FitchRatings

FITCH AFFIRMS SOUTHERN ILLINOIS HEALTHCARE'S REVS AT 'A+'; OUTLOOK STABLE

Fitch Ratings-Chicago-11 December 2013: Fitch Ratings has affirmed the 'A+' rating on the following bonds issued by the Illinois Finance Authority on behalf of Southern Illinois Healthcare Enterprises, Inc. (SIHE).

--$69 million series 2005 revenue refunding bonds;
--$51.75 million series 2008 variable rate demand bonds.

The Rating Outlook is Stable.

SECURITY

Bond payments are secured by a pledge of the gross revenues of the obligated group.

KEY RATING DRIVERS

STRONG PROFITABILITY AND LOW DEBT BURDEN: Operating profitability has been consistently strong with operating margin averaging 3.9% since fiscal 2008. SIHE's strong profitability and low debt burden, with maximum annual debt service (MADS) equal to a light 2% of revenue in fiscal 2013, allow for strong MADS coverage by EBITDA of 8.3x.

ROBUST LIQUIDITY METRICS: Strong cash flows and moderate capital spending increased unrestricted liquidity by 48% since fiscal 2010 to $349.7 million at Sept. 30, 2013, equating to a very strong 39.0x cushion ratio and 265.5% cash to debt.

INCREASED CAPITAL SPENDING: Capital expenditures are expected to increase in fiscal years 2014 and 2015 primarily due to investments in renovating and expanding surgical suites and a new cancer center. The projects are expected to be funded by a debt issuance in early fiscal 2015 and cash flows, with no adverse impact to liquidity metrics.

LEADING MARKET SHARE: A stable leading primary service area market share of 50.6% in fiscal 2012 has supported consistent revenue generation and is approximately twice the share of its nearest competitor.

UNFAVORABLE PAYOR MIX: With Medicare and Medicaid accounting for a high 63% of gross revenues, SIHE remains vulnerable to potential state and federal budget cuts. Additionally, bad debt expense remains high at 8.4% of patient service revenue in fiscal 2013.

RATING SENSITIVITIES

MAINTENANCE OF CREDIT PROFILE: Fitch believes that SIHE has the capacity to absorb the additional debt expected to be issued in early fiscal 2015 at the current rating. However, Fitch expects that SIHE will maintain coverage metrics that are consistent with the 'A+' rating and that capital projects will not negatively impact unrestricted liquidity.

CREDIT PROFILE

SIHE is a three-hospital health system headquartered in Carbondale, IL, approximately 105 miles from St. Louis. Total revenues equaled $439.9 million in fiscal 2013. SIHE covenants to disclose both annual and quarterly financial statements through the Municipal Securities Rulemaking Board's EMMA system.

STRONG PROFITABILITY AND LOW DEBT BURDEN

Operating profitability has consistently exceeded the 'A' category medians, with operating margin averaging 3.9% since fiscal 2008 relative to Fitch's 'A' category median of 3.3%. Operating margin declined to 0.7% in fiscal 2012 primarily due to an unexpected drop in high acuity cardiology and neurology volumes. Volumes rebounded in fiscal 2013 and operating margin rebounded to 3.8% in fiscal 2013.

Consistently strong profitability and a low debt burden allow for strong debt service coverage. SIHE's debt burden is low with MADS equal to 2% of revenue in fiscal 2013, comparing favorably to Fitch's 'A' category median of 3.1%. MADS coverage by EBITDA is strong at 8.3x in fiscal 2012 and the interim period, easily exceeding Fitch's 'A' category median of 3.8x.

ROBUST LIQUIDITY METRICS

Unrestricted cash and investments increased 48% since fiscal 2010 to $349.7 million at Sept. 30, 2013. The liquidity growth reflects SIHE's strong cash flow generation and moderate capital spending. Liquidity metrics are strong across the board with 298.6 days cash on hand, 39.0x cushion ratio and 265.5% cash to debt, easily exceeding Fitch's 'A' category medians of 196.3 days, 15.6x and 129.2%. The strong liquidity provides significant cushion for payment of debt service.

INCREASED CAPITAL SPENDING

Capital spending is projected to increase to $59 million in fiscal 2014 and $101 million in fiscal 2015 after a period of more moderate capital spending, averaging $30 million since fiscal 2008. The increased capital spending includes strategic investments in renovated and expanded surgical suites, a new cancer center and a new energy center to insulate SIHE from adverse weather events such as tornados. SIHE broke ground on the new cancer center in fall 2013 with an expected completion date in fiscal 2015.

The projects are expected to be funded by a debt issuance in early fiscal 2015 with a maximum par amount of $80 million and cash flows from operations with no impact to SIHE's liquidity position. The expected bond issuance has not yet been board approved and is not incorporated into Fitch's credit analysis. Fitch will assess the impact of the additional debt on SIHE's credit profile as plans become more certain. However, Fitch believes that SIHE currently has the capacity to absorb the additional debt at the current rating level. Additionally, Fitch views the capital projects favorably as they should bolster SIHE's already strong competitive position and help to reduce outmigration.

The increased capital spending reflects strategic choices as opposed to capital requirements to maintain its existing facilities. Historic capital spending, averaging 130% of depreciation expense, has sustained a low average age of plant of 8.8 years at Sept. 30, 2013 relative to Fitch's 'A' category median of 10.3 years.

LEADING MARKET SHARE

SIHE's stable leading primary service area market share, equal to 50.6% in fiscal 2012, is approximately twice the share of its nearest competitor and has supported consistent revenue generation. The limited competition is a primary credit strength. However, the service area is characterized by high levels of outmigration to St. Louis area hospitals. Management is taking steps to decrease outmigration, including the recruitment of additional specialists in oncology, cardiology, orthopedics and surgical specialties; construction of the new cancer center and renovated surgical suites; and SIHE's participation in the BJC Collaborative.

The BJC Collaborative, founded in 2012 by BJC HealthCare in St. Louis, is a partnership amongst six health care systems located in Illinois, Missouri and Eastern Kansas. The collaboration allows members to remain independent while achieving cost savings, sharing clinical data, developing clinical protocols and improving access to high acuity services through BJC's flagship Barnes Jewish Hospital in St. Louis.

UNFAVORABLE PAYOR MIX

Credit concerns include a challenging payor mix and relatively high bad debt levels. Medicare and Medicaid account for over 60% of gross revenues, leaving the system vulnerable to potential federal and state budget cuts. Additionally, SIHE received roughly $18 million in supplemental government funding in fiscal 2013, or 4% of total operating revenue. Bad debt as a percent of revenue remains high in fiscal 2013 at 8.4%, but did decrease from 9.1% in fiscal 2012.

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Applicable Criteria and Related Research:
--'Nonprofit Hospitals and Health Systems Rating Criteria', dated May 30, 2013.

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U.S. Nonprofit Hospitals and Health Systems Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=708361