement in balance sheet and leverage metrics, including cash and investments sustained at or above 200% of adjusted debt.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Weaker financial performance or significant additional borrowing that brings cash to adjusted debt to below 120% for a prolonged period could place pressure on the rating;

--Failure to maintain operating EBIDA margins at or above 9% could result in a lower assessment of operating risk, which in turn would place pressure on the 'AA' rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

Stanford Health Care (SHC) is a principal teaching affiliate of Stanford University's School of Medicine. SHC, together with Lucile Salter Packard Children's Hospital (rated AA-), operates clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research. SHC's close relationship with Stanford University and its School of Medicine generates certain reputational and clinical benefits that are unique in the service area and important for recruitment.

SHC operates a 605 licensed-bed tertiary, quaternary and specialty hospital, as well as the primary, specialty and subspecialty clinics in which the medical faculty of the School of Medicine provide clinical services. SHC is also the sole corporate member of the 167-bed SHC ValleyCare, located in the East Bay.

The main Stanford hospital is located on the campus of Stanford University, adjacent to the School of Medicine in Palo Alto, CA.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Stanford Hospital and Clinics (CA)	LT IDR	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Stanford Hospital and Clinics (CA) /General Revenues/1 LT	LT	AA Rating Outlook Stable	Affirmed	AA Rating Outlook Stable
Stanford Hospital and Clinics (CA) /Self-Liquidity/1 ST	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 18 Nov 2020) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v1.3.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Stanford Health Care (CA)	EU Endorsed, UK Endorsed

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