FitchRatings

RATING ACTION COMMENTARY

Fitch Ratings Affirms Salem Health's (OR) Rev Bonds at 'AA-'; Outlook Stable

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Fitch Ratings - San Francisco - 26 Mar 2024: Fitch Ratings has affirmed the rating on the series 2019A and 2016A revenue bonds issued by the Salem Hospital Facility Authority of the city of Salem, Oregon on behalf of Salem Health (Salem) at 'AA-'. Fitch has also affirmed Salem's Issuer Default Rating (IDR) at 'AA-'.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Salem Hospital (OR)	LT IDR	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable
Salem Hospital (OR) /General Revenues/1 LT	LT	AA- Rating Outlook Stable	Affirmed	AA- Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

The affirmation of the 'AA-' rating reflects Salem's leading and dominant market position in a stable service area with good population growth and solid demand for acute care services. Salem's strong operating risk and very strong financial profile assessments continue to provide sufficient financial cushion as the hospital progresses on its plan to meet improved operating performance goals. Fitch expects Salem to maintain and then incrementally improve upon its strong balance sheet resources especially as the organization returns to stronger cash flow generation levels over the medium-term.

Salem's capital needs are manageable as the organization completed construction of its new inpatient bed tower in the summer of 2022. The Hospital's capital expenditures over the medium-term should provide added flexibility to allow operational cashflow to rebuild unrestricted liquidity levels more in line with historical.

In fiscal 2023 (June 30; audited), Salem recorded a large operating loss of approximately $25.5 million, which translated into a negative 2.4% operating margin and a softer 4.2% operating EBITDA margin. Like many other providers in the Pacific Northwest, Salem's operational pressures stemmed from various expense increases primarily related to labor and supplies, coupled with post-pandemic challenges associated with capacity, throughput, and average length of stay (ALOS). However, through the first seven-months of fiscal 2024 (January 31; unaudited), the Hospital has significantly improved performance and generated approximately $10.4 million in operating income (7.5% operating EBITDA margin, which Fitch views favorably.

The Stable Outlook reflects Fitch's expectation that Salem is expected to fully achieve its operational improvement plan goals, which should return the organization to historical performance operating EBITDA margins to be consistently around 9% over time, which Fitch believes is reasonable.

SECURITY

The bonds are secured by a gross revenue pledge of the obligated group (OG). The OG is made up of Salem Health and Salem Health Hospitals and Clinics. Other non-obligated entities include the foundations, a critical access health center, a captive health insurance company and a billing company. Fitch's analysis is based on the consolidated entity.

KEY RATING DRIVERS

Revenue Defensibility - bbb

Dominant Market Position in Stable Service Area

Salem's revenue defensibility is midrange, which reflects its leading market share of nearly 70%; the organization's next largest competitor has an approximately 8% share. Salem has a stable payor mix that has moderate exposure to Medicaid and self-pay payors, which

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represented approximately 22.7% of the organization's total payor base in 2023. A majority of Salem's payor mix is concentrated in Medicare at nearly 51% due to the service area's somewhat older population. As the service area population continues to age, Fitch expects the payor mix will continue to shift to more Medicare payors over the longer-term.

Fitch views the service area's characteristics as good, with moderate population increases over the last several years coupled with wealth, income, and unemployment measures generally consistent with state and national averages.

Operating Risk - a

Demonstrable Rebound in Operating Performance; Solid Historical Investment in Plant

In fiscal 2023, Salem had a challenging year, which resulted in a loss from operations of approximately $25.5 million and led to a softer 4.2% operating EBITDA margin. This marked a four-year low for the organization and was primarily the result of post-pandemic industry pressures related to labor and supplies, capacity constraints, and challenges with throughput and ALOS. However, management quickly implemented a financial turnaround plan and thus far through fiscal 2024 (January 31; unaudited) Salem has returned to profitability, which was reflective in a favorable 7.5% operating EBITDA margin.

The most meaningful financial impacts have come primarily from additional capacity through Salem's swing bed expansion and significant improvements to throughput and ALOS, which amounted to more than $51 million in operational progress. In total, management has produced more than $110 million of financial improvements over the last 12 months-18 months, which has supported the enhanced financial performance.

Over the past four fiscal years, Salem has spent an average of nearly 215% of depreciation expense annually on capital expenditures, which Fitch views favorably. Fitch expects Salem's age of plant to remain healthy over the Outlook period, especially with the recent completion of the new inpatient tower in 2022. Going forward, management anticipates capex to be around 1x annual depreciation expense.

Financial Profile - aa

Financial Profile Anticipated to Improve

Fitch expects Salem to achieve an operating EBITDA margin near 8.5% in fiscal 2024 and then incrementally improve from there, which should allow for the organization's entire financial profile to gradually improve as well. Fitch views the Hospital's unrestricted liquidity position as consistent with the very strong 'aa' financial profile assessment. As of Jan. 31, 2024 (unaudited), Salem had approximately $948 million in unrestricted cash and investments, which equated to an approximate 307 days cash on hand and nearly 197% cash-to-adjusted, which is strong. Coupled with an expectation of manageable capital spending needs over the medium-term, leverage metrics through Fitch's forward-looking scenario analysis demonstrate incremental improvement.

Salem's net adjusted debt to adjusted EBITDA remained favorable at negative 2.4x through the fiscal 2024 interim period and through the scenario analysis is expected to be negative through 2028. Fitch believes Salem's strong financial profile assessment provides the Hospital with operating flexibility and supports rating stability over the Outlook horizon.

Through Fitch's base scenario, or Fitch's best estimate of the most likely scenario of financial performance over the next five years given the agency's expectations for current economic conditions and operational performance, Fitch expects that Salem will see meaningful improvement in key metrics after the period of observed lower margins in fiscal 2023. Fitch expects improvement to continue over the medium to long term, which should lead to balance sheet accretion.

Fitch's stress scenario assumes an economic stress to reflect potential revenue stress and equity volatility understanding that the organization is already in a period of operational stress. Despite the stress, Fitch's forward-looking analysis shows cash-to-adjusted debt around 230% in the out years of the five-year scenario analysis. The Hospital's portfolio stress is fairly moderate with a majority of the organization's investment allocation being weighted towards cash, cash equivalents, fixed income, and domestic equities.

Asymmetric Additional Risk Considerations

There are no asymmetric risk considerations associated with Salem's rating. Its debt and asset allocation are standard for the sector and are not an asymmetric risk. The hospital has no exposure to swap instruments with a debt profile made up of 100% fixed-rate debt.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--If operating EBITDA margins were to reverse course from recent positively trending performance and return to negative operating margins and low operating EBITDA margins, respectively, and thus not meeting budgeted expectations;

--Significant decline in unrestricted liquidity levels resulting in weakened cash-to-adjusted debt metrics approaching 120% or below;

--Although unexpected, any material increases in long-term leverage that is not met with commensurate revenue enhancements.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Exceptionally positive impacts to Salem's unrestricted liquidity position such that cash-to-adjusted debt exceeds 250% for a sustained period;

--Longer-term positive rating action would be contingent on Salem fully achieving and exceeding its plan to return operations to historical levels, which would reflect consistently posting double-digit operating EBITDA margins.

PROFILE

Salem Health includes Salem Hospital, a 561-staffed bed hospital located in Salem, OR, approximately 45 miles south of Portland, OR, as well as other healthcare-related entities. Salem is the only hospital located in Salem, OR and is known as one of the most advanced hospitals in the region. The obligated group accounts for a majority of total assets and revenues (over 90%) of the consolidated entity. Fitch's analysis is based on the consolidated entity. In fiscal 2023, Salem reported nearly $1.1 billion in total revenues.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub. 18 Nov 2020) (including rating assumption sensitivity)

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v2.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Salem Hospital Facility Authority (OR)	EU Endorsed, UK Endorsed

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