MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa3 RATING TO CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY'S (NC) $150 MILLION OF SERIES 2011A BONDS; OUTLOOK IS STABLE

Global Credit Research - 28 Apr 2011

CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY HAS A TOTAL OF $1.7 BILLION OF RATED DEBT TO BE OUTSTANDING

Health Care-Hospital
NC

Moody's Rating

ISSUE	RATING
Fixed Rate Revenue Bonds, Series 2011A	Aa3

Sale Amount	$149,995,000
Expected Sale Date	05/12/11
Rating Description	Healthcare Revenue Bonds

Moody's Outlook Stable

Opinion

NEW YORK, Apr 28, 2011 -- Moody's Investors Service has assigned a Aa3 rating to Charlotte-Mecklenburg Hospital Authority's (d/b/a Carolinas HealthCare System) $150 million of Series 2011A fixed rate revenue bonds. The outlook is stable. At this time, we are affirming our Aa3 rating and stable outlook on $1.6 billion of debt to remain outstanding (see RATED DEBT section below).

SUMMARY RATINGS RATIONALE: The assignment of the Aa3 rating reflects CHS' strong market position in the Charlotte metro area and presence in many other markets through the Carolinas, and the organization's continued good operating performance.

STRENGTHS

*Large health system with $3.6 billion of revenue and 95,000 admissions. In addition to its community hospitals, CHS operates several sizeable facilities including a major teaching hospital and two children's hospitals

*Sizeable network of nearly 1,400 employed physicians and full spectrum of services allows CHS to retain referrals and patient volume within the System

*Same store admission growth of 3.4% in FY 2010 and 2.7% in FY 2009, at a time when many other providers are reporting flat or negative volume trends

*CHS maintains the highest level of tertiary and quaternary admissions in the state, providing the highest end clinical services in the region

*Long-standing and successful hospital management business provides CHS with access to new markets and a platform from which to grow the business

*Highly liquid balance sheet with only $50 million exposure to illiquid assets out of $2.2 billion of unrestricted cash and investments

CHALLENGES

*Operating leases (primarily medical office space) which stress debt metrics when converted to a debt equivalent. FY 2010 lease adjusted cash to debt falls to 119% from 142% and Moody's Adjusted MADS coverage declines to 3.9 times from 5.5 times

*Sizeable capital plans of $1.6 billion over the next five years, although current projections are for spending at a lower rate than the past five years

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The bond proceeds will be used to fund future capital expenditures, thereby enabling CHS to continue to strengthen its balance sheet with additional cash flow generated from operations.

LEGAL SECURITY: The bonds are secured by a revenue pledge from the members of the Obligated Group, which is comprised essentially of the "Primary Enterprise" (primarily the four acute care hospitals located in Mecklenburg County, CMC-NorthEast, a 457 licensed bed hospital located in Cabarrus County, and CMC-Lincoln, a 101 bed hospital located in Lincoln County) and one of CHS' discretely presented "Component Units", The Carolinas HealthCare Foundation (CHF), which became an Obligated Group member on June 12, 2007.

Throughout this report, all references to CHS and financial performance are based on the primary enterprise which includes six directly owned acute care hospitals and management contract revenue; "component unit" hospitals are excluded as their assets are controlled by the individual hospitals and do not roll up to the primary enterprise.

INTEREST RATE DERIVATIVES: CHS has entered into a total of fourteen fixed payer swaps with a total notional amount of approximately $736 million under which CHS makes fixed rate payments and receives floating rate payments based on SIFMA and LIBOR. At December 31, 2010, CHS' swap portfolio had a mark-to-market liability of $132.1 million, of which the largest position is a negative $19.1 million swap liability. CHS is required to post collateral on one uninsured swap with a notional amount of $80.9 million should the fair value liability reach $25 million on the swap and CHS ratings fall below A1 from Moody's and A+ from Standard & Poor's. The remaining thirteen swaps are insured by Assured Guaranty Municipal Corp. and Ambac with no requirement for CHS to post collateral as long as the insurer is rated at least A3 by Moody's and A- by Standard & Poor's, CHS' rating remains above A2/A, and the market-to-market liability on any single swap is not greater than $25 million. CHS is not required to post any swap collateral at this time and has not had to since the swaps were put in place.

MARKET POSITION/COMPETITIVE STRATEGY: BROAD MARKET THROUGHOUT THE CAROLINAS

CHS owns or operates nearly three dozen hospitals in North and South Carolina. The Primary Enterprise, which is the organization on which we base our analysis, is comprised of six acute care hospitals with over $3.5 billion operating revenue. The Primary Enterprise is geographically concentrated in Charlotte and the surrounding communities. Although unemployment spiked during the recession, Charlotte is a generally good market with pockets of strong population growth. CHS manages hospitals in other North Carolina markets and various markets in South Carolina and has an ownership interest in a South Carolina hospital; revenue from these arrangements is reported as other operating revenue and are included in the Primary Enterprise financial results.

Charlotte is a competitive market and Carolinas Medical Center, the CHS flagship, competes with Novant's Presbyterian Hospital. Based on statistics from both Primary Enterprise and Component Unit hospitals, CHS has maintained a 57% - 58% market share in the Charlotte market and surrounding counties of Union, Lincoln, and Cabarrus over the last five years. CHS does not have an acute care hospital in Gaston County, to the west of Charlotte, where CaroMont (rated A1/positive) has the only acute care hospital. Across the entire 31 county service area, CHS has nearly 38% inpatient market share.

CHS has constructed several facilities over the past several years to renovate or replace aging facilities and add capacity in growing areas of the market. Construction of a replacement hospital for CMC-Lincoln was completed in June 2010, and expansion of CMC-Pineville (a fast growing suburb south of Charlotte) will allow 97 beds to be transferred from other CHS facilities by summer 2012. CHS opened its first "Healthcare Pavilion" (essentially a large outpatient center with physician offices, diagnostic imaging, and emergency department that does not have inpatient capacity or operating rooms) at Steele Creek (15 miles from Carolinas Medical Center) and has received CON's to build an additional four pavilions. Growth within and without the Charlotte metropolitan area continues to be a primary strategic focus for the organization. Management believes growing the organization allows it to spread fixed costs over a larger base, introduce best practices to different organizations, and minimize variability across the system. We believe that CHS has developed a strong expertise in integrating new hospitals into the system and entering new markets and that the System's growth plans are reasonable and achievable.

A significant strength of the organization is the nearly 1,400 employed physicians that support the Primary Enterprise. CHS owns practices across all markets and has steadily grown the number of employed physicians, adding 232 in FY 2010 to support the Primary Enterprise and managed hospitals with further growth expected. Combined with good market share, we believe this gives CHS good negotiating leverage.

OPERATING PERFORMANCE: STABLE OPERATING PERFORMANCE CONTINUES

Financial performance in FY 2010 continued the organization's historical record of good performance. Inpatient admissions grew 3.4% to 95,089 and contributed to solid operating revenue growth of 8.3%. The operating cash flow margin declined slightly to 10.1% from 10.3% in FY 2009, but Moody's Adjusted MADS coverage was unchanged at 5.5 times and debt-to-cash flow declined slightly to 3.8 times from 4.1 times in FY 2009.

Volume gains were strongest at CMC - Mercy (23% growth), and CMC - Pineville (9.4% growth). Mercy benefited from the relocation of orthopedic and bariatric surgery from Carolinas Medical Center, while management attributes Pineville's volume growth to its location in a rapidly growing section of the market. Inpatient admissions at Carolinas Medical Center grew 3.3% as CHS was able to backfill volumes transferred to CMC - Mercy. Management prepared data also indicates the Healthcare Pavilion constructed at Steele Creek has improved emergency department volumes and market share at CMC - Mercy and CMC - Pineville.

BALANCE SHEET POSITION: GOOD BALANCE SHEET METRICS

CHS maintains a large and diversified investment portfolio of over $2.2 billion. The portfolio is highly liquid (nearly all cash and investments are available within a month) and has a relatively conservative allocation of 8% cash, 34% fixed income, 56% equity, with the balance in private equity funds.

The current bond issue is a modest 9.6% increase in debt outstanding and has minimal impact on key leverage metrics. Debt-to-cash flow rises to 4.2 times from 3.8 times, Moody's adjusted MADS coverage weakens to 5.0 times from 5.5 times, and cash- to-debt declines to 138% from 142%. All key leverage metrics have shown improvement over the last three years since CHS' last debt issuance in FY 2007.

CHS maintains a defined benefit pension plan. At FYE 2010, the plan was 86.5% funded with annual contributions that have increased significantly in recent years from $35 million in FY 2007 to nearly $54 million in FY 2010. In addition, CHS has $49.1 million in annual lease expense, which lowers Moody's adjusted MADS coverage to 3.7 times and cash-to-debt to 118% when converted to a debt equivalent (adjustments made using FY 2010 numbers including the $150 million of Series 2011A bonds.

Outlook

The stable outlook reflects our expectation that CHS will continue to generate favorable operating results and good debt service coverage metrics.

WHAT COULD MAKE THE RATING GO UP

Improvement in operating profitability; strengthening of balance sheet metrics; growth in market share and revenue

WHAT COULD MAKE THE RATING GO DOWN

Sustained operating losses; weakening of balance sheet metrics; additional debt without commensurate revenue growth

KEY INDICATORS

Assumptions & Adjustments:

- Based on financial statements for The Charlotte-Mecklenburg Hospital Authority (d/b/a Carolinas HealthCare System); Moody's numbers below represent the Primary Enterprise (primarily the four acute care hospitals located in Mecklenburg County, CMC-NorthEast, a 457 licensed bed hospital located in Cabarrus County, and CMC-Lincoln, a 101 bed hospital located in Lincoln County) and one of CHS' discretely presented "Component Units", The Carolinas HealthCare Foundation (CHF), which became an Obligated Group member on June 12, 2007)

-First number reflects audit year ended FY 2009

-Second number reflects unaudited year ended FY 2010 plus Series 2011A bonds ($150 million; 10% increase in debt outstanding)

-Series 2011A bonds added to FYE 2010 cash position to reflect financing of capital expenditures previously expected to be paid with cash

-Investment returns normalized at 6% unless otherwise noted

-Interest expense "grossed up" to include capitalized interest: $14.4 million in FY 2009 and $29.8 million in FY 2010

*Inpatient admissions: 91,978; 95,089

*Total operating revenues: $3.3 billion; $3.6 billion

*Moody's-adjusted net revenue available for debt service: $463.6 million; $494.6 million

*Total debt outstanding: $1.6 billion; $1.7 billion

*Maximum annual debt service (MADS): $83.8 million; $98.8 million

*MADS Coverage with reported investment income: 4.3 times; 3.9 times

*Moody's-adjusted MADS Coverage with normalized investment income: 5.5 times; 5.0 times

*Debt-to-cash flow: 4.1 times; 4.2 times

*Days cash on hand: 236 days; 258 days

*Cash-to-debt: 126%; 138%

*Operating margin (primary enterprise): 2.5%; 2.8%

*Operating cash flow margin (primary enterprise): 10.3%; 10.1%

RATED DEBT (debt outstanding as of December 31, 2010)

-Series 2001A (fixed) ($88.5 million outstanding), rated Aa3

-Series 2005B-D (variable rate demand bonds) ($80.9 million outstanding), rated Aa1/VMIG1 based on Letters of Credit from US Bank, expiring January February 17, 2016, and Aa3 rating of Charlotte-Mecklenburg Hospital Authority

-Series 2007A (fixed) ($200.3 million outstanding), rated Aa3

-Series 2007B (variable rate demand bonds) ($86.9 million outstanding), rated Aa3/VMIG1, (supported by SBPA from JP Morgan Chase Bank NA, expiring May 4, 2015)

-Series 2007C (variable rate demand bonds) ($87.6 million outstanding), rated Aa3/VMIG1, (supported by SBPA from JP Morgan Chase Bank NA, expiring May 4, 2015)

-Series 2007D, E, F (variable rate demand obligations) $201.4 million outstanding), rated Aa3/VMIG1 based on insurance from Assured Guaranty Municipal Corp. and a SBPA from Dexia Capital, expiring September 18, 2017, Aa3 underlying rating

-Series 2007 G, (variable rate demand obligations) ($113.8 million outstanding), rated Aa1/VMIG1 based on a Letter of Credit from Bank of America and Aa3 rating of Charlotte-Mecklenburg Hospital Authority, expiring January 1, 2016

-Series 2007H (variable rate demand obligations) ($166.1 million outstanding), rated Aaa/VMIG1 based on a Letter of Credit from Wells Fargo and Aa3 rating of Charlotte-Mecklenburg Hospital Authority, expiring June 20, 2016

-Series 2008A (fixed rate) ($309.3 million outstanding), rated Aa3

-Series 2009 (fixed rate) ($214.8 million outstanding), rated Aa3

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PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was Not-for-Profit Hospitals and Health Systems published in January 2008

REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings and confidential and proprietary Moody's Analytics information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of assigning a credit rating.

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