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# Hardin County, Kentucky Hardin Memorial Hospital; Hospital

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| Hardin Cnty (Hardin Memorial Hospital) hosp (AGM) | | |
| *Unenhanced Rating* | A-(SPUR)/Stable | Affirmed |

Many issues are enhanced by bond insurance.

## Rationale

S&P Global Ratings affirmed its 'A-' underlying rating (SPUR) on Hardin County, Ky.'s series 2013 revenue bonds, issued for Hardin Memorial Hospital (HMH). The outlook is stable.

We recognize that HMH's financial performance is deteriorating. However, a definitive agreement that HMH will be sold to Baptist Healthcare System of Kentucky (Baptist) is in place, and if the acquisition occurs, the rating can be maintained because Hardin's very light debt load supports the hospital's ability to repay debt despite weaker performance and low unrestricted reserves. If the sale is delayed or HMH's financial performance deteriorates further, we could lower the rating or the revise the outlook to negative at our next review.

On May 22, 2018, HMH and Baptist entered into an asset purchase agreement with a closing date of Dec. 1, 2018. Since then, the sale has been delayed pending the decision of a lawsuit filed by a former member of the HMH medical staff that alleges that the county's sale of the hospital to Baptist was not legal because the county did not follow state statutes and because the sale was not negotiated with enough time for public commentary. Originally filed in Hardin County and later appealed, the lawsuit currently sits with the state court of appeals awaiting judgement. Regardless of the outcome of the case, HMH management expects the sale to be completed, though the timing will be greatly delayed if the former employee wins the case, as it is expected that he will merely require HMH and the county to go through the sale process again.

The rating and outlook reflect our expectation that HMH's sale to Baptist (unrated by S&P Global Ratings) will mitigate HMH's long-term capital needs and underfunded pension liabilities, generate beneficial operating synergies at HMH, and limit disruption in service at HMH, as HMH has had a management agreement with Baptist for several years; separately, HMH would retain its dominant market share and continues to generate healthy debt service coverage.

On April 5, 2019, HMH found a virus on its computer systems. HMH called in extra employees and switched to manual documentation protocols, which management notes did not affect patients. Overall, key systems were down for approximately 22 hours, and management expects to be able to recover all data from backups and manual entry. The bulk of extra costs incurred as a result of the attack are employee overtime and computer replacements for those affected by the attack. However, management expects all of these costs to be recouped by multiple insurance policies, which have nominal deductibles.

Operating performance remains relatively weak compared to historical margins, although operations remain positive and have rebounded from a very weak fiscal 2017. Management expects operations to improve through the remainder of the year as expense-savings initiatives are enacted and one-time costs associated with the merger abate. While the timing of the acquisition is unknown at this point, we expect management will continue to ramp up newly hired physicians and continue to meet community needs with additional care access points.

The SPUR incorporates our view of the hospital's:

- Dominant market share that supports a strong enterprise profile,
- Extremely solid maximum annual debt service (MADS) coverage, and
- Low debt burden and low debt to capitalization.

Partially offsetting these strengths, in our view, are HMH's:

- Small, slower-growing economic base with lower incomes relative to national averages, and
- Days' cash on hand that is much lower than rating medians.

The 'A-' SPUR also reflects our view of the HMH's group credit profile (GCP) and the obligated group's "core" status. Accordingly, the SPUR is the same as the GCP. The 'AA' issue rating is based on insurance provided by Assured Guaranty Municipal Corp.

## Outlook

The stable outlook reflects our view that HMH will maintain its dominant market position. Even as margins have showed softness in the last couple of years, HMH continues to generate strong MADS coverage. We also believe the pending acquisition will provide long-term stability to HMH, once completed.

### Downside scenario

We could lower the rating if the sale is delayed outside of our outlook period and operating margins fail to improve substantially, lease-adjusted MADS coverage falls below 3x, or cash on hand does not improve, especially in light of ample capital needs and a large pension liability.

### Upside scenario

We are unlikely to raise the rating in the next two years given our view that the hospital's enterprise profile is unlikely to change in this time frame and our opinion that the hospital's balance sheet remains a limiting factor on the financial profile. Upon completion of the sale to Baptist, we will evaluate the system's impact on the HMH rating.

## Enterprise Profile - Adequate

The enterprise profile is characterized by a limited service area population and HMH's difficulty in recruiting physicians to meet the growing community demand. This is partly offset by a dominant market share, with very strong growth in utilization statistics since 2016 and a strong outpatient presence. HMH's payer mix has moderated slightly in the past few years with an uptick in Tricare, the military insurance plan, as a result of the closure of the hospital at Fort Knox.

### Market position

Hardin Memorial is in Elizabethtown, approximately 40 miles south of Louisville. Its dominant 62% share of the primary service area is a credit strength that we view as indicative of the hospital's essentiality to the market. However, the hospital competes with Louisville health care providers for nurses and other staff, which we believe puts some pressure on salary expense.

Hardin Memorial has taken steps to maintain its competitiveness in the market, adding more than 40 physicians to its staff over the past three years. It will also upgrade the facility to handle increasing volumes. A 14,000-square-foot expansion of the emergency department (ED) was completed in January 2018, which doubled the size of the original ED. The original ED was designed to see 40,000 patients per year, and HMH expects to see more than 72,000 patients in the ED in fiscal 2019.

### Computer virus has minimal impact

In the April 2019 virus infection, key HMH systems were down for approximately 22 hours and approximately 20 computers were corrupted. Because HMH had reworked its IT systems with firewalls and backups a few years earlier to meet industry standards, the virus was minimally invasive and backups were able to be used to restore the systems to pre-virus conditions. While there will be manual work to enter patient and billing data from while the systems were down, HMH expects minimal time to get back to normal. Based on initial management estimates, most of the cost of the attack will be for replacement computers and employee overtime as IT workers restored the systems and additional staff was called in to keep manual patient records so as not to disrupt patient care. HMH has both cyber-attack insurance and business interruption insurance, which are expected to cover the totality of the attack. Because the disruption to volumes is nonexistent and the additional costs will be covered with nominal insurance deductibles, we don't expect the attack to have a lasting effect on HMH's operations, and expect little to no impact on the hospital's financial health.

### Acquisition by Baptist Health pending lawsuit

HMH signed an asset purchase agreement with Baptist Health in May 2018, with the original closing to occur in December 2018. A lawsuit filed by a former member of the HMH medical staff is currently holding up the sale and, once resolved, will determine the new closing date. HMH management is waiting for the opinion of the judges of the state court of appeals, but is uncertain of when a decision could occur. If the judge rules in favor of HMH, the sale can commence rather quickly after the decision. If the ruling is in favor of the former medical staff member, the sale will likely be delayed for several months, as HMH management understands that the doctor doesn't intend to ultimately block the sale of the hospital.

The terms of the sale include an initial payment to Hardin County of approximately $60 million, less the amount needed to fully fund the pension plan (about $30 million-$35 million) as well as $66.4 million over 25 years. Baptist will also assume all of HMH's outstanding debt and has committed $250 million in capital investments over the next 10 years ($150 million in the first four years). Since the CEO, chief financial officer, and chief operating officer are currently employees of Baptist health under the management agreement, there are no expected changes in senior leadership postacquisition. However, because the board is currently composed of county-appointed leaders, it will be appointed by Baptist from the greater community, but three current board members will remain after the sale is complete.

Management continues to focus on ramping up newly recruited physicians, recruiting physicians to fulfill community needs and fill service gaps, and implementing expense-saving initiatives to counter softening operations. We view positively that the management team is expected to remain stable, as this will alleviate additional transition risk during the acquisition.

**Table 1**

| Hardin Memorial Hospital, Kentucky Enterprise Statistics | | | | |
|---|---|---|---|---|
| | --Eight months ended Feb. 28-- | --Fiscal year ended June 30-- | | |
| | 2019 | 2018 | 2017 | 2016 |
| PSA population | N.A. | 150,465 | 148,338 | 160,439 |
| PSA market share (%) | N.A. | 65.2 | 61.8 | 63.5 |
| Inpatient admissions | 8,892 | 13,450 | 13,128 | 11,684 |
| Equivalent inpatient admissions | 31,757 | 48,035 | 44,841 | 38,674 |
| Emergency visits | 48,248 | 70,823 | 70,124 | 67,144 |
| Inpatient surgeries | 1,626 | 2,317 | 2,346 | 2,339 |
| Outpatient surgeries | 8,543 | 13,049 | 12,538 | 12,003 |
| Medicare case mix index | 1.6500 | 1.6000 | 1.5200 | 1.5600 |
| FTE employees | 2,354 | 2,270 | 2,156 | 1,918 |
| Active physicians | 222 | 222 | 213 | 207 |
| Based on net/gross revenues | Net | Net | Net | Net |
| Medicare (%) | 37.4 | 37.7 | 37.0 | 36.2 |
| Medicaid (%) | 11.7 | 13.7 | 14.0 | 14.3 |
| Commercial/Blues (%) | 40.9 | 40.0 | 47.0 | 46.0 |

N.A.--Not available. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions.

## Financial Profile – Strong

HMH's financial profile is characterized by healthy MADS coverage (though lease-adjusted MADS is less robust), a very low debt burden, and long-term debt to capitalization offset by uneven operating performance the past couple years, declining unrestricted reserves, and a high average age of plant.

### Financial performance

Following a negative operating performance in 2017, operations have rebounded slightly, but remain lower than historical averages after heavy locum use in 2018 with the opening of the expanded ED, and a number of one-time costs related to the Baptist acquisition. Although we expected HMH to end 2018 with a higher operating margin, acquisition costs were higher than budget, with approximately $1.7 million in expenses incurred in 2018. Because of the pending lawsuit, costs have jumped, with approximately $2.4 million in extra expenses incurred in 2019. In 2018, following the opening of the new ED, locum expenses surged to 2.5 million, but have lessened in 2019, with about $1.3

million in locum nursing expenses. HMH is working to create better recruiting pipelines for nursing and focusing on retention, which management attributes to lower use of locum nurses in the interim period. Management is also working to implement expense savings initiatives like workforce optimization and supply chain efficiencies, and estimates that total annual savings could amount to about $3 million once all identified savings have been enacted.

## Debt and contingent liabilities

Long-term debt includes $38.9 million of hospital refunding revenue bonds, series 2013, and less than $1 million of capital leases. The hospital's debt burden and debt-to-capitalization are very low, in our view, at about 0.76% and 19.4%, respectively. Hardin Memorial has no contingent liabilities, but its defined-benefit pension plan was only 71% funded at June 30, 2018. In anticipation of the sale to Baptist, the plan was frozen to additional benefit accruals in May 2018. At the time of the completion of the sale, funds transferred to the county will be used to fully fund and liquidate the plan, which is estimated to be between $30 million and $35 million.

**Table 2**

**Hardin Memorial Hospital, Kentucky Financial Statistics**

| | --Eight months ended Feb. 28-- | --Fiscal year ended June 30-- | | | Medians for 'A-' rated stand-alone hospital | Medians for 'BBB+' rated stand-alone hospital |
|---|---|---|---|---|---|---|
| | 2019 | 2018 | 2017 | 2016 | 2017 | 2017 |
| **Financial performance** | | | | | | |
| Net patient revenue ($000s) | 250,401 | 353,902 | 316,723 | 287,428 | 321,979 | 215,372 |
| Total operating revenue ($000s) | 254,195 | 356,017 | 318,973 | 290,506 | MNR | MNR |
| Total operating expenses ($000s) | 252,158 | 352,050 | 319,516 | 276,124 | MNR | MNR |
| Operating income ($000s) | 2,037 | 3,967 | (543) | 14,382 | MNR | MNR |
| Operating margin (%) | 0.80 | 1.11 | (0.17) | 4.95 | 2.00 | (1.30) |
| Net nonoperating income ($000s) | 2,305 | 3,807 | 2,203 | 983 | MNR | MNR |
| Excess income ($000s) | 4,342 | 7,774 | 1,660 | 15,365 | MNR | MNR |
| Excess margin (%) | 1.69 | 2.16 | 0.52 | 5.27 | 4.10 | 0.70 |
| Operating EBIDA margin (%) | 4.87 | 5.00 | 3.86 | 9.39 | 8.70 | 6.20 |
| EBIDA margin (%) | 5.72 | 6.00 | 4.52 | 9.70 | 10.50 | 8.10 |
| Net available for debt service ($000s) | 14,684 | 21,594 | 14,512 | 28,271 | 38,756 | 22,047 |
| Maximum annual debt service ($000s) | 2,743 | 2,743 | 2,743 | 2,743 | MNR | MNR |
| Maximum annual debt service coverage (x) | 8.03 | 7.87 | 5.29 | 10.31 | 3.90 | 2.50 |
| Operating lease-adjusted coverage (x) | 2.89 | 3.10 | 2.50 | 5.27 | 3.30 | 2.20 |
| **Liquidity and financial flexibility** | | | | | | |
| Unrestricted reserves ($000s) | 77,461 | 81,025 | 84,970 | 85,552 | 187,103 | 146,386 |
| Unrestricted days' cash on hand | 77.5 | 86.9 | 100.7 | 118.0 | 233.10 | 198.40 |
| Unrestricted reserves/total long-term debt (%) | 206.6 | 211.9 | 217.7 | 219.2 | 165.40 | 154.90 |
| Unrestricted reserves/contingent liabilities (%) | N/A | N/A | N/A | N/A | 443.40 | 332.20 |
| Average age of plant (years) | 18.9 | 20.7 | 20.5 | 19.5 | 12.40 | 12.70 |

**Table 2**

**Hardin Memorial Hospital, Kentucky Financial Statistics (cont.)**

| | --Eight months ended Feb. 28-- | --Fiscal year ended June 30-- | | | Medians for 'A-' rated stand-alone hospital | Medians for 'BBB+' rated stand-alone hospital |
|---|---|---|---|---|---|---|
| | 2019 | 2018 | 2017 | 2016 | 2017 | 2017 |
| Capital expenditures/depreciation and amortization (%) | 128.5 | 161.9 | 159.2 | 95.5 | 108.30 | 113.40 |
| **Debt and liabilities** | | | | | | |
| Total long-term debt ($000s) | 37,496 | 38,237 | 39,032 | 39,034 | MNR | MNR |
| Long-term debt/capitalization (%) | 18.4 | 19.4 | 19.8 | 19.6 | 32.40 | 28.60 |
| Contingent liabilities ($000s) | 0 | 0 | 0 | 0 | MNR | MNR |
| Contingent liabilities/total long-term debt (%) | 0.0 | 0.0 | 0.0 | 0.0 | 34.80 | 44.60 |
| Debt burden (%) | 0.71 | 0.76 | 0.85 | 0.94 | 2.60 | 3.30 |
| Defined-benefit plan funded status (%) | N.A. | 70.59 | 64.20 | 64.24 | 83.80 | 83.70 |

N/A--Not applicable. N.A.--Not available. MNR--Median not reported.

## Credit Snapshot

- Security: A revenue pledge secures the bonds.
- Group rating methodology: Core
- Organization description: Hardin Memorial operates a 270-bed acute-care hospital in Elizabethtown in central Kentucky. It also has 30 psychiatric and skilled-nursing beds and more than 45 outpatient facilities in its service area.