FitchRatings

Fitch Rates Ochsner Clinic Foundation (LA) 2017 Revs 'A-'; Affirms Outstanding; Outlook Stable

Fitch Ratings-New York-24 April 2017: Fitch Ratings has assigned an 'A-' rating to the following Louisiana Public Facilities Authority bonds expected to be issued on behalf of Ochsner Clinic Foundation (OCF; Obligated Group [OG] entity within the Ochsner Health System):

--$408,365,000 revenue and refunding revenue bonds (Ochsner Clinic Foundation Project) series 2017.

In addition, Fitch affirms the 'A-' on OCF's parity debt listed at the end of this release.

The Rating Outlook is Stable.

Bond proceeds will be used to refund the series 2007A and 2007B bonds, fund approximately $160 million in capital projects, and pay for cost of issuance. OCF will be releasing the debt service reserve funds associated with the refunded bonds. Maximum annual debt service (MADS), as provided by management, will be approximately $71.4 million, dropping from $74.3 million. Bonds are expected to sell via negotiation the week of May 8.

SECURITY
Gross revenue pledge of the OG and a mortgage on certain properties.

KEY RATING DRIVERS
SIZABLE REGIONAL SYSTEM: Based in New Orleans, OCF is the largest integrated health system in Louisiana, with 11 owned or managed hospitals, 17 affiliated hospitals, urgent care centers and over 60 health centers. OCF is a leading referral center for health care services, with regional referrals and patient discharges continuing to grow regionally year over year. Patient revenue continues to show strong growth, rising by 8% from 2015 to 2016.

REDUCED RISK OFFSETS THINNER FINANCIALS: The rating incorporates OCF's lower operating risk profile, supported by a strong market share position, growing regional footprint, high acuity services (a 2.27 Medicare case index at its flagship hospital, Ochsner Medical Center), and over 1,200 employed physicians, which offset a thinner financial profile and allows for greater variance from 'A' category medians and peers.

SOFTER 2016 PERFORMANCE: Fiscal 2016 (Dec. 31 year end; draft audit) results show a slight drop in performance with OCF's operating EBITDA margin softening to 7.8% from 8.5%, which was unexpected. Approximately $14 million in unanticipated expenses--including the implementation of a midyear state sales tax on medical devices and disruptions from the flood in Baton Rouge--coupled with flat volumes, affected performance. First quarter 2017 performance shows OCF meeting its budgeted performance.

THIN LIQUIDITY FOR RATING LEVEL: Continued cash flow and a taxable bond issue helped shore up liquidity in 2015, but OCF's unrestricted liquidity ratios dropped at year-end 2016 and remain thin for the rating level. OCF has debt structure is largely fixed rate, which limits any potential draws on OCF's liquidity. Despite capital spending, liquidity growth is expected to improve modestly as some of the capital is debt financed.

CAPITAL PROJECTS REFLECTING GROWTH: OCF is undertaking a number of projects--the largest of which is a tower expansion on its main campus--that will provide additional capacity to meet the increasing demand for OCF's services. The projects are expected to be funded by the current debt issuance, previously issued debt, cash flow, and philanthropy.

RATING SENSITIVITIES
STABILITY EXPECTED: Fitch expects Ochsner Clinic Foundation's operations to remain stable, its unrestricted cash and investments to show modest growth, and its debt metrics to improve as the debt burden begins to moderate. A further increase in the debt burden or a further drop in liquidity could lead to negative rating pressure.

CREDIT PROFILE

Located in New Orleans, LA, OCF is a large regional academic, multi-specialty, healthcare delivery system with 11 owned and managed hospitals and over 60 health centers in Louisiana. Ochsner employs more than 1,200 physicians in over 67 medical specialties and subspecialties and conducts over 1,000 clinical research trials annually. In 2016 (unaudited), OCF reported approximately $2.8 billion in operating revenue.

SOFTER 2016

OCF's 1.8% operating margin and 7.8% operating EBITDA margin in fiscal 2016 (draft audit) were lower than the 2.6% operating margin and 8.5% operating EBITDA margin in 2015. The 2016 unaudited results reflect approximately $14 million in unbudgeted expenses. The largest impact was from the state of Louisiana's midyear implementation of a sales tax on medical devices. The additional cost to OCF was $11 million for 2016 and the full year impact will be $14 million, unless the tax is rescinded. Ochsner has budgeted for the extra expense for 2017, and 1Q 2017 results show Ochsner meeting its budget.

OCF's regional referral strategy continues to see growth. Regional referrals increased by 35% in 2015 and discharges from patients more than 25 miles away grew by 10%, in 2015. Final volume numbers in 2016 show regional referrals growing by another 16% to over 10,000, and discharges from patients more than 25 miles away growing by 6%. These referrals are mostly for higher acuity patients.

OCF's growth strategy has involved a variety of affiliation strategies including clinical affiliations, management agreements, joint ventures, and acquisitions. Over the last two years, these partnerships include St. Charles Parish Hospital, St. Tammany Parish Hospital, the River Parishes Hospital, Lafayette General Health, CHRISTUS Health Louisiana, Terrebonne General Medical Center, and Slidell Memorial Hospital.

OCF continues to execute on expense management and efficiency initiatives, with OCF management reporting margin improvement totaling $187 million from 2014 through 2016. These initiatives have helped to blunt the effect of Medicaid cuts that Ochsner has absorbed over the years. The strong expense management, along with the increased size of the system, has led to more stability, with coverage remaining relatively stable over the last three years, averaging 3.2x, in spite of the off year of performance in 2016.

The 'A-' rating and Stable Outlook also factor in OCF's other credit strengths, including a growing market position in its primary service area, a sizable base of employed physicians, and experience with population health management. OCF continues to increase the number of lives it manages, with approximately 55,000 lives in Southeast Louisiana under full risk contracts through capitated payments. OCF performs well under these contracts and continues to show the ability to bend the cost curve for the care of these patients while maintaining high quality.

Liquidity Weakened in 2016

At Dec. 31, 2016, unrestricted cash and investments was $798.6 million (reduced by a $52.4 million draw on a line of credit). The unrestricted liquidity equated to 110.2 days cash on hand (DCOH) and cash to debt of 78.5%. Both of these trail 'A' medians.

Unrestricted cash and investments fell to $798.6 million from $856.1 million at year-end 2015. The drop was driven by continued spending on capital, the softer year of performance, and a $54 million rise in accounts receivable (AR) due largely to the timing of Managed Medicaid payments and growth in patient volume at year end. Fitch expects liquidity to stabilize in 2016, as the AR issue is resolved. The good operational start to the year also supports a stable year for liquidity. However, a further drop in unrestricted liquidity could pressure the rating.

New Capital Projects

Bond funds will be used to finance a couple of new projects. In January 2017, OCF completed the purchase of an urgent care company, with 16 clinical sites, 12 of which are urgent care. OCF will use bond funds to reimburse itself for the purchase. The urgent care centers are expected to be cash flow positive, and OCF anticipates capturing additional patient populations, given the locations and demographics of the current urgent care volume. Fitch believes the assumption is reasonable given OCF's ability to engage patients through its advanced information technology systems and wide physician coverage.

OCF is also moving forward on an outpatient clinic in Baton Rouge, which will relocate and move from a clinic it currently leases on the campus of Baton Rouge General Medical Center. Last year, Fitch noted that OCF had announced the signing of a letter of intent to form a strategic partnership with Baton Rouge General Medical Center, but the due diligence ended with the health systems parting ways. The new clinic, which will add 25 new providers and include a new endoscopy suite, will cost approximately $72 million and be funded with the 2017 bond issuance.

OCF continues to move forward on approximately $250 million of other capital projects that are being funded largely with the 2015 debt issuance. The largest project is a tower expansion at OCF's flagship hospital, Ochsner Medical Center (OMC), in New Orleans. The $84 million project will add six floors to the main building, with 66 beds added as part of a Phase 1 and a potential 100 beds added as part of a Phase II.

The remaining projects include a cancer center expansion, an operating room expansion at Elmwood Hospital, and an expansion at the Elmwood Clinic. The tower project is expected to be completed by first quarter 2018 and the other projects are expected to be completed at various times through 2019.

While the projects bring construction risk, Fitch notes that the need for the project is being driven by the demand for and growth in OCF's services. Further mitigating concerns is OCF's recent completion of a number of capital projects that have proved accretive to its operating performance, including a primary care medical office building.

Debt Profile

After issuance, OCF will have approximately $1.1 billion in long term debt. The vast majority of the debt will be fixed rate, of which approximately $1 billion will be fixed rate revenue bonds and the rest various notes and loans payable. Excluded from total long term debt calculation is a $52.4 million in borrowing under a line of credit agreement, which is classified as short term debt and netted out of unrestricted cash and investments.

An analysis of the debt at the end of fiscal 2016 shows pro forma MADS as a percentage of revenue of 2.5%, better than the 'A' median of 2.7%, and debt-to-EBITDA of 4.5x above the 'A' median of 2.9x. Pro forma MADS coverage was 3.2x in 2016, relative to Fitch's 'A' category median of 4.5x.

Disclosure
OCF has covenanted to provide annual and quarterly disclosure through the Municipal Securities Rule Making Board's EMMA system.

Fitch has affirmed the following OCF parity debt:

--$150,000,000 refunding revenue bonds (Ochsner Clinic Foundation Project) series 2016;
--$252,800,000 Ochsner Clinic Foundation taxable bonds series 2015;
--$114,800,000 Louisiana Public Facilities Authority refunding revenue bonds (Ochsner Clinic Foundation Project) series 2015;
--$255,345,000 Louisiana Public Facilities Authority fixed rate revenue bonds (Ochsner Clinic Foundation), series 2007A;
--$53,660,000 Louisiana Public Facilities Authority fixed rate revenue bonds (Ochsner Community Hospitals), series 2007B.

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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)

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