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Ascension Readies $1 Billion Refunding, Including Taxables

by: Yvette Shields

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CHICAGO — Ascension Health Alliance will make its first foray into the long-term taxable market this week when it sells $1 billion of refunding bonds in a mix of tax-exempt and taxable paper.

A large portion of the deal will refinance debt of the newly acquired Marian Health System Inc.

The nation's largest not-for-profit healthcare system on Wednesday will sell about $600 million of tax-exempt refunding bonds through the Wisconsin Health and Educational Facilities Authority. It will sell another $430 million of taxable debt on its own.

Morgan Stanley is the senior manager with JPMorgan, Wells Fargo Securities, and Citi serving as co-managers. Kaufman Hall is adviser. Orrick Herrington & Sutcliffe LLP is bond counsel.

Ahead of the sale, Fitch Ratings and Standard & Poor's affirmed Ascension's high-grade senior lien AA-plus ratings. Both assign a stable outlook. Moody's Investors Service downgraded $5.2 billion of rated debt one level. It rates senior bonds Aa2 and subordinated bonds Aa3.

The tax-exempt piece offers $100 million of fixed-rate paper and $500 million of variable-rate bonds using windows and put structures. The taxable piece offers longer maturing, fixed-rate paper.

Ascension has sold some taxable commercial paper in the past but the deal this week marks its first issuance of permanent, fixed-rate taxable bonds, said Ascension's director of capital finance, Steve Gilmore.

"The spread between taxable and tax-exempt is attractive so we feel there is some advantage to entering that market," Gilmore said of the decision. "It provides greater flexibility" in how the system uses proceeds, expands the universe of buyers holding Ascension bonds, and offers a "quicker and easier issuance process." It also eases work on compliance, Gilmore said.

About 80% of the transaction will refund Oklahoma-based Marian Health System debt, although some portions of that system's debt will remain outstanding.

St. Louis-based Ascension formally joined with the three separate regional hospital organizations that make up Marian on April 1. The other 20% will refund existing Ascension debt for savings.

Marian was the parent of three regional systems with 36 affiliated hospitals and 150 clinics. Its groups include Via Christi Health in Wichita, Kan.; Ministry Health Care, based in Milwaukee; and St. John Health System in Tulsa.

The nation has seen a wave of health care consolidation as hospitals grapple with capital needs and changes under national health care reform while seeking to remain competitive, although Ascension's series of acquisitions predates the latest trend.

The sale will refund portions of $305 million of Ministry's debt, $49 million of St. John's debt and all of Via Christie's $405 million of debt. After the transaction, St. John's will still have $400 million of debt outstanding and Ministry $388 million. "We are refunding what's economically feasible," Gilmore said. Some of remaining debt is structured with long call features making it less economical to refund now.

The system has no new-money borrowing plans.

The credit benefits from the leading or secondary market share enjoyed by a majority of Ascension's hospitals, geographic and cash flow diversity, a large and liquid investment portfolio, and a fully funded pension plan, Moody's said.

Moody's had previously assigned a negative outlook to Ascension and last month lowered the rating one level while assigning a stable outlook. The downgrade "reflects moderate operating margins over the last several years, which are likely to continue given the system's large investment and short-term risks related to a major enterprise resource project to centralize support services and provide a common information system for finance, supply chain and human resources," Moody's wrote.

Once the project — known as Symphony — is fully implemented, Ascension expects a significant reduction in costs and improved operating efficiencies which should better position it to deal with federal health care reforms. Gilmore said Symphony will result in $1.7 billion in savings over a 10-year implementation period which represents a $300 million profit over the $1.4 billion cost of the system.

Ascension benefits from $9.7 billion in unrestricted investments that could cover costs for 234 days. Ascension's moderate debt levels given its balance sheet resources drive strong debt coverage ratios of 7.4 times with a 29% debt to revenue ratio. Capital spending will rise in the coming years to about $1 billion annually, but Moody's called the level "manageable" relative to current cash flow.

A drop in its traditional operating cash flow margins to 7-8% in recent years from a traditional 9-10% range prior to fiscal 2010 poses a challenge to the credit. Industry-wide challenges and the costs of funding the Symphony project are straining margins. The system also faces some concentration risks. The Michigan market — struggling with high unemployment and a declining population — accounted for 21% of system revenues in fiscal 2012. It also faces competition in some markets from regional systems.

Ascension — a Catholic sponsored system — operates more than 70 acute-care hospitals and nine specialty hospitals operating in 20 states and the District of Columbia which generate $16 billion in annual operating revenues.