FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Stanford Health Care, CA's LT Ratings at 'AA' and CP Program at 'F1+'; Outlook Stable

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Fitch Ratings - Austin - 13 May 2024: Fitch Ratings has affirmed Stanford Health Care's (SHC) (fka Stanford Hospital and Clinics) Issuer Default Rating (IDR) at 'AA'. Fitch has also affirmed the 'AA' long-term rating on approximately $2.4 billion of SHC's outstanding California Health Facilities Financing Authority (CHFFA) revenue bonds and self-issued taxable bond series.

Fitch has also affirmed the 'AA'/'F1+' rating on $168.2 million in bonds (2008B series) that are supported by SHC's self-liquidity and the 'F1+' short-term rating on SHC's taxable and tax-exempt commercial paper (CP) facilities. The CP programs' 'F1+' short term rating is based on SHC's long term rating, and ample liquidity to service liquidity needs.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Stanford Hospital and Clinics (CA)	LT IDR Affirmed	AA Rating Outlook Stable	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

SHC's 'AA' IDR and long-term bond ratings reflect its excellent operations and very strong financial profile, within the context of a midrange revenue defensibility and very strong operating risk profile assessment.

While some of SHC's capital-related ratios are only just slightly below Fitch's 'AA' rated medians and peers, the 'AA' rating continues to be supported by its extensive clinical reach in the greater San Francisco and Central Valley regions and as a nationwide/worldwide destination facility for very high-acuity services. SHC's strong market credit characteristics are balanced by a high degree of competition in its markets. Its highly favorable service area characteristics and very close relationship with Stanford University (rated 'AAA' by Fitch), further support the rating.

SHC's operating and operating EBITDA margins moderated only slightly in fiscal 2023 (audited results through Aug., 31, 2023), after a very strong fiscal 2022 operational gain, and are expected to remain consistently strong going forward. Capital needs are expected to remain high, but manageable, for the rating, assuming robust future capital spending in the coming years as the system addresses campus renovation/renewal efforts on its 300 Pasteur facility and addresses a few remaining seismic items.

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 and tax-exempt CP (no amounts are currently outstanding on either program) and variable rate demand bond (VRDB) program including weekly mode and CP mode, with cash and highly liquid, highly rated investments.

SECURITY

Under a recently amended MTI, bonds will be secured by a security interest in all of the obligated group's gross receivables. The amended MTI changed the base of the annual rate covenant to annual debt service (ADS) from maximum annual debt service (MADS). An annual debt service coverage below 1.1x requires a consultant but does not trigger an event of default.

KEY RATING DRIVERS

Revenue Defensibility - 'bbb'

Solid Position in Competitive Market with Favorable Demographics

SHC has an excellent market position as the sole level I trauma center between San Francisco and San Jose, CA; an expansive service array of high acuity clinical services across the Central Valley and Northern California market; and a nationally/internationally recognized brand. Additionally, SHC is the primary adult academic teaching hospital for Stanford University. SHC's clinical strength is reflected in its healthy clinical volume growth and solid fundraising activity.

Operating Risk - 'aa'

Consistently Positive Operating Margins; Additional and Robust Capital Spending Anticipated

SHC's operating EBITDA and EBITDA margins were very strong at 11.6% and 13.2%, respectively, as of fiscal YE 2022 (Aug. 31) and remained strong in this most recent fiscal 2023 YE at 9.6% and 10.7%, respectively. SHC's sustained operations are driven in large part by sizable growth in clinical volumes and related net patient revenue. SHC avoided the worst of the sector-wide salary/wage/benefit expense increase and produced exceptional operating EBITDA and EBITDA margins the pandemic when significant portions of the sector struggled from an operational perspective.

Most recently, through the six-month interim period (unaudited) ended Feb., 29, 2024, SHC is still generating a very strong 8.5% operating margin and 12.5% operating EBITDA margin. Going forward, Fitch assumes that SHC can produce operating EBITDA margins in a similar range, but perhaps slightly more conservative than historical levels, at around an 9% operating EBITDA margin, but still very solid when compared to the sector.

Future capital needs remain manageable, with spending focused on the renewal of their 300 Pasteur inpatient buildings and remaining seismic needs.

Financial Profile - 'aa'

Solid Balance Sheet Metrics Expected to Remain Consistent; Elevated Capital Spending Levels Anticipated

SHC's financial profile continued to be stable and capital-related ratios remain resilient through Fitch's forward-looking scenario analysis. As of YTD Feb. 29, 2024, total adjusted debt of $2.9 billion (which includes $372 million in operating lease liability) is manageable against SHC's (as calculated by Fitch) over $5.8 billion in unrestricted liquidity, equaling 270 days' cash on hand, and 198% cash to debt.

Asymmetric Additional Risk Considerations

No asymmetric risk factors are associated with SHC's rating.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

-- While not expected over the Outlook period, a significant additional borrowing that brings cash to adjusted debt to below 120% for a prolonged period could pressure the rating.

-- Should operating EBITDA margins drop below approximately 9% for a protracted period of time leading to a re-assessment of SHC's operating risk profile, might begin to pressure the current 'AA' rating.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- Over a longer period, positive rating movement would require completion of major capital projects, and improvement in balance sheet and leverage metrics, such that cash and investments are sustained well in excess of 200% of debt and debt equivalents.

PROFILE

SHC is the 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 imperative for on-going recruitment purposes.

SHC operates a 619 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 242 licensed-bed Stanford Health Care Tri-Valley, located in the East Bay. SHC's total revenues in fiscal 2023 were approximately $7.9 billion.

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

Sources of Information

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

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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PARTICIPATION STATUS

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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)

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (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), v2.0.0 (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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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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