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S&P U.S. Not-For-Profit Acute Health Care Speculative Grade Median Financial Ratios -- 2019 vs. 2018

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We define speculative grade ratings as those rated 'BB+' and below. Within speculative grade, and consistent with the rating distribution last year, a majority, or almost half, of the health care organizations are rated 'BB+' (see chart 1). However, there has been a material unfavorable shift in the outlook distribution with just 13% of speculative grade credits carrying a stable outlook compared with almost two-thirds last year. At June 30, a vast majority of speculative grade ratings carry a negative outlook, which represents a material rise from about one-third last year (see chart 2). This partially represents fundamentally weaker credit fundamentals that lead to more rating and outlook changes. However, the high number of negative outlooks was also influenced by our multi-credit action that unfavorably revised outlooks on many speculative grade credits and those with less than 100 days' cash on hand due to likely pandemic related challenges (see "Outlooks Revised On Certain U.S. Not-For-Profit Health Care Organizations Due To Potential COVID-19 Impact," published April 21, 2020, on RatingsDirect). We believe that the financial repercussions associated with the pandemic will be evident in the medians based on fiscal 2020 results published in 2021.

We expect to see continued unfavorable rating and outlook revisions for the remainder of this year and into next year as pandemic related pressures accelerate underlying credit weakness. However, the 2019 medians show that the speculative grade credits as a group have generally strengthened financial metrics overall, which could help cushion financial profiles during the current challenging environment (see table 1). Between 2017 and 2019, debt service coverage, debt burden, operating margin, unrestricted reserves relative to debt, and the defined benefit pension plan funding status all improved. There is less consistency relative to days' cash on hand, which remained generally flat in 2019 relative to 2017 after a spike in 2018.

Certain 'BB+' speculative grade financial medians, such as margins and coverage ratios, compare favorably to the 'BBB-' stand-alone hospital medians (see table 2). However 'BBB-' rated credits have meaningfully higher unrestricted reserves relative to both operating expenses and long term debt, which provides significant cushion to an organization that might be experiencing operating pressure. In addition, credits rated 'BB+' may still be establishing a longer track record of improvement prior to moving to investment grade or may have weaker enterprise profiles that preclude an upgrade to investment grade despite solid financial performance.

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