Healthcare
New Issue

Rex Healthcare, Inc.

North Carolina Medical Care Commission

Ratings

New Issue

$166,000,000 Health Care Facilities Revenue and Revenue Refunding Bonds (Rex Healthcare), Series 2010	A+

Outstanding Debt

$74,415,000 Hospital Revenue Bonds, Series 1998	A+

Rating Outlook

Stable

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New Issue Details

Sale Information: Health Care Facilities Revenue and Revenue Refunding Bonds (Rex Healthcare), Series 2010, expected to sell the week of Oct. 4, via negotiation.
Security: Pledge of gross receipts and assets.
Purpose: To refinance existing debt, fund various capital expenditures, and pay costs of issuance.

Related Research

For information on Build America Bonds, visit www.fitchratings.com/BABs.

Applicable Criteria
- *Nonprofit Hospitals and Health Systems Rating Criteria, Dec. 29, 2009*
- *Revenue-Supported Rating Criteria Aug. 16, 2010*

Other Research
- *Fitch Rates Rex Healthcare's 2010 Revs 'A+' and Affirms Outstanding Debt, Outlook Stable, Aug. 10, 2010*

Rating Rationale

- Rex Healthcare, Inc. (Rex) benefits from a strong relationship with the University of North Carolina Health Care System (UNCHCS, not rated by Fitch Ratings). UNCHCS is the sole member of Rex and, as such, appoints a majority of Rex's board, assists in the negotiation of managed care contracts, and approves operating and capital plans.
- In fiscal 2010 (unaudited), Rex earned approximately $35 million from operations and generated an operating margin of 5.9%, the highest in its history. Operating EBITDA improved to $66 million, or 11.1% in operating EBITDA margin, in fiscal 2010, an increase from $49.7 million, or 9.2% in operating EBITDA margin, in fiscal 2009. Both metrics compare favorably against Fitch's 2010 'A' category medians of 3% and 10%, respectively.
- Growing utilization trends reflect the strong growth and demographic profile of Rex's primary service area (PSA) of Wake County, NC, which is one of the fastest growing counties in the state. Fitch views Rex's service area positively, as it has relatively low unemployment and higher wealth and education levels per capita compared to state and national averages.
- Rex's service area is highly competitive, with primary competitors being WakeMed (revenue bonds rated 'AA–' by Fitch) and Duke University Health System (DUHS, revenue bonds rated 'AA' by Fitch). Within Wake County, Rex's market share of inpatient admissions in calendar year 2009 was 31.7%, compared to 45.2% for WakeMed and 9.5% for DUHS. However, based on the most recent data available (first quarter of calendar year 2009), Rex held the leading market share in outpatient surgeries with 34.7%, compared to WakeMed at 24.9% and DUHS at 22.9%.
- Rex's multipronged approach to physician alignment, including employment, joint venturing, and the use of independent contracts, provides credit stability. Additionally, the Triangle Physician Network (TPN), which formed in 2009 between UNCHCS and Rex, has helped volume growth.
- The 'A+' rating takes into account an additional expected borrowing of $15 million in fiscal 2011 for the continued expansion and renovation of the North Carolina Cancer Hospital at Rex. After the issuance, the organization's leverage metrics will be consistent with rating category medians, with an operating EBITDA debt service coverage of 3.9x and MADS as a percentage of revenue of 2.9% in fiscal 2010.

Key Rating Drivers

- Delivery of capital projects on time and on budget.
- Maintenance of historical profitability and balance sheet indicators.

Credit Summary

Rex operates a 431 licensed-bed acute care tertiary hospital and two nursing care facilities that have a total of 227 beds. Rex is a controlled affiliate of UNCHCS, which operates a 799-bed academic medical center located in Chapel Hill, NC. In fiscal 2010, Rex had total revenues of approximately $594 million. All of Rex's outstanding debt is fixed rate, with no outstanding interest-rate swaps.

Rating History

Rating	Action	Outlook/ Watch	Date
A+	Affirmed	Stable	8/10/10
A+	Affirmed	Stable	4/24/09
A+	Affirmed	Stable	10/20/06
A+	Affirmed	Stable	2/20/04
A+	Affirmed	Stable	12/19/00
A+	Assigned	Stable	4/16/98

The 'A+' rating reflects Rex's strong relationship with UNCHCS, improved operating profitability, strong utilization trends, good service area characteristics, and adequate leverage-related indicators. Credit concerns include Rex's competitive marketplace with DUHS and WakeMed and light liquidity indicators relative to Fitch's 'A' category medians.

The primary credit strength continues to be Rex's status as a controlled affiliate of UNCHCS, which is owned by the state of North Carolina. Since the merger between the two organizations in 2000, Rex continues to operate as a not-for-profit entity and retains its separate identity. Additionally, Rex remains independently obligated for its debt. The most significant benefit of the affiliation has been UNCHCS' negotiation of Rex's managed care contract and improved supply chain management through joint purchasing, which Fitch views favorably.

Rex's financial profile is characterized by solid operating profitability, good pro forma leverage indicators, and a light balance sheet for the rating category. Since fiscal 2006, Rex has averaged a 3.3% operating margin and 9.2% operating EBITDA margin. In fiscal 2010 (unaudited), Rex posted 5.9% and 11.1% margins, respectively, which are the strongest in Rex's history. Management attributes the profit gains to increased volume, various expense controls and reductions, and revenue cycle enhancements. Increased profitability contributed to balance sheet growth, as Rex's unrestricted cash position improved to $186.6 million in fiscal 2010 from $143.9 million in fiscal 2009. However, days cash on hand of 133.7, a pro forma cushion ratio of 10.9x, and cash to pro forma debt of 92.3% are light compared to Fitch's 'A' category medians of 183.8 days, 14.4x, and 105.5%, respectively.

The Wake County service area is very competitive. DUHS operates the 186 licensed-bed Duke Raleigh Hospital, while WakeMed has two inpatient facilities, the 515 licensed-bed WakeMed-Raleigh, and the 114 licensed-bed WakeMed-Cary. Within Wake County, Rex's market share of inpatient admissions in calendar 2009 was 31.7%, compared to 45.2% for WakeMed and 9.5% for DUHS. However, based on the most recent data available (first quarter of calendar year 2009), Rex held the leading market share in outpatient surgeries of 34.7% compared to WakeMed at 24.9% and DUHS at 22.9%.

The Stable Rating Outlook reflects Fitch's expectation that Rex will maintain historical operating profitability. Liquidity indicators may remain light as Rex expands its outpatient network and executes its physician alignment strategy. Fitch assumes that Rex's audited results for fiscal 2010 will not be materially different than the unaudited numbers used in the rating analysis.

Disclosure

Rex covenants to submit annual and quarterly financial and utilization information to the MSRB's EMMA system. Management was candid and timely in its responses to Fitch during the credit review process.

Governance and Management

UNCHCS is the sole member of Rex and appoints all 13 members of Rex's board of trustees (the board). However, Rex designates five members, while UNCHCS designates the remaining eight individuals. Members serve four-year terms and may not serve more than three successive terms. Rex Hospital (the hospital) is governed by a board of directors that ranges in size from nine to 13 members. Currently, both boards consist of the same members.

Rex is led by its CEO who joined in 2004. Prior to joining Rex, he was the COO of Mercy Health Center in Oklahoma City and currently sits on several boards in the Raleigh-Durham area. The CFO has been in her current role since 2005 and was controller for the four years prior. She has more than 20 years of healthcare experience, directs all financial operations, and guides strategic planning at Rex.

Fitch analysts had an opportunity to meet with senior members of the board and management team and views them favorably.

Operating Profile

Rex offers a vast array of the healthcare services to the Raleigh-Durham, NC area and surrounding counties through a network of operating affiliates: the hospital; Rex Enterprises Company (REC), Inc.; The Rex Healthcare Foundation (the foundation); and Rex Holdings, LLC (RH). Rex is a member of UNCHCS, but Rex is not a member of UNCHCS' obligated group. The sole obligors of Rex's series 2010 bonds are Rex Healthcare, Inc. and the hospital.

Non-obligated members include the foundation, REC, and RH. The foundation's primary purpose is to support Rex and its affiliates, REC is a for-profit corporation that engages in commercial transactions, and RH provides medical services through affiliations, joint ventures, and independent physician practices. Furthermore, RH is the sole member of Rex Physicians, LLC (RP), which was established in 2009 to employ physicians of specialty practices. Overall, Rex's obligated members consisted of 96% and 98% of total revenues and assets in fiscal 2009, respectively.

Rex has been a member of UNCHCS since 2000 and benefits from various cost-saving measures through consolidation of services and economies of scale. Additionally, UNCHCS negotiates payor contracts for Rex, which benefits the organization most typically through better reimbursement rates. In addition, Rex and UNCHCS partner in several clinical areas, including oncology, surgery, obstetrics, and nursing. UNCHCS also reviews and approves Rex's annual operating and capital budgets. Fitch views the relationship between Rex and UNCHCS as a primary credit strength.

Rex's main campus is located in west Raleigh, NC on a 62-acre site. The campus consists of a 431 licensed-bed acute care hospital, the 120-bed Rex Rehabilitation and Nursing Center of Raleigh, and the Rex Cancer Center. Additionally, Rex operates the following centers that provide specialty services: heart and vascular; surgery; women's services; breast care center; senior health; wound care; sleep disorders; pain clinic; wellness centers; and occupational health.

Medical and Nursing Staff

As of July 30, 2010, Rex's medical staff consisted of 1,090 physicians, with approximately 94% being board certified. Rex has a 28-member hospitalist group whose primary responsibility is to care for the hospital's inpatients. Management noted that the hospitalist program, which dates back to 1998, helped support improvement for both employee and patient satisfaction scores in 2009.

In 2009, UNCHCS and Rex formed a primary care physician network, TPN, that will employ practices throughout Wake, Orange, and other counties. Fitch views this relationship favorably because it will enhance Rex's physician growth strategy throughout the market.

In 2006, Rex became the first hospital in the Triangle area to gain nursing Magnet recognition and thus has an excellent relationship with its nursing staff, which Fitch views favorably. In 2009, Rex's nursing turnover and vacancy rates were 10.3% and 5.9%, which compare favorably against national averages of 11.2% and 6.8%, respectively.

Service Area

Rex's service area consists of a four-county area including Wake, Harnett, Franklin, and Johnston counties. Approximately 81.3% of Rex's patients come from Wake County and

Johnston County makes up the second largest percentage of patients, with 4.6% in 2009. According to the North Carolina Office of State Budget and Management, Wake County is the fastest growing county in North Carolina, which Fitch views as a positive characteristic. Furthermore, Wake County's population is expected to grow by more than 30% between 2010 and 2020 by an estimated 275,000 people.

Fitch views favorably the service area's socioeconomic indicators and the PSA's 7.7% unemployment rate, which was less than both state and national averages as of May 2010. Additionally, average household income and education levels compare favorably against local and national averages.

Strategy

Management has identified five key areas where it believes Rex has strategic advantages over its competitors in Wake County: physician loyalty; ease of use; quality; technology; and economics. Rex's strategic plan is a multiyear approach developed with input from physicians, key staff, and reviewed by the board. The goals of Rex's strategic plan are to identify best opportunities to grow market share; leverage its competitive advantages; work in cooperation with UNCHCS; maintain quality and financial performance; and reinforce partnerships with physicians, staff, patients, and the broader community.

Education and Research

Rex has more than 60 agreements with health professional training programs throughout the southeastern U.S. In addition to being a member of UNCHCS, Rex has relationships with Duke University, East Carolina University, North Carolina State University, and other institutions of higher education in the area.

Utilization Data

(Fiscal Years Ended June 30)

	2005	2006	2007	2008	2009	2010[a]
Licensed Beds	394	394	394	423	431	431
Operated Beds	394	394	394	423	431	431
Acute Discharges/Admissions Excluding Newborn Births	27,287	25,618	27,324	28,118	27,396	27,645
Acute Patient Days Excluding Newborn Days	95,482	93,832	95,873	99,254	105,146	102,199
Average Length of Stay (Days)	3.5	3.7	3.5	3.5	3.8	3.7
Average Daily Census	262	257	263	272	288	280
Occupancy (%)	66	65	67	64	67	65
Normal Newborn Births	5,201	5,571	6,085	6,757	6,791	6,308
Outpatient Surgeries	21,826	23,701	25,032	26,477	N.A.	20,074
Net Emergency Room Visits[b]	41,279	54,612	57,414	57,811	55,608	55,690
Clinic Visits	146,890	N.A.	133,086	139,800	211,155	237,157
Full-Time Equivalents	2,996	3,112	3,310	3,479	3,688	3,805
Medicare Casemix Index	1.6	1.6	1.5	1.5	1.6	1.6

[a]Unaudited. N.A. – Not Available. [b]Excluding emergency room admissions. N.A. – Not applicable.

Utilization and Payor Mix

Rex's utilization trends are positive as increased capacity is driving increases in surgical volume. In fiscal 2010, surgeries rose to 36,760 from 36,272 in 2009. Additionally, the number of cardiac procedures and primary care office visits continue to increase as well. In fiscal 2011, management is budgeting for 66,168 visits, an increase of 18% over fiscal 2008's 40,667 visits.

Payor Mix

(% of Gross Revenues, Fiscal Years Ended June 30)

	2005	2006	2007	2008	2009	2010[a]
Medicare	40.4	40.4	40.3	39.0	38.4	40.2
Medicaid	3.6	3.6	4.1	4.3	3.7	4.8
Blue Cross	19.0	20.2	24.8	29.1	34.9	32.2
Commercial	8.5	8.5	4.6	2.4	0.0	0.0
Managed Care	24.1	22.3	21.1	20.1	20.0	19.5
Self-Pay	2.5	3.0	3.6	3.4	3.4	3.3
Other	1.9	1.8	1.5	1.7	0.0	0.0
Total	**100.0**	**99.8**	**100.0**	**100.0**	**100.4**	**100.0**

[a]Unaudited. Note: Numbers may not add to 100% due to rounding.

Rex's payor mix is characterized by a relatively low governmental payor base, with Medicare and Medicaid comprising approximately 40.2% and 4.8% of gross revenues, respectively, in fiscal 2010. The remainder of Rex's mix consists of insured or self-paying patients, which Fitch views favorably.

Debt Profile

New Issue Details

Series 2010 bonds will be used to refinance the series 1998 bonds, which lowered MADS on the series 1998 bonds by approximately $2 million; fund the relocation of Rex's central energy plant; fund approximately $76 million of various capital expenditures; and pay the costs of issuance. The rating takes into account an expected new issuance of $15 million of new debt for the renovation and expansion of Rex's Cancer Hospital. The 2010 MADS is $12.9 million, and total MADS after 2011 will increase to $17.1 million according to Rex's financial advisors.

Financial Profile

Rex's financial profile is characterized by solid operating profitability, good pro forma leverage indicators, and a light balance sheet for the rating category. Since fiscal 2006, Rex has averaged a 3.3% operating margin and a 9.2% operating EBITDA margin. In fiscal 2010 (unaudited), Rex posted 5.9% and 11.1% margins, respectively, which is the most profitable year in its history. Management attributes the profit gains to increased volume, various expense controls and reductions, and revenue cycle enhancements.

Increased profitability has helped support balance sheet growth, as Rex has approximately $186.6 million of unrestricted cash in fiscal 2010, which amounts to 133.7 days cash on hand, a pro forma cushion ratio of 10.9x, and a cash to pro forma debt of 92.3%. Fitch notes Rex's very low days in accounts receivable of 37.2 days in fiscal 2010, which has also help bolster cash growth. Overall, Rex's liquidity metrics are light, with days cash on hand being below Fitch's 'A' medians of 183.8 days, 14.4x, and 105.5%.

Rex's future capital plans include the renovation and expansion of the Cancer Hospital, which is expected to be funded through a combination of future debt and cash flow; a new heart and vascular services center; same-day surgery center renovation, and a new front entrance to the main campus.

Financial Summary

($000, Audited Fiscal Years Ended June 30)

	2005	2006	2007	2008	2009	2010[a]
Balance Sheet Data						
Unrestricted Cash	126,674	150,404	164,850	154,177	143,908	186,556
Restricted Cash	2,203	3,152	3,159	3,695	3,707	3,512
Trustee-Held Cash	818	818	818	818	818	770
Net Patient Accounts Receivable	61,789	63,152	62,189	61,721	53,642	58,633
Gross Property, Plant, and Equipment (PP&E)	412,560	452,171	471,900	501,492	544,588	556,922
Accumulated Depreciation	236,125	255,867	259,298	280,704	304,200	329,872
Net PP&E	176,435	196,304	212,602	220,788	240,388	227,050
Total Assets	391,068	438,585	468,563	472,639	473,740	510,389
Current Liabilities	44,593	55,633	65,741	74,465	89,018	95,303
Due to Third-Party Payors	6,963	3,791	3,720	2,924	9,490	15,757
Long-Term Debt	97,254	113,066	101,162	89,367	86,711	67,601
Unrestricted Net Assets	171,818	194,306	198,504	184,620	152,340	292,268
Income and Cash Flow Data						
Net Patient Revenue	348,039	389,740	423,157	470,031	522,434	575,938
Other Revenue	15,315	16,561	16,959	16,086	18,084	18,366
Total Revenue	363,354	406,301	440,116	486,117	540,518	594,304
Salaries, Wages, Fees, and Benefits	175,210	197,240	214,823	238,124	259,493	338,250
Depreciation and Amortization	22,821	20,712	21,170	22,976	24,344	26,600
Interest Expense	5,363	4,940	5,704	5,390	4,873	4,426
Provision for Bad Debts	11,513	11,675	13,426	16,656	27,392	23,304
Total Expenses	356,901	393,431	426,667	472,059	520,049	559,355
Income from Operations	6,453	12,870	13,449	14,058	20,469	34,949
Operating EBITDA	34,637	38,522	40,323	42,424	49,686	65,975
Non-Operating Gains/(Losses)	7,645	7,993	17,889	4,601	(12,374)	1,641
Excess Income	14,098	20,863	31,338	18,659	8,095	36,590
Total Investment Income	8,624	9,303	19,900	6,217	(9,456)	15,248
Net Unrealized Gains/(Losses)	4,833	1,994	12,534	(11,742)	(18,628)	11,492
Cash Flow from Operations	36,972	35,177	42,934	43,193	65,231	67,639
Net PP&E Acquisitions	26,038	35,016	29,232	28,873	34,792	12,865
EBITDA	42,282	46,515	58,212	47,025	37,312	67,616
CFFOBI	42,335	40,117	48,638	48,583	70,104	72,065
Free Cash Flow	10,934	161	13,702	14,320	30,439	54,774
Maximum Annual Debt Service (MADS)	17,104	17,104	17,104	17,104	17,104	17,104
Liquidity Ratios						
Days Cash on Hand	143.3	152.1	153.5	130.1	112.2	133.7
Days in Accounts Receivable	64.8	59.1	53.6	47.9	37.5	37.2
Days in Current Liabilities	50.5	56.2	61.2	62.9	69.4	68.3
Cushion Ratio (x)	7.4	8.8	9.6	9.0	8.4	10.9
Cash to Debt (%)	130.3	133.0	163.0	172.5	166.0	276.0
Profitability and Operational Ratios (%)						
Operating Margin	1.8	3.2	3.1	2.9	3.8	5.9
Operating EBITDA Margin	9.5	9.5	9.2	8.7	9.2	11.1
Excess Margin	3.8	5.0	6.8	3.8	1.5	6.1
EBITDA Margin	11.4	11.2	12.7	9.6	7.1	11.3
Cash Flow Margin	10.0	8.5	9.4	8.8	12.4	11.3
Investment Income as % of Excess Income	61.2	44.6	63.5	33.3	(116.8)	41.7
Personnel Cost as % of Revenues	48.2	48.5	48.8	49.0	48.0	56.9
Bad Debt Expense as % of Revenues	3.2	2.9	3.1	3.4	5.1	3.9

[a]Unaudited. EBITDA – Earnings before interest, taxes, depreciation and amortization. CFFOBI – Cash flow from operations before interest. Note: Fitch Ratings may have reclassified certain financial statement items for analytical purposes.

Financial Summary (continued)

($000, Audited Fiscal Years Ended June 30)

	2005	2006	2007	2008	2009	2010[a]
Capital-Related Ratios						
MADS Coverage by EBITDA (x)	2.5	2.7	3.4	2.7	2.2	4.0
MADS Coverage by Operating EBITDA (x)	2.0	2.3	2.4	2.5	2.9	3.9
MADS Coverage by CFFOBI (x)	2.5	2.3	2.8	2.8	4.1	4.2
MADS Coverage by CFFOBI Less Capital Expenditures (x)	1.0	0.3	1.1	1.2	2.1	3.5
MADS as % of Revenue	4.7	4.2	3.9	3.5	3.2	2.9
Debt to EBITDA (x)	2.3	2.4	1.7	1.9	2.3	1.0
Debt to Operating EBITDA (x)	2.8	2.9	2.5	2.1	1.7	1.0
Debt to Free Cash Flow (x)	8.9	702.3	7.4	6.2	2.8	1.2
Debt to Capitalization (%)	36.1	36.8	33.8	32.6	36.3	18.8
Average Age of Plant (Years)	10.3	12.4	12.2	12.2	12.5	12.4
Capital Expenditures as % of Depreciation Expense	114.1	169.1	138.1	125.7	142.9	48.4
Capital Expenditures as % of EBITDA	61.6	75.3	50.2	61.4	93.2	19.0
Capital Expenditures as % of Total Revenue	7.2	8.6	6.6	5.9	6.4	2.2

[a]Unaudited. EBITDA – Earnings before interest, taxes, depreciation and amortization. CFFOBI – Cash flow from operations before interest. Note: Fitch Ratings may have reclassified certain financial statement items for analytical purposes.