

**Rating Update: MOODY'S AFFIRMS A1 RATING ASSIGNED TO PROHEALTH CARE INC.'S (WI) BONDS;
OUTLOOK IS STABLE**

Global Credit Research - 19 Jul 2010

ACTION AFFECTS TOTAL OF \$340 MILLION RATED DEBT OUTSTANDING

Wisconsin Health & Educational Fac. Auth.
Health Care-Hospital
WI

Opinion

NEW YORK, Jul 19, 2010 -- Moody's Investors Service has affirmed the A1 rating assigned to ProHealth Care Inc.'s, bonds issued by the Wisconsin Health and Educational Facilities Authority. The rating outlook remains stable. The rating action affects \$340 million of ProHealth's outstanding rated debt listed at the conclusion of this report.

LEGAL SECURITY: All outstanding debt enjoys a joint and several pledge of the Obligated Group secured by Pledged Revenues (all rents, issues, income, revenues and receipts). The Obligated Group consists of ProHealth Care, Waukesha Memorial Hospital (WMH) and Oconomowoc Memorial Hospital (OMH).

INTEREST RATE DERIVATIVES: ProHealth entered into a 30-year floating-to-fixed rate swap on a notional amount of \$71.325 million, related to the Series 2004A bonds. In addition, ProHealth entered into a 20-year floating-to-fixed rate swap on a notional amount of \$52.94 million, related to the Series 2001B bonds. ProHealth transferred these swap agreements to the Series 2008A and 2008B which defeased the Series 2001B and 2004A bonds. No collateral posting is required under the swap documents. At the current A1 rating level, we are comfortable with the level and terms of the swap and variable rate exposure.

STRENGTHS

*Long history of profitable operating performance evidenced by operating and cash flow margins that have averaged 4.9% and 14.3%, respectively, over the last five years; though FY 2009 was softer than historic levels, performance remained profitable with a 2.9% operating margin and 11.4% operating cash flow margin. With strong expense management, operating and operating cash flow margins have rebounded through six months of FY 2010 (March 31) to 4.9% and 13.4%, respectively.

*Good market penetration and a strong clinical reputation for primary and tertiary clinical services; new and recently developed relationships should continue to enhance reputation and market position. Leading market share in Waukesha County, where socio economic indices remain favorable relative to the state and the nation (7.4% County unemployment and higher than state and national household income as of April 2010)

*Absolute level of liquidity is strengthening after having moderated in FY 2008 and 2009 as a result of the acquisition of a physician group and the volatile investment market. Unrestricted investments totaled \$301 million as of FYE 2009, equating to a solid 156 days cash on hand. Monthly liquidity is equivalent to 144 days and covers demand debt by 188%. Expectations are that cash will exceed \$370 million by FYE 2010, after accounting for a real estate transaction and other pending actions; continued balance sheet growth will be a key consideration in evaluation of additional debt capacity (see discussion below).

*A strong and consistent management team with a defined culture and a substantial track record of meeting budgets and exercising fiscal discipline

CHALLENGES

*With just 75% cash-to-debt at FYE 2009, balance sheet is leveraged relative to A1 rated peers (median is 124%). With weaker performance in FY 2009 debt ratios of 4.7 times debt to cashflow and 4.0 times maximum annual debt service coverage were stressed relative to the A1 rating as well (medians of 3.3 times and 5.2 times, respectively), however most recent performance and strategic initiatives suggests a rebound to historic levels of cashflow and a rebuild of balance sheet resources by FYE 2010 (see discussion above). Capital of \$430 million over next five years includes plans to borrow as much as \$55 million in early FY 2011 (late CY 2010). Though not explicitly incorporated in this action, we feel current operating momentum and growing balance sheet metrics, should they be sustained, will allow ProHealth to absorb a modest increase in debt (13%)

*While not yet evident in FY 2009 or the majority of the year to date period of FY 2010, ProHealth is likely to experience a diminution of inpatient demand at OMH related to the shift of inpatient admissions from physicians affiliated with the Wilkinson Clinic, an affiliate of A3-rated Aurora Health Care, with the opening of Aurora's new acute care facility (Summit Hospital) in western Waukesha County. Though ProHealth's planning for the opening of Summit Hospital has been underway for several years, including the opening of a new bed tower at OMH, enhanced services and permanent staffing adjustments, nearly 24% of OMH's revenue and 45% of admissions in 2009 were derived from Aurora Physicians suggesting that the impact on ProHealth could be material as FY 2010 (March through September) and 2011 (October through March) are measured to FY 2009. Management projects that OMH will be break even in FY 2010

*Following years of strong overall market demand for services, volumes are soft due to recessionary pressures and continual shift to outpatient venues; inpatient volumes declined 5% in FY 2009 over the prior year largely offset by growth in observation stays

*Sizable physician losses dilute profitability of acute care facilities. The \$13 million loss in FY 2009 was absorbed by the extremely healthy margin generated by WMH. Management is actively working to reduce the annual operating loss.

*Absence of Certificate of Need legislation in Wisconsin renders ProHealth vulnerable to competitive encroachment by any number of traditional acute care providers located in neighboring Milwaukee as well as competition from entrepreneurially spirited physicians

Outlook

The stable outlook is based on our belief that ProHealth will continue to be able to translate its market position into the cash flow needed to satisfy debt service and finance strategic initiatives, as suggested by interim FY 2010 performance. We caution that the very recent introduction of an alternate acute care provider into OMH's marketplace is a significant challenge and that an impairment in ProHealth's financial profile due to market shifts would likely result in negative rating action

What could change the rating--UP

An upgrade would be considered with the restoration and maintenance of strong margins and cash flow growth that lead to material improvement of all balance sheet ratios and a measurable reduction in leverage ratios as well as the successful ability to withstand new competitive encroachment

What could change the rating--DOWN

Capital needs that exceed ProHealth's ability to fund with cashflow weakening already modest leverage measures; material decline in market share that results in a deterioration of current financial profile

KEY INDICATORS

Assumptions & Adjustments:

-Based on financial statements for ProHealth Care, Inc. and Affiliates

-First number reflects audit year ended September 30, 2008

-Second number reflects audit year ended September 30, 2009

-Investment returns smoothed at 6% unless otherwise noted

-Interest expense "grossed up" to include capitalized interest

*Inpatient admissions: 22,505; 21,383

*Total operating revenues: \$693.7 million; \$773.4 million

*Moody's-adjusted net revenue available for debt service: \$110.9 million; \$104.9 million

*Total debt outstanding: \$294 million; \$403 million

*Maximum annual debt service (MADS): \$19.6 million; \$26.2 million

*MADS Coverage with reported investment income: 4.8 times; 2.5 times

*Moody's-adjusted MADS Coverage with normalized investment income: 5.7 times; 4.0 times

*Debt-to-cash flow: 3.1 times; 3.4 times

*Days cash on hand: 174 days; 156 days

*Cash-to-debt: 99.6%; 74.7%

*Operating margin: 4.9%; 2.9%

*Operating cash flow margin: 13.5%; 11.4%

RATED DEBT

Series 1995A, fixed rate

Series 1999, fixed rate, insured by Ambac, A1 underlying rating

Series 2001A, fixed rate, insured by Ambac, A1 underlying rating

Series 2008A, VRDO, A1 underlying rating

Series 2008B, VRDO, A1 underlying rating

Series 2009, fixed rate, rated A1

CONTACTS

Issuer: Robert Mlynarek, Senior Vice President and CFO, 262.928.2510

Underwriter: Nesity Shems, Managing Director, Piper Jaffray & Co., 617.654.0771

The principal methodology used in rating ProHealth Care was Moody's Not-For-Profit Hospitals and Health System Methodology, published in January 2008 and available on www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Rating Methodologies sub-directory on Moody's website.

The last rating action with respect to ProHealth Care was on April 8, 2009, when the municipal finance scale rating of A1 with a stable rating outlook was assigned to the Series 2009 bonds and affirmed on parity obligations. That rating was subsequently recalibrated to a global scale rating on May 7, 2010

Analysts

Beth I. Wexler
Analyst
Public Finance Group
Moody's Investors Service

Mark Pascaris
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376

Research Clients: (212) 553-1653