FitchRatings

Fitch Affirms HCA Healthcare at 'BB'; Stable Outlook

Fitch Ratings - New York - 09 December 2019:

Fitch Ratings has affirmed HCA Healthcare, Inc.'s ratings (HCA), including the company's Long-Term Issuer Default Rating (IDR) at 'BB'. A full list of ratings follows at the end of this release. The ratings apply to approximately $34.5 billion of debt at Sept. 30, 2019. The Rating Outlook is Stable.

Key Rating Drivers

Industry-Leading Financial Flexibility: HCA has for-profit hospital industry-leading operating margins and generates consistent and ample FCF (CFFO less dividends, payments to minority interests and capex). Financial flexibility has improved significantly in recent years as a result of organic growth in the business and proactive management of the capital structure. The affirmation and Stable Outlook reflect Fitch's belief that HCA has limited financial incentive to operate with leverage sustained below the 3.5x, which is viewed as consistent with a higher rating level. As such, future rating actions are more likely to be driven by changes in the company's financial policy rather than accelerating or decelerating operating fundamentals.

Stable Leverage: At 3.7x at Sept. 30, 2019, HCA's leverage is below the average of the group of publicly traded hospital companies. Fitch Ratings forecasts HCA will produce cash flow from operations of $6.3 billion in 2019, roughly the same amount as in 2018, and will continue to prioritize use of cash for organic investment in the business, tuck-in M&A and payments to shareholders, including a common dividend that consumes about $500 million of cash.

Secular Headwinds Buffet Operating Outlook: Measured by revenues, HCA is the largest operator of for-profit acute care hospitals in the country, with a broad geographic footprint and good depth of care delivery assets in the company's markets. This favorable operating profile makes HCA relatively resilient although not immune to any weakness in organic operating trends in the for-profit hospital industry. HCA's top line growth has consistently outpaced most industry peers, but secular challenges, including a shift to lower-cost sites of care driven by health insurer scrutiny, increasing healthcare consumerism, and growing Medicare volumes relative to commercial volumes will be long-term headwinds to organic growth.

Increasing Focus on M&A: HCA has recently increased the pace of acquisitions, which will help to bolster growth in the intermediate term. Recent transactions have been tuck-in in nature, as HCA follows a strategy of adding hospitals mainly in existing markets. The recent acquisitions of Memorial Health System in Savannah, GA in February 2018 and seven-hospital system Mission Health, in Asheville, NC in February 2019, represent the first new hospital markets HCA entered in more than a decade, signaling an openness to geographic expansion in the right situations. The company has the financial flexibility necessary to complete a larger transaction that is more transformative to the operating profile, but Fitch believes it is more likely that the company will continue to focus on smaller targets.

Regulatory Environment In-Flux: Amidst partisan gridlock in Washington, the Affordable Care Act (ACA) has remained a target of legal challenges, and broader healthcare reform themes will play a dominant role in debates leading up to the 2020 presidential election. Fitch believes the ACA has had a slightly positive effect on the financial profile of most healthcare issuers. About 8.5% of Americans are without health insurance, down about 500bp from before the ACA's insurance expansion took effect, but up in 2019 for the first time since 2008. HCA's management has stated that the company has benefited from the ACA, and that enrollees in the ACA health insurance marketplaces comprised 2.6% of admissions in 2017 and 2.5% in first-quarter 2018, the last data points provided.

ACA Insurance Expansion Undermined: The Trump administration has made several changes that weaken the insurance expansion elements of the ACA. These include removal of the individual mandate penalty effective in 2019; an extended timeline for short-term, less comprehensive health plans; increased state Medicaid waiver flexibility; and cuts to ACA healthcare exchange open enrolment advertising spending. Such changes are expected to lead to small increases in the number of uninsured and underinsured individuals and will not influence business profiles enough to change any ratings in the for profit hospital industry.

Derivation Summary

HCA is operationally well-positioned relative to the four publicly traded hospital company peers (Tenet Healthcare Corp., Community Health Systems, Universal Health Services, and Quorum Health Corp.). Compared to CHS, and Quorum, HCA's hospitals are located in more rapidly growing urban and suburban markets and the company is the best positioned in the industry in developing a continuum of care delivery assets in its acute care hospital markets. The financial profile is also amongst the strongest in the peer group because of a moderate degree of financial leverage, industry leading profitability and a high absolute level of FCF generation. Amongst the peer group, only one-notch higher rated UHS (IDR BB+) has a stronger balance sheet than HCA.

Key Assumptions

Fitch's Key Assumptions Within its Rating Case for the Issuer

- Organic revenue growth of 4%-5% from 2019-2022, driven equally by pricing and volume;

- Operating EBITDA margin of 19-20% through the forecast period;

- Fitch forecasts 2019 EBITDA before associate and minority dividends of $9.9 billion and 2019 FCF after associate and minority distributions of $2.0 billion for HCA, with capital expenditures of about $3.9 billion and dividends slightly over $500 million;

- The $1.4 billion acquisition of Mission Health closed early in 2019 and is incorporated in Fitch's operating forecast for the year;

- Debt due during the forecast period is assumed to be refinanced;

- The company issues some incremental debt to fund capital deployment and forecast leverage is sustained above the 3.5x positive leverage sensitivity through 2021.

RATING SENSITIVITIES

Developments That May, Individually or Collectively, Lead to Positive Rating Action

-The 'BB' rating considers HCA operating with leverage (total debt/EBITDA after associate and minority dividends) around 4.0x with a FCF margin of 3%-4%.

-An upgrade to 'BB+' from 'BB' is possible if HCA maintains leverage (total debt/EBITDA after associate and minority dividends) at 3.5x or below.

Developments That May, Individually or Collectively, Lead to Negative Rating Action

-A downgrade to 'BB-' could be caused by leverage sustained above 4.5x; however, this is unlikely in the near term because these targets afford HCA with significant financial flexibility to increase acquisitions and organic capital investment, while still returning a substantial amount of cash to shareholders.

Liquidity and Debt Structure

Good Financial Flexibility: HCA's liquidity profile is solid for the 'BB' IDR. There are no significant debt maturities until 2021, when the $1 billion unsecured, structurally subordinated HCA Holdings, Inc. notes will mature. In 2022 the $3.75 billion ABL terminates and a 7.5% $2 billion unsecured bond matures. Fitch's forecast assumes that HCA will refinance this debt. HCA does not have large cash needs for working capital or exhibit much seasonality in cash flow generation. Cash on hand is typically $500 million-$600 million; the company has $5.75 billion in revolving credit capacity and in recent periods has maintained at least $2.0 billion in available capacity on these credit lines.

HCA also has good flexibility under the debt agreement covenants. The bank agreement includes a financial maintenance covenant that limits consolidated net leverage to 6.75x or below and an incurrence covenant for first lien secured net leverage (includes debt under the bank facilities and first lien secured notes) of 3.75x. At Sept. 30, 2019, Fitch estimates the HCA has incremental secured first-lien debt capacity of roughly $15 billion under the 3.75x consolidated leverage ratio test.

Debt Issue Notching: The notes outstanding at the HCA Healthcare Inc. (Hold Co) level are structurally subordinate to the debt outstanding at HCA Inc. and are rated 'B+'/'RR6', two notches below the IDR, to reflect this subordination.

The ABL facility has a first-lien interest in substantially all eligible accounts receivable (A/R) of HCA, Inc. and the guarantors, while the other bank debt and first-lien notes have a second-lien interest in certain of the receivables. Due to this priority secured interest, the ABL is rated 'BBB-', two notches higher than the IDR. The availability on the ABL facility is based on eligible A/R as defined per the credit agreement.

The cash flow revolver, term loans and first lien secured notes, are rated 'BB+'/'RR1', one notch above the IDR. These obligations are not notched up to investment grade because of a large amount of non-guarantor value in the capital structure (operating subsidiaries that are not guarantors of the secured debt comprise about 40% of total assets), and a relatively lenient secured debt incurrence covenant that allows for net secured debt/EBITDA of up to 3.75x.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3 - 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.

HCA has an ESG Relevance Score of 4 for Exposure to Social Impacts due to societal and regulatory pressures to constrain growth in healthcare spending in the U.S. This dynamic has a negative impact on the credit profile, and is relevant to the rating in conjunction with other factors.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING	RECOVERY	PRIOR
HCA Healthcare, Inc.	LT IDR BB ⭘ Affirmed		BB ⭘
senior unsecured	LT B+ Affirmed	RR6	B+
HCA Inc.	LT IDR BB ⭘ Affirmed		BB ⭘
senior unsecured	LT BB Affirmed	RR4	BB
senior secured	LT BB+ Affirmed	RR1	BB+
senior secured	LT BBB- Affirmed	RR1	BBB-

Additional information is available on www.fitchratings.com

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Applicable Criteria

Corporate Rating Criteria (pub. 19 Feb 2019)
Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)
Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019)

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