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Volatile Times Continue For Speculative-Grade Health Care Providers

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Volatile Times Continue For Speculative-Grade Health Care Providers

Not-for-profit hospitals and health systems on the lower end of the rating spectrum continue to face numerous challenges, which have resulted in a disproportionately larger percentage of downward rating actions within the speculative-grade category and a greater number of providers joining the speculative-grade ranks. In Standard & Poor's Ratings Services' opinion, these rating trends will likely continue over the near to medium term.

Though Standard & Poor's has observed some signs that it believes indicate a return to stability in the U.S. not-for profit health care sector, we have seen that speculative-grade providers continue to exhibit much greater volatility than their investment-grade counterparts (see “U.S. Not-For-Profit Health Care Sector Moves Toward Stability, But Its Long-Term Outlook is Uncertain”, published Feb. 18, 2010, on RatingsDirect on the Global Credit Portal). The challenges facing lower-rated providers vary, but based on what we have seen, often relate to operating losses, weak demographics, limited business position, and balance sheet metrics often characterized by high debt and low liquidity. In addition, they often have aging facilities that require high capital spending that some providers cannot afford. Industrywide, we believe that financial and operational difficulties tend to be more problematic for lower-rated providers because those providers are more likely to lack the operational flexibility and balance sheet cushion needed to withstand additional strain. This has been particularly evident since our last report (see "U.S. Not-For-Profit Health Care 2007 Speculative-Grade Medians," published Sept. 25, 2007) where pressures from the recession have pushed more providers into speculative grade from investment grade as well as driven providers deeper within the speculative-grade category. Our report shows that the ratio of downgrades to upgrades within the speculative category has increased significantly and the number of credits joining the speculative ranks was also what we consider to be substantial. Despite the increase in providers with ratings lowered to speculative grade, the total number of speculative providers actually decreased from our last study as an even greater number of speculative-grade hospitals had their ratings withdrawn for a variety of reasons, including the refunding of bonds and defaults. The decline in the number of providers is thus not a sign of stability within the group, but rather, in our view, indicative of the more volatile nature of these credits.

We expect that instability will continue to prevail in this category of credits as organizations contend with ongoing economic and industrywide hurdles, including softer volumes, potential state Medicaid funding or eligibility changes, high bad debt and charity care, capital needs related to information technology (IT) investment, and physical plant upkeep. In addition, we believe that the Centers for Medicare and Medicaid Services' (CMS) fiscal 2011 Medicare rates will likely result in lower total inpatient payments to acute-care hospitals compared with fiscal 2010, which in our view will further burden providers. Moreover, we remain uncertain as to how the Patient Protection and Affordable Care Act will ultimately affect providers as many rules have yet to be written, though we do believe that certain aspects will present additional credit risks in the medium to long term (see “Health Care Reform Could Increase Credit Risk For U.S. Not-For-Profit Providers”, published May 13, 2010). We believe that some of the specific longer-term risks resulting from health care reform include the potential for lower volumes and revenues, penalties for readmissions and hospital-acquired infections, and added costs related to factors such as physician integration and investment in clinical information systems. While reform will affect the entire industry, we believe lower-rated providers may face greater rating volatility because, in our experience, they generally have thinner margins and weaker balance sheets and as such are less capable of absorbing additional strain. In recent years, some speculative-grade providers have sought mergers with stronger partners to alleviate added financial and

operational stress. We believe that the added pressures stemming from health care reform may accelerate consolidation as weaker providers struggle to adapt to the changing environment and as stronger systems seek opportunities to expand their organizations and benefit from larger economies of scale. Nevertheless, potential partners may not find some of the weaker providers attractive, which we believe could result in continued weakness for speculative-grade providers.

Analyzing The Rating Trends: Increased Volatility

While downgrades for all not-for-profit acute-care hospitals exceeded upgrades for the past three years and are close to a one-to-one ratio in the current year, the proportion of downgrades to upgrades for the lower-rated providers was more negatively skewed. The number of downgrades to speculative grade and within the speculative-grade category has exceeded the number of upgrades to investment grade and within the speculative-grade category by a ratio of nearly 5.9 to 1 since Standard & Poor's last published a detailed profile of speculative-grade medians in September 2007. The ratio in this report is higher than the 2.6 to 1 downgrade-to-upgrade ratio we reported in 2007, which we attribute largely to the economic downturn that began in 2007 and continued through 2009. In our view, the downturn took a toll on already weak providers with softer volumes and poor investment performance.

Since September 2007, we have lowered 23 ratings to speculative grade, and raised only three ratings to investment grade from speculative grade. Further indicative of the heightened turmoil over the past three years is the number of downgrades to upgrades within the speculative realm; there were five times as many downgrades (30) than upgrades (six) (see tables 1-a and 1-b). When we look at just the nine-month period from November 2009 to July 2010, however, the downgrade trend improved with only 10 downgrades compared with six upgrades affecting speculative providers (1.7 to 1). We believe that this points to the general stabilizing of credit quality noted for the sector as a whole, but still illustrates that speculative-grade providers face greater pressure versus the broader sector.

Among health care providers with ratings in the speculative-grade category, negative outlooks still outnumber positive outlooks by what we consider a large percentage: Thirty percent of providers had negative outlooks and 13% had positive outlooks, which we believe indicates that rating activity on balance is likely to be negative for the next one to two years (see chart 2-a).

Table 1-a

Rating Changes Affecting Speculative-Grade Health Care Providers (July 26, 2007 - July 31, 2010)

Ratings lowered to speculative grade

		Rating Action		
Organization	**State**	**To**	**From**	**Year**
Antelope Valley Healthcare District	CA	BB	BBB-	2008
Beebe Medical Center	DE	CCC	BBB+	2010
Chattahoochee Valley Hospital*	AL	BB-	BBB-	2009
Hillsdale Community Health Center	MI	BB+	BBB-	2009
Mercy Memorial Hospital System	MI	BB+	BBB-	2007
Metropolitan Health Corp.	MI	BB+	BBB	2009
Milton Hospital	MA	BB-	BBB-	2009
Nanticoke Memorial Hospital	DE	BB	BBB-	2008
Norman Regional Hospital	OK	BB+	BBB-	2009

Table 1-a

Rating Changes Affecting Speculative-Grade Health Care Providers (July 26, 2007 - July 31, 2010) (cont.)				
Palisades Medical Center of N.Y. Presbyterian Hospital	NJ	BB+	BBB	2008
Portneuf Medical Center	ID	BB	BBB-	2007
Proctor Hospital	IL	BB+	BBB-	2010
Regina Medical Center	MN	BB+	BBB-	2008
Richardson Reigional Medical Center	TX	BB+	BBB-	2009
Russell Hospital Corp.	AL	BB+	BBB-	2008
Ryder Memorial Hospital	PR	BB+	BBB-	2008
Skaggs Community Health Center	MO	BB	BBB	2009
Sky Lakes Medical Center	OR	BB+	BBB	2009
Solaris Health System	NJ	BB	BBB-	2008
St. Barnabas Health System	NJ	BB+	BBB-	2009
Stevens Healthcare	WA	BB+	BBB-	2008
Touro Infirmary	LA	BB	BBB-	2009
West Branch Regional Medical Center	MI	BB	BBB-	2008

		Rating Action		
Ratings lowered within the speculative-grade category				
Organization	**State**	**To**	**From**	**Year**
Bloomsburg Hospital	PA	B-	B	2008
Bloomsburg Hosptial	PA	CCC	B-	2009
Chippewa County War Memorial Hospital	MI	BB	BB+	2010
Community General Hospital of Greater Syracuse	NY	BB-	BB	2008
Downey Community Hospital	CA	CCC	BB	2008
Downey Community Hospital	CA	C	CCC	2009
Forum Health	OH	B+	BB	2008
Forum Health	OH	C	B+	2009
Hospital of Good Samaritan	CA	BB-	BB	2007
Jordan Hospital	MA	BB-	BB+	2008
Mercy Memorial Hospital System	MI	BB	BB+	2008
Mount Sinai Medical Center	FL	BB	BB+	2008
North Oakland Medical Center	MI	D	B	2008
Ohio Valley Health Service and Educational Corporation	WV	B-	B	2008
Ozarks Medical Center	MO	B+	BB	2008
Pascack Valley Hospital	NJ	CC	CCC	2007
Pascack Valley Hospital	NJ	D	CC	2008
Ryder Memorial Hospital	PR	BB	BB+	2010
Sacred Heart Hospital of Allentown	PA	BB-	BB+	2008
Sacred Heart Hospital of Allentown	PA	B-	BB-	2010
St. John's Riverside Hospital	NY	B-	B+	2007
St. Joseph Health Services	RI	BB	BB+	2008
St. Joseph Health Services	RI	BB-	BB	2009
St. Luke's Hospital of Duluth	MN	BB-	BB	2008

Table 1-a

Rating Changes Affecting Speculative-Grade Health Care Providers (July 26, 2007 - July 31, 2010) (cont.)				
SunCoast Hospital	FL	C	B	2008
The Pottsville Hospital and Warne Clinic	PA	BB-	BB+	2007
Valley Health System	CA	C	B-	2007
Valley Health System	CA	D	C	2010
West Penn Alleghany Health System	PA	BB-	BB	2010
Westerly Hospital	RI	BB-	BB	2008

*Rating lowered to speculative grade in February 2008 due to planned debt issuance, which was cancelled, resulting in the rating being raised back to investment grade in March 2008. Subsequently, operations and balance sheet deterioration prompted a return to speculative grade in March 2009.

Table 1-b

Rating Changes Affecting Speculative-Grade Health Care Providers (July 26, 2007 - July 31, 2010)				
		Rating Action		
Ratings raised out of speculative-grade categories	**State**	**To**	**From**	**Year**
Organization				
Community Medical Center	MT	BBB-	BB+	2010
NYU Hospital Center	NY	BBB	BB+	2010
Richardson Regional Medical Center	TX	BBB-	BB+	2010
		Rating Action		
Ratings raised within speculative-grade categories	**State**	**To**	**From**	**Year**
Organization				
Mercy Memorial Hospital System	MI	BB+	BB	2010
Mount Clemens General Hospital	MI	BB+	BB	2007
Northern Berkshire Health System	MA	BB	BB-	2008
NYU Hospital Center	NY	BB+	BB	2009
Princeton Community Hospital	WV	BB-	B	2008
Princeton Community Hospital	WV	BB	BB-	2010

Table 1-c

Rating Changes Affecting Speculative-Grade Health Care Credits (July 26, 2007 - July 31, 2010)					
Negative outlook changes					
	State	**Rating**	**To**	**From**	**Year**
Appalachian Regional Healthcare	KY	BB-	Negative	Stable	2008
Beebe Medical Center	DE	CCC	Developing	CW Developing	2010
Citrus Valley Health Partners	CA	BB+	Negative	Stable	2009
Community Hospital of Greater Syracuse	NY	BB-	Negative	Stable	2009
HealthEast	MN	BB+	Stable	Positive	2009
Hutcheson Medical Center	GA	BB+	Negative	Stable	2008
Maria Parham Medical Center	NC	BB	Stable	Positive	2008
Massachusette Eye and Ear Infirmary	MA	BB+	Stable	Positive	2008
Moses Taylor Hospital	PA	B-	Negative	CW Devloping	2008
Moses Taylor Hospital	PA	B-	Negative	Stable	2010
Northern Berkshire Health System	MA	BB	Negative	Stable	2009
Rahway Hospital	NJ	BB	Negative	Stable	2010

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Table 1-c

Rating Changes Affecting Speculative-Grade Health Care Credits (July 26, 2007 - July 31, 2010) (cont.)					
Roger Williams Hospital	RI	BB	Stable	Positive	2008
Sacred Heart Hospital of Allentown	PA	BB-	Negative	Stable	2009
West Branch Regional Medical Center	MI	BB	Negative	Stable	2009
West Penn Allegheny Health System	PA	BB	CW Negative	Stable	2008
West Penn Allegheny Health System	PA	BB	Negative	CW Negative	2008
Positive outlook changes					
Antelope Valley Healthcare	CA	BB	Stable	Negative	2009
Appalachian Regional Healthcare	KY	BB-	Stable	Negative	2009
Appalachian Regional Healthcare	KY	BB-	Positive	Stable	2010
Chattahoochee Valley Hospital Society	AL	BB-	Stable	Negative	2010
Chippewa Cnty War Mem Hosp, MI	MI	BB+	Stable	Negative	2009
Community Medical Centers	MT	BB+	Positive	Stable	2008
Forum Health	OH	C	Stable	Negative	2010
Healtheast Care System	MN	BB+	Positive	Stable	2008
Jordan Hospital	MA	BB-	Stable	Negative	2010
Maria Parham Medical Center	NC	BB	Positive	Negative	2007
Massachusetts Eye and Ear Infirmary	MA	BB+	Positive	Stable	2009
Mennonite General Hospital	PR	BB-	Stable	Negative	2007
Milton Hospital	MA	BB-	Stable	Negative	2010
Moses Taylor Hospital	PA	B-	Stable	Negative	2009
Oconee Regional Medical Center	GA	BB+	Positive	Stable	2008
Oconee Regional Medical Center	GA	BB+	Stable	Positive	2010
Regina Medical Center	MN	BB+	Stable	Negative	2009
Skaggs Community Health Center	MO	BB	Stable	Negative	2010
Sky Lakes Medical Center	OR	BB+	Stable	Negative	2010
St. Johns Riverside Health System	NY	B-	Stable	Negative	2010
Stevens Healthcare	WA	BB+	Positive	Stable	2010
Touro Infrimary	AL	BB	Positive	CW Negative	2010
Valley Health System	CA	C	Developing	Negative	2009
Westerly Hospital	RI	BB-	Stable	Negative	2009

Table 1-d

Rating Changes Affecting Speculative-Grade Health Care Credits (July 26, 2007 - July 31, 2010)			
Ratings Withdrawn or Debt Repaid	**State**	**Previous Rating**	**Year**
Athens & Limestone County Health Care Authority	AL	BB-	2007
Columbus Hospital	NJ	CCC	2008
Crittenden Memorial Hospital	AR	B+	2008
Downey Comnity Hospital	CA	CCC	2009
East Orange General Hospital	NJ	BB-	2007
Fairmount General Hospital	WV	BB-	2008
Hutcheson Medical Center	GA	BB+	2008
Jackson County Hospital	AL	BB+	2010
Littleton Regional Hospital	NH	BB+	2008

Table 1-d

Rating Changes Affecting Speculative-Grade Health Care Credits (July 26, 2007 - July 31, 2010) (cont.)			
Madera Community Hospital	CA	BB+	2009
Mennonite General Hospital	PR	BB-	2010
Mercy Jeannette Hospital	PA	BB-	2008
Mount Clemens General Hospital	MI	BB+	2009
Mount Sinai Med Center	FL	BB	2009
North Oakland Medical Center	MI	D	2009
Ohio Valley Health Services	WV	B-	2010
Pascack Valley Hosptial	NJ	D	2010
Portneuf Medical center	ID	BB	2009
Pottsville Hospital and Warne Clinic	PA	BB-	2010
Sacred Health Hospital of Allentown	PA	B-	2010
Samaritan Medical Center	NY	BB	2009
Solaris Health System	NJ	BB	2009
St Anthonys Health Center	IL	BB+	2009
St. Francis Healthcare Center	OH	BB-	2008
Sun Coast Hospital	FL	C	2009
Windham Community Memorial Hospital	CT	BB	2007

As of July 31, 2010, we rated 12 providers 'BBB-' with a negative outlook, and only three providers were rated 'BB+' with a positive outlook. We believe that this supports our expectation that the speculative-grade health care pool will likely continue to grow over the next one to two years.

Upgrades are possible

Historically, it has proven difficult for providers to return to an investment-grade rating once placed in the speculative-grade category. We have found that it usually takes a long time for those few that have been successful to again obtain an investment-grade rating. Nevertheless, since we raised a few speculative-grade ratings to investment grade in the past three years, we consider it feasible for providers to improve their credit ratings. We have found that many of the providers whose ratings we raised demonstrated what we view as a keen focus on operational improvement and an ability to implement projects successfully that enhanced revenues, improved efficiencies, and effectively managed costs, thereby resulting in improved operations, cash flow, and balance sheet metrics. However, we realize it is not easy for the bulk of speculative-grade providers struggling with multiple operating issues such as decreased admissions, heightened competition, physician-recruitment difficulties, and aging facilities to improve their ratings.

The Sample Creates Unique Challenges

Standard & Poor's median-ratio analysis is an important tool in our assessment of not-for-profit health care providers' credit quality and helps us to identify the overall trends of the ratios. Our analysis of the speculative-grade pool of providers offers some challenges that differ from our broader ratio studies, such as the relatively small and constantly changing sample. In our view, these challenges can make data interpretation difficult and can pose some complexity when comparing results of varying periods. Nevertheless, we believe the examination of the data is valuable because important observations can still be drawn.

Small sample size

The small sample size at each rating level can sometimes have a measurable impact on medians, which in our view highlights the importance of having as many financial statements as possible. The absence of even one statement could affect results. In addition, many speculative-grade providers are in transition and their financials can often have one-time changes that could distort results. Due in part to the financial duress at some of the organizations, audited financials are sometimes not available in a timely manner. In our opinion, we had good participation in this year's study with 88% (42 of 48) of the speculative-grade pool providing statements. Fiscal 2009 audits were not available for one 'BB+' rated entity, two 'BB' rated entities, one 'B-' rated entity, one 'C' and one 'D' rated entity. Notably, the sample size for providers rated 'B+' or lower is very small with only five providers in the pool.

Withdrawn ratings can skew results

Within the speculative-grade category, we have withdrawn many credit ratings for a variety of reasons. Between 2007 and 2009, the number of speculative-grade ratings remained fairly steady with 48 providers in 2009 versus 58 providers in 2007. However, what the raw numbers do not show is that nearly half of the 58 speculative-grade-rated providers included in the 2007 report are no longer on our list (see table 1-d). Of these ratings, about half were withdrawn due to bonds being refunded or repaid as part of a new debt issuance or because the hospital was acquired. About one-third of the ratings were withdrawn at the issuers' request or due to what we consider a lack of information and we raised the remaining ratings to investment grade or now rate the provider under our district hospital criteria.

Several of the withdrawn ratings involved providers in bankruptcy that negotiated a sale to a third party and included repayment of the bonds as part of the sale. This happened with Sun Coast Hospital, Fla., which was part of the sample in our 2007 report. An affiliate of the for-profit HCA Inc. purchased the hospital in 2008 and defeased the bonds. Ultimately, the number of withdrawn ratings had a dampening effect on the actual growth in speculative-grade credits.

Credit Trends Show Modest Improvement, But Strain Remains

Certain median ratios for the speculative-grade group showed modest overall improvement in 2009 compared with the results from our previous report (see table 2), despite the challenging economic period between publications. We observed slightly better operating results and improved balance sheet metrics. When we compare the 'BBB-' medians with the 'BB+' medians, we see that the credit gap separating the two ratings is narrowing with respect to some ratios, specifically ratios derived from income statements. However, the difference remains considerable when we look at balance sheet metrics because, as a whole, the speculative-grade providers maintain what we consider to be much weaker balance sheets (see table 3).

Table 2

Speculative-Grade Overall Median Ratios

Fiscal Year	2009*	2006
Sample Size	42	43
Statement of operations		
Net patient revenue ($000)	152,859	108,048
Salaries & benefits/NPR (%)	51.5	55.0
Bad debts exp/total operating revenue (%)	7.0	5.9
Max debt service coverage (x)	1.9	2.0

Table 2

Speculative-Grade Overall Median Ratios (cont.)		
Max debt serv to tot op rev (%)	3.2	3.5
Max debt serv to tot rev (%) (Debt Burden)	3.1	3.5
EBIDA ($000)	9,117	6,999
Non-operating rev (%)	0.4	1.0
EBIDA margin (%)	6.2	6.4
Operating cashflow margin (%)	5.6	5.5
Operating margin (%)	(0.5)	(0.9)
Excess margin (%)	(0.2)	0.8
Capital exp to dep & amort exp (%)	76.8	95.6
Balance sheet		
Avg Age of Plant (yrs)	13.2	13.9
Cushion Ratio (X)	4.9	3.2
Days' cash on hand	61.1	47
Days in accounts receivable	44.4	47.8
Cash flow/total liabilities (%)	7.2	8.8
Unrestricted cash/long-term debt (%)	57.8	48.8
Long-term debt/capitalization (%)	52.9	56.7
Payment period (days)	65.7	66.1

*2009 figures are based on 2009 audited financials. Ratings are as of July 31, 2010.

Table 3

Speculative Grade vs. Investment Grade		
	2009	
	'BBB-'*	'BB+'*
Sample size	49	14
Statement of operations		
Net patient revenue ($000)	97,580	161,754
Salaries & benefits/NPR (%)	51.0	48.2
Bad debts exp/total operating revenue (%)	6.7	7.4
Max debt service coverage (x)	2.3	2.3
Max debt serv to tot op rev (%)	3.9	3.3
Max debt serv to tot rev (%) (Debt Burden)	3.8	3.1
EBIDA ($000)	10,319	11,542
Non-operating rev (%)	0.9	0.3
EBIDA margin (%)	9.5	6.6
Operating cashflow margin (%)	8.6	6.1
Operating margin (%)	0.6	0.6
Excess margin (%)	1.6	0.3
Capital exp to dep & amort exp (%)	95.3	67.2
Balance sheet		
Avg Age of Plant (yrs)	9.8	12.4
Cushion Ratio (X)	7.6	5.1

Table 3

Speculative Grade vs. Investment Grade (cont.)		
Days' cash on hand	107.9	68.3
Days in accounts receivable	48.5	46.6
Cash flow/total liabilities (%)	10.9	7.5
Unrestricted cash/long-term debt (%)	66.0	61.2
Long-term debt/capitalization (%)	43.2	47.3
Payment period (days)	53.8	56.1

*2009 figures are based on 2009 audited financials. Ratings are as of July 31, 2010.

By several measures, speculative-grade providers improved slightly in 2009. Although still negative, operating margins were better, which we believe is likely due to the implementation of cost-control and revenue-enhancement initiatives in response to the strained economy. As we expected with the turbulent investment markets, excess margins and debt service coverage declined somewhat. Days' cash on hand rose slightly, which we believe is partly attributable to an observable decrease in capital investments. Average age of plant also fell slightly, which is counterintuitive because declining capital investment would generally lead to a higher age of plant. We believe that the decline in this ratio is more a function of the different hospitals in the speculative-grade groups in 2007 and 2009 and less a result of capital investment in physical plant.

Debt measures also improved, including cash to debt, debt to capitalization, and maximum debt service to total operating revenue. We believe the improved debt measures may indicate that speculative-grade providers have limited access to capital, and that existing debt is simply amortizing normally with limited new debt added.

We see a clear distinction between providers in the 'BB' and 'B' rating categories with greater stress seen in nearly all ratios for credits rated lower than the 'BB' category (see table 4). Providers rated below the 'BB' category typically have much weaker income statement metrics and balance sheet ratios. We believe providers in the 'BB' rating category have more potential for a positive rating action to investment grade than those rated lower. In fact, many providers with 'BB' category ratings were previously in the investment-grade category. However, while there is some migration out of the 'BB' rating category, there are some providers that remain in the 'BB' rating category indefinitely. We find it is generally more difficult for providers to improve, once we lower their ratings to the 'B' rating category. We believe providers with ratings in the 'B' category are more vulnerable to unexpected events that could quickly result in a default.

Table 4

Speculative-Grade Median Ratios By Rating Category				
	'BB' Category		'B' Category And Below	
Fiscal year-end	2009*	2006	2009¶	2006¶
Sample size	37	38	5	5
Statement of operations				
Net patient revenue (NPR: $000)	151,319	105,310	180,496	139,687
Salaries and benefits/NPR (%)	49.2	55.2	57.1	53.9
Bad debts exp/total operating revenue (%)	7.2	5.9	6.3	7.1
Maximum debt service coverage (x)	2.0	2.1	1.1	0.9
Maximum debt service to total operating revenue (%)	3.3	3.6	3.0	3.1
Maximum debt service to total revenue (%) (debt burden)	3.1	3.6	3.0	3.0

Table 4

Speculative-Grade Median Ratios By Rating Category (cont.)				
EBIDA ($000)	9,242	7,086	6,325	4,460
Non-operating revenue (%)	0.4	1.1	0.4	1.0
EBIDA margin (%)	6.5	6.8	3.3	3.0
Operating cashflow margin (%)	5.6	5.9	1.6	2.2
Operating margin (%)	(0.4)	(0.5)	(3.5)	(4.0)
Excess margin (%)	0.3	1.2	(2.2)	(3.2)
Capital exp to dep and amort exp (%)	75.8	97.4	86.5	91.5
Balance sheet				
Average age of plant (years)	13.1	13.2	14.2	15.7
Cushion Ratio (X)	5.1	4.0	2.4	2.4
Days' cash on hand	63.1	58.3	20.9	24.7
Days in accounts receivable	44.6	47.7	42.6	49.2
Cash flow/total liabilities (%)	7.4	9.1	4.4	2.3
Unrestricted cash/long-term debt (%)	61.2	54.2	43.7	24.4
Long-term debt/capitalization (%)	54.1	51.7	46.4	76.8
Payment period (days)	60.6	65.8	76.0	71.7

*2009 figures are based on 2009 audited financials. Ratings are as of July 31, 2010. ¶The 2009 figures include two hospitals rated below the 'B' category, while the 2006 figures had zero.

Table 5

Speculative-Grade Median Ratios By Rating Level								
	'BB+'		'BB'		'BB-'		'B+' and below	
	2009*	2006	2009*	2006	2009*	2006	2009¶	2006¶
Sample size	14	14	12	16	11	8	5	5
Statement of operations								
Net patient revenue (NPR: $000)	161,754	110,451	101,715	108,878	192,149	85,695	180,496	139,687
Salaries and benefits/NPR (%)	48.2	55.1	47.9	55.8	55.3	49.3	57.1	53.9
Bad debts exp/total operating revenue (%)	7.4	4.9	8.1	6.3	7.2	11.4	6.3	7.1
Maximum debt service coverage (x)	2.3	1.7	1.9	2.2	1.8	2.3	1.1	0.9
Maximum debt service to total operating revenue (%)	3.3	3.9	3.6	3.7	2.9	3.2	3.0	3.1
Maximum debt service to total revenue (%) (debt burden)	3.1	3.8	3.5	3.6	2.9	3.2	3.0	3.0
EBIDA ($000)	11,542	6,441	7,167	7,523	15,473	6,822	6,325	4,460
Non-operating revenue (%)	0.3	1.1	1.2	1.1	0.3	0.8	0.4	1.0
EBIDA margin (%)	6.6	6.8	7.3	6.5	5.8	8.2	3.3	3.0
Operating cashflow margin (%)	6.1	4.6	6.3	5.9	5.6	7.3	1.6	2.2
Operating margin (%)	0.6	(1.2)	(0.7)	(0.7)	(1.8)	0.6	(3.5)	(4.0)
Excess margin (%)	0.3	0.9	0.3	1.0	(0.8)	1.6	(2.2)	(3.2)
Capital exp to dep & amort exp (%)	67.2	81.3	76.5	105.5	82.5	86.9	86.5	91.5
Balance sheet								
Average age of plant (years)	12.4	13.3	11.8	14.3	14.5	12.5	14.2	15.7
Cushion ratio (X)	5.1	3.6	5.2	5.9	4.0	2.5	2.4	2.4

Table 5

Speculative-Grade Median Ratios By Rating Level (cont.)								
Days' cash on hand	68.3	61.3	70.3	62.7	51.9	34.1	20.9	24.7
Days in accounts receivable	46.6	48.2	43.0	47.7	44.0	44.4	42.6	49.2
Cash flow/total liabilities (%)	7.5	8.2	8.2	9.2	7.4	9.4	4.4	2.3
Unrestricted cash/long-term debt (%)	61.2	51.1	57.8	68.9	72.5	39.7	43.7	24.4
Long-term debt/capitalization (%)	47.3	45.3	48.8	54.7	72.8	64.7	46.4	76.8
Payment period (days)	56.1	63.8	59.8	63.0	68.2	73.4	76.0	71.7

*2009 figures are based on 2009 audited financials. Ratings are as of July 31, 2010. ¶The 2009 figures include two hospitals rated below the 'B' category, while the 2006 figures had zero.

Limited Movement From Speculative Grade To Investment Grade

Since our last report in 2007, we believe that economic conditions have been particularly difficult, and as a result, only three providers have moved from the speculative-grade category to investment grade. There were also six rating actions moving providers higher within the speculative-grade category.

The three credit ratings raised to investment grade were on NYU Hospital Center (NYUHC), N.Y., which was raised twice and is now rated 'BBB', Community Medical Center (CMC), Mont., and Richardson Regional Medical Center (RRMC), Texas, which are rated 'BBB-'. These providers have little in common, as they are located in different regions with different types of markets, and vary dramatically in size -- from $1.3 billion of revenue at NYUHC to less than $200 million at the other two facilities. However, they all improved their financial performance and exhibit institutional characteristics that we consider typical of investment-grade providers.

NYU Hospital Center, N.Y.

We raised the rating on NYUHC to 'BB+' from 'BB' in February 2009 and then subsequently to 'BBB' in March 2010 based on what we consider to be significant structural changes at NYUHC, which is under a new management team that we believe has helped the hospital achieve improved earnings and an improved, though still limited, balance sheet. While we have considered NYUHC's market share, payor mix, and fundraising ability consistently positive, even when we rated the organization in the speculative-grade category, we considered its financial profile weak partly due to the disruption caused by a failed merger with Mount Sinai Medical Center and the subsequent unwinding.

Community Medical Center, Mont.

We lowered the rating on CMC to speculative grade in 2006 due to what we considered an extremely weak financial profile despite what we viewed as solid demographics and limited competition. In addition, CMC was the sole provider of certain services, and a regional provider of rehabilitation, which we viewed as positive credit factors. Under new management and governance since 2005, the move to the investment-grade category in 2010 reflects our assessment of CMC's significantly improved financial profile. In our view, the new management team was able to take advantage of CMC's strong business position to improve operations. CMC also improved its liquidity, which has more than doubled in the past three years.

Richardson Regional Medical Center, Texas

We lowered the rating on RRMC to speculative grade in March 2009 due to continued negative financial results and a constrained balance sheet. We returned the rating to investment grade in June 2010. The higher rating reflected our view of RRMC's affiliation and long-term lease agreement with 'A+' rated Methodist Health System (MHS) and

our assessment of the relationship's resulting benefits. Under the agreement, the Richardson Hospital Authority maintains ownership of RRMC's assets and liabilities. However, the assets are leased to MHS and the hospital is run by MHS. The affiliation has resulted in operating results that in our view have increased significantly due to more favorable managed-care contracts and other revenue and cost efficiencies stemming from its affiliation with a stronger system. We view the outlook as developing because the affiliation is based on a lease agreement, which contains provisions that could potentially trigger a full sale to MHS or dissolution of the agreement. In our opinion, the former could result in a higher rating while the latter could result in a lower rating.

Providers with positive outlooks

As of July 31, 2010, three providers were rated 'BB+' with a positive outlook: Massachusetts Eye & Ear Infirmary, Mass., Mercy Memorial Hospital System, Mich., and Stevens Healthcare, Wash. There are also three additional providers rated 'BB' and 'BB-' with positive outlooks. We believe those providers with positive outlooks may achieve higher ratings, but will likely remain in the speculative-grade category. The six positive outlooks represent 13% of all speculative-grade ratings, which we consider high compared with just 5% of providers in the stand-alone hospital universe with positive outlooks. We believe this difference reflects the volatility faced by speculative-grade providers. Overall, we believe the relatively small number of providers on the cusp of investment grade continues to reflect the difficult health care operating environment.

The Number Of Speculative-Grade Providers Remains Relatively Flat, But The Universe Is Constantly Changing

Between 2007 and 2009, we lowered ratings on 23 providers from investment grade to speculative grade and lowered 30 other ratings within the speculative-grade category, including seven providers that had ratings lowered more than once during this period. Given what we consider to be the more volatile and unpredictable nature of speculative-grade providers' operations, we have found that once a provider begins a downward slide from a financial and operational perspective, it is often difficult to stop. Five of the seven providers whose ratings we lowered more than once are in or near default and rated 'CCC', 'C', or 'D'. Of the remaining 16 providers with ratings lowered within the speculative-grade category, we moved five to or within the single 'B' category or lower. Historically, we have found that many of these lower-rated providers will find a merger or acquisition partner to assume and repay debt. We expect this trend to continue, and potentially even accelerate as the effects of health care reform take hold.

Most of the providers with ratings lowered to the speculative-grade category were lowered just one notch from 'BBB-' to 'BB+', which we believe reflects the fine line between the investment-grade and speculative-grade categories. Of the 23 providers with ratings lowered to speculative grade since 2007, 13 were lowered from investment grade to 'BB+'. We lowered the ratings on seven providers to 'BB' and two to 'BB-'. Occasionally, we lower ratings several notches. For example, we lowered the rating on Beebe Medical Center, Del. 10 notches earlier this year from 'BBB+' to 'CCC' due to our assessment of risks related to numerous lawsuits filed against Beebe stemming from the arrest of a physician on its medical staff.

In our view, providers with a 'BBB-' rating, the lowest investment-grade rating, usually have inherent weaknesses and in many cases, the recently difficult economic environment has intensified the weaknesses, directly contributing to our decision to lower certain ratings to speculative grade. With the exception of Beebe, we cited operating losses as a main reason for the downgrade of every provider whose ratings we lowered from investment grade to

speculative grade. Of the 23 providers whose ratings we lowered from investment grade since 2007, the majority (20) were lowered during 2008 -- primarily in the third quarter -- through 2009 at the height of the recession. However, operating losses alone were not the only reason we lowered ratings; most of the providers had additional weaknesses such as future financing plans, light liquidity, competitive markets, or weak demographics.

Rating And Outlook Distributions

Despite the sharp increase in the proportion of negative rating actions over the past three years in the speculative category, the distribution of speculative-grade ratings has actually improved since 2007 (see charts 1-a and 1-b). In 2010, 84% of the speculative-grade providers were in the 'BB' category, compared with 73% in 2007. The 'B' category decreased to 8% from 24% in 2007 while providers rated 'CCC' and below increased to 8% from 3%. Though the 'BB' category increased and the 'B' category decreased, it was largely because many low-investment-grade providers moved into the speculative-grade category; it was not because we raised a large number of the ratings on 'B' rated providers. Over the past three years, we have lowered the ratings on 23 investment-grade providers to speculative grade, which we think is one of the key reasons we have not seen a measurable decline in the credit quality of the speculative-grade providers. We only moved one 'B' rated provider to the 'BB' rating category, while we lowered four from the 'BB' category.

Of the current providers with speculative-grade ratings, only three originally started with a speculative-grade rating: St. Luke's Hospital of Duluth, Minn., Nicholas H. Noyes Memorial Hospital, N.Y., and West Penn Allegheny Health System, Pa. The remaining providers originally had an investment-grade rating that we have since lowered to speculative grade.

Chart 1-a

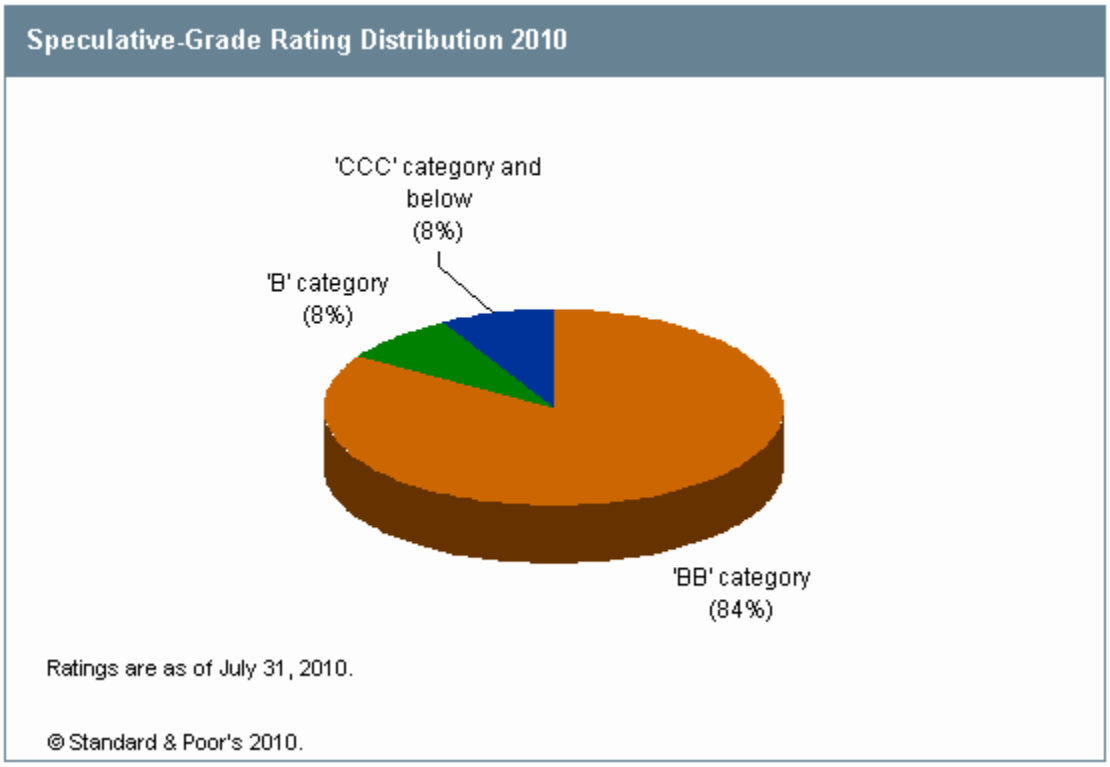
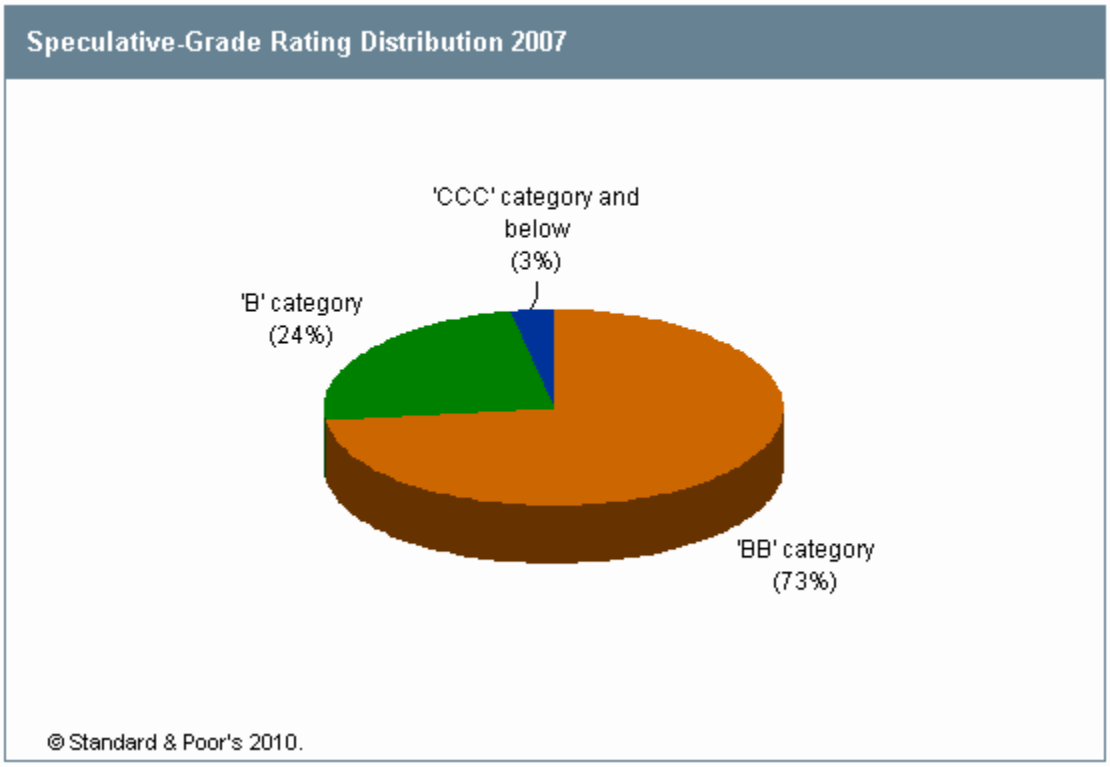


Chart 1-b



We consider outlooks an indicator of the expected credit performance for the upcoming 12 to 24 months. Based on our review of outlooks for the entire acute-care sector, we believe the outlooks have started to reflect some industry stabilization beginning in the third quarter of 2009. However, we believe the distribution for speculative-grade providers continues to indicate that providers falling in this category face more volatility than the rest of our rated universe.

In 2010, 57% of speculative-grade providers had a stable outlook compared with 78% for all stand-alone hospitals. The current percentage of stable outlooks for speculative providers has decreased from the 69% we cited in our 2007 report. Positive outlooks increased to 13% in 2010 from 7% in 2007, while negative outlooks increased to 30% from 24% (see chart 2-a and 2-b). Though the percentages increased a fair amount, the absolute numbers were very small. For example, only one more hospital had a negative outlook and two more had a positive outlook compared with the respective absolute numbers from 2007. We believe this outcome illustrates the rather large impact a small number of providers can have when there is a small sample size.

Chart 2-a

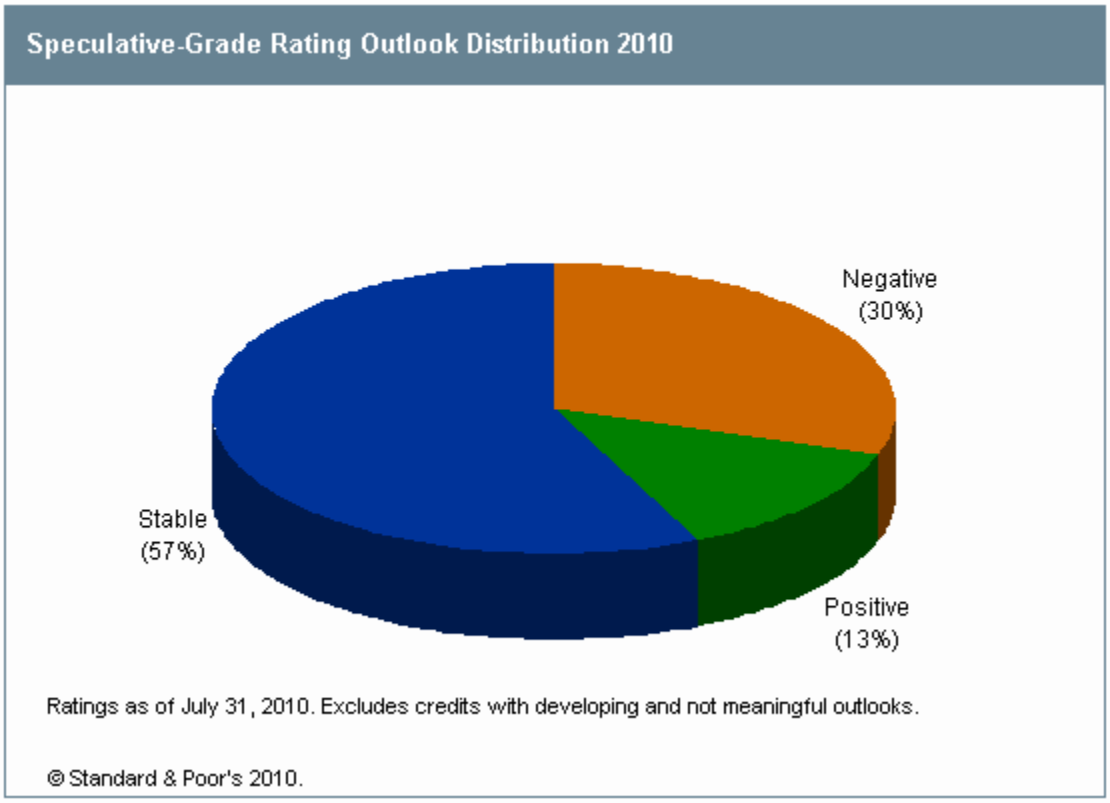
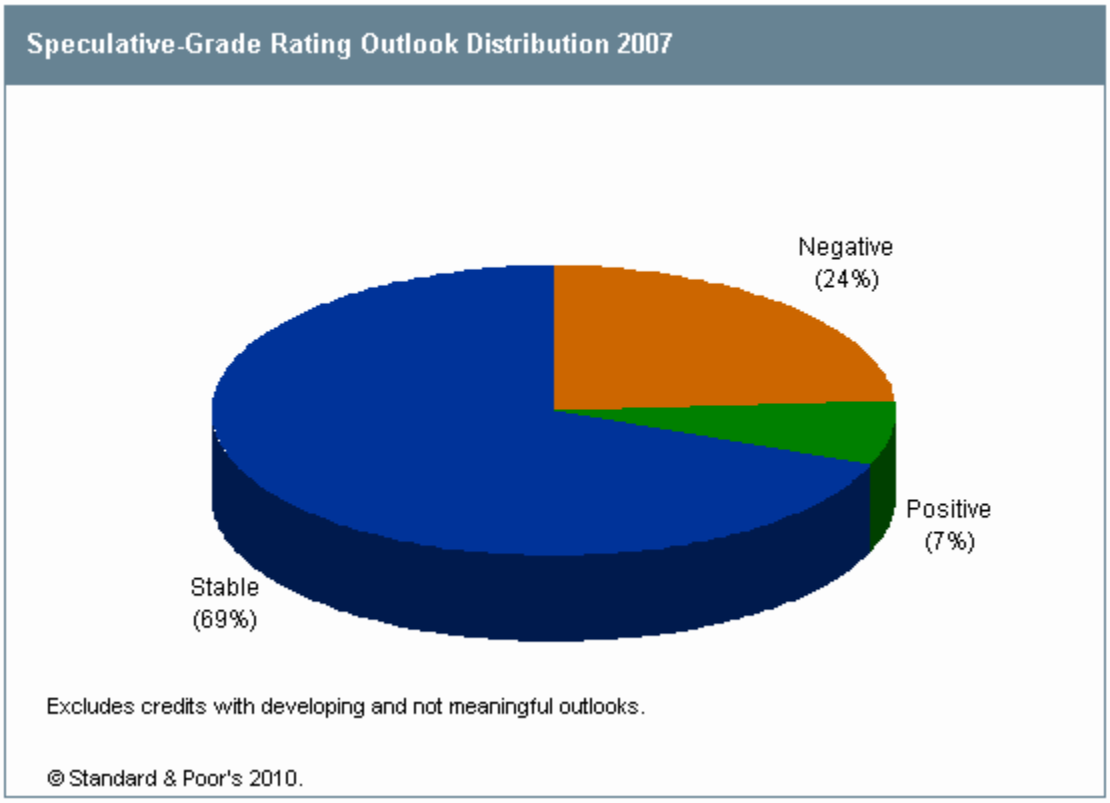

Speculative-Grade Rating Outlook Distribution 2010
Negative
(30%)
Stable
(57%)
Positive
(13%)
Ratings as of July 31, 2010. Excludes credits with developing and not meaningful outlooks.
© Standard & Poor's 2010.

Chart 2-b



Credit Gap Remains Between Speculative-Grade And Investment-Grade Providers

Though only one notch apart, we believe the distinction in credit quality between the lowest investment-grade credits ('BBB-') and the highest speculative-grade credits ('BB+') remains notable (see table 3). Based on our data, the disparity in balance sheet metrics is most evident when comparing the two ratings. While only having slightly stronger liquidity, when we compare cash to long-term debt, 'BBB-' rated providers are in our view markedly stronger compared with 'BB+' providers from a days-cash-on-hand perspective; the medians for 'BBB-' rated providers are 66.0% cash to long-term debt and 108 days' cash on hand compared with 61.2% and 68 days for 'BB+' providers. Additionally, we observed that the lower-rated providers tend to have a lower capital-spending ratio as a percentage of depreciation expense and consequently a much higher average age of plant; the median is 12.4 years for 'BB+' rated providers compared with 9.8 years for the 'BBB-' rated providers. We also found that leverage is only slightly greater for the speculative-grade providers, which we believe indicates that it is generally more difficult to access affordable capital so there is less added debt.

We understand that it is difficult for many speculative-grade providers to access the traditional tax-exempt debt markets, so they are more likely to seek more expensive or restrictive financing, such as federally insured debt, capital leases, and bank loans. Certain states, such as California and Montana, offer programs that help higher-risk providers access capital markets based on guarantees from state-sponsored programs.

Even though we found essentially no difference between the operating margins and maximum annual debt service

coverage levels between the 'BBB-' and 'BB+' rated providers, there is a gap between the two categories for EBIDA margins, operating cash flow, and excess margins.

Characteristics Vary Within The Speculative-Grade Group

Typically we found that speculative-grade providers have weaker credit profiles and are more susceptible to adverse business, financial, and economic conditions that makes them generally greater credit risks. Although we believe the weaker profiles are often driven by numerous factors that vary from one provider to the next, we analyzed the data set to ascertain whether certain broad statements could be made reflecting similarities regarding factors such as size, market dynamics, and geographic location.

Generally smaller net patient revenue medians

We found that providers with speculative-grade ratings tend to be smaller on average, with a 2009 median net patient revenue median of $152.9 million. We believe that in certain cases, smaller providers can be disadvantaged as they may have less negotiating power with payers compared with their larger counterparts due to their small size. This is not always the case however. We have seen that some small providers, particularly in rural locations, are sometimes able to obtain more favorable contracts due to the essentiality of the services they provide to an area. In addition, small providers often rely on small medical staffs for a substantial portion of their business. At times, we have seen this lead to large swings in volume and revenues when their top admitters depart.

We don't believe that a large size precludes a provider from suffering from speculative-grade characteristics though, as evidenced by the fact that nearly 17% of our speculative-grade pool comprises providers with net patient revenues in excess of $300 million. In fact, three large systems are included in our speculative-grade pool: Saint Barnabas Health Care System, N.J. (net patient revenue of $2.1 billion), Detroit Medical Center, Mich. (net patient revenue of $1.9 billion), and West Penn Allegheny Health System, Pa. (net patient revenue of $1.6 billion).

Michigan and California have the greatest number of speculative-grade providers

Our speculative-grade providers represent 21 different states and Puerto Rico. While speculative-grade providers are located throughout the U.S., a few states have what we consider a disproportionately large number of representatives in the ranks. Of the speculative-grade providers, the greatest concentrations are in Michigan with six and California with four.

The recession hit the Michigan economy hard -- particularly the auto industry -- which led to higher unemployment rates in the state. As a result, we saw the state's health care providers suffer from lower patient volumes, an increase in the number of uninsured and underinsured patients, and a deteriorated overall payer mix. While we saw these trends in the state overall, the individual providers experienced recessionary hardships to different extents.

We found that California providers tend to have a higher average age of plant; the median average age of plant is between 14 and 28 years. In fact, two California providers reported significant capital spending needs related to the state's seismic-compliance requirements, which we viewed as negative credit factors.

Varied business positions

In some cases, we have seen speculative-grade providers compete in markets with stronger investment-grade systems. For example, 'BB-' rated Milton Hospital, Mass. is a small community hospital located fairly close to downtown Boston. Historically, the hospital has struggled to keep inpatient volumes from migrating to the downtown Boston academic medical centers. According to management, Milton has had relatively flat inpatient volumes for several

years and has struggled with persistent operating losses. In addition, we believe the hospital has limited financial flexibility due to elevated debt levels and a weak cash-to-debt ratio.

Conversely, we consider Appalachian Regional Healthcare, Ky.'s (BB-/Positive) business position very strong. It is the dominant health care provider within its largely rural service area, and posted what we consider strong operating results in fiscal 2009, which we attribute partly to management's focus on employee compensation and staff productivity levels, decreased bad debt expense, and control of other key expense-line items. However, we consider Appalachian Regional Healthcare's weak balance sheet metrics and likelihood of additional debt issuance in the near term as negative credit factors.

Rating Actions After The Compilation Of The Speculative-Grade Median Data

The data used in this report was based on ratings as of July 31, 2010. Since the compilation of the data through Aug. 31, 2010, we have taken five rating actions that affected the speculative-grade category. We raised the rating on Massachusetts Eye & Ear Infirmary to 'BBB-/Stable' from 'BB+/Positive'. We revised the outlook on Hillsdale Community Health Center, Mich.'s rating to stable from negative and affirmed the 'BB+' rating. We lowered the rating on Northern Berkshire Health System, Mass. to 'CCC/Negative' from 'BB/Negative'. We also lowered the ratings on two additional providers to the speculative-grade category from investment grade in August 2010: We lowered our rating on Good Samaritan Hospital of Lebanon, Penn. to 'BB+/Negative' from 'BBB-/Negative' and lowered the rating on Memorial Health University Medical Center, Ga. to 'BB+/Negative' from 'BBB-/Stable'. These five rating actions are not reflected in the 2010 median ratios due to the timing of the rating revisions and the publication of this report (see table 6).

Table 6

Speculative-Grade Health Care Provider Ratings

Health Care Provider	State	Rating*	Outlook
Antelope Valley Healthcare District	CA	BB	Stable
Appalachian Regional Healthcare Inc.	KY	BB-	Positive
Beebe Medical Center	DE	CCC	Developing
Bloomsburg Hospital	PA	CCC	Stable
Chattahoochee Valley Hospital Society	AL	BB-	Stable
Chippewa County War Memorial Hospital	MI	BB	Negative
Citrus Valley Health Partners	CA	BB+	Negative
Community General Hospital of Greater Syracuse	NY	BB-	Negative
Detroit Medical Center	MI	BB-	Stable
Forum Health	OH	C	Stable
HealthEast Care System	MN	BB+	Stable
Hillsdale Community Health Center (HCHC)¶	MI	BB+	Negative
Good Samaritan Hospital	CA	BB-	Stable
Iglesia Episcopal Puertorriquena Inc.	PR	B-	Stable
Jackson County Memorial Hospital	OK	BB	Stable
Jordan Hospital	MA	BB-	Stable
Maria Parham Medical Center	NC	BB	Stable
Massachusetts Eye and Ear Infirmary (MEEI)¶	MA	BB+	Positive
Mercy Memorial Hospital System	MI	BB+	Positive

Table 6

Speculative-Grade Health Care Provider Ratings (cont.)			
Metropolitan Health Corp.	MI	BB+	Negative
Milton Hospital	MA	BB-	Stable
Moses Taylor Hospital	PA	B-	Negative
Nanticoke Memorial Hospital	DE	BB	Negative
Nicholas H. Noyes Memorial Hospital (Livingston Health System)	NY	BB	Stable
Norman Regional Hospital Authority	OK	BB+	Stable
Northern Berkshire Healthcare System (NBHS)¶	MA	BB	Negative
Oconee Regional Medical Center	GA	BB+	Stable
Ozarks Medical Center	MO	B+	Stable
Palisades Medical Center of N.Y. Presbyterian Health Care System Obligated Group	NJ	BB+	Stable
Princeton Community Hospital	WV	BB	Positive
Proctor Hospital	IL	BB+	Stable
Rahway Hospital	NJ	BB	Negative
Regina Medical Center	MN	BB+	Stable
Roger Williams General Hospital	RI	BB	Negative
Russell Hospital Corp.	AL	BB+	Stable
Ryder Memorial Hospital	PR	BB	Stable
Skaggs Community Health Center	MO	BB	Stable
Sky Lakes Medical Center	OR	BB+	Stable
St. Barnabas Health Care System	NJ	BB+	Negative
St. Johns Riverside Hospital	NY	B-	Stable
St. Joseph Health Services	RI	BB-	Negative
St. Lukes Hospital of Duluth	MN	BB-	Negative
Stevens Healthcare	WA	BB+	Positive
Touro Infirmary	LA	BB	Positive
Valley Health System	CA	D	Not meaningful
West Branch Regional Medical Center	MI	BB	Negative
West Penn Allegheny Health System	PA	BB-	Stable
Westerly Hospital	RI	BB-	Stable

*Ratings are as of July 31, 2010. ¶After compilation of median data, the following rating actions occurred in August 2010: HCHC's rating outlook was revised to 'BB+/Stable'; MEEI's rating changed to 'BBB-/Stable'; and NBHS' rating changed to 'CCC/Negative'. **After compilation of median data, two additional hospitals had their ratings lowered to speculative grade in August 2010: Good Samaritan Hospital of Lebanon, Pa. lowered to 'BB+/Negative' from 'BBB-/Negative'; and Memorial Health University Medical Center, Ga. lowered to 'BB+/Negative' from 'BBB-/Stable'.