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Atrium Health, North Carolina; CP; Joint Criteria; System

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Related Research

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Credit Profile		
US\$300.0 mil taxable hlth care rev bnds ser 2021B due 01/15/2050		
<i>Long Term Rating</i>	AA-/Stable	New
US\$100.0 mil variable rate hlth care rfdg bnds ser 2021E due 01/15/2049		
<i>Long Term Rating</i>	AA-/Stable	New
US\$100.0 mil variable rate hlth care rfdg bnds ser 2021D due 01/15/2049		
<i>Long Term Rating</i>	AA-/Stable	New
US\$100.0 mil variable rate hlth care rfdg bnds ser 2021C due 01/15/2049		
<i>Long Term Rating</i>	AA-/Stable	New
Atrium Health		
<i>Long Term Rating</i>	AA-/Stable	Affirmed
North Carolina Med Care Comm, North Carolina		
Wake Forest Baptist Oblig Grp, North Carolina		
North Carolina Med Care Comm (Wake Forest Baptist Obligated Group)		
<i>Long Term Rating</i>	AA-/Stable	Upgraded
Wake Forest Baptist Medical Center, North Carolina		
Wake Forest Baptist Oblig Grp, North Carolina		
Wake Forest Baptist Med Ctr taxable new money bnds (Wake Forest Baptist Oblig Grp) ser 2016 dtd 11/10/2016 due 12/01/2046		
<i>Long Term Rating</i>	AA-/Stable	Upgraded

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to the Charlotte-Mecklenburg Hospital Authority, N.C.'s \$600 million series 2021B-E bonds. The authority does business as Atrium Health.

At the same time, we affirmed our 'AA-' long-term ratings on the authority's series 2011A, 2012A, 2013A, 2016A, 2018A, 2018B, 2018C, 2018D, and 2018E bonds. We also affirmed our 'AA-/A-1+' dual rating on the authority's series 2018F variable-rate demand bonds (VRDBs) supported by the authority's own self-liquidity, as well as our 'A-1+' short-term rating on the authority's taxable commercial paper (CP) program. We also affirmed our 'AA-/A-1' dual-term rating on its 2007B, 2007C, 2018G, and 2018H VRDBs, all of which are supported by standby bond purchase agreements (SBPAs) from JPMorgan Chase Bank. The long-term rating component reflects the 'AA-' long-term rating on the authority, and the short-term rating component reflects the 'A-1' short-term rating on JPMorgan Chase Bank. The SBPAs supporting the series 2007 and 2018 bonds expire in 2021 and 2024, respectively.

In addition, we affirmed our 'AAA/A-1+' dual rating and 'AA-' underlying rating (SPUR) on the authority's series 2007E bonds. A letter of credit (LOC) from TD Bank supports the 2007E bonds. We based the long-term rating component on the application of joint criteria between TD Bank and the 'AA-' SPUR on the authority. The short-term rating

component reflects the 'A-1+' short-term rating on TD Bank. The series 2007E bonds are also supported by insurance from Assured Guaranty Municipal Corp. The LOC with TD Bank was recently extended into 2025. The 'AAA' long-term rating on its series 2007E variable-rate demand bonds is eligible to be rated above the sovereign based on joint criteria and the fact that the rating is not constrained by the sovereign rating.

Finally, we raised our long-term rating to 'AA-' from 'A' on the North Carolina Medical Care Commission's series 2012A, 2012B, 2019A, 2019B, and 2019C bonds issued for Wake Forest Baptist Obligated Group (WFB). We raised our long-term rating to 'AA-' from 'A' on WFB's series 2016 taxable bonds.

The outlook on all ratings, where applicable, is stable.

The series 2021B-E bonds are expected to raise \$600 million in new money for future capital spending. They include the \$300 million series 2021B taxable bonds and three \$100 million series 2021C-E bonds, which will likely be issued as fixed-rate put bonds with mandatory tenders ranging from four to 10 years. Depending on market conditions at the time of issuance, some of the series 2021C-E bonds might be structured as floating-rate notes, and this possibility does not change our rating assignment. We also expect the Charlotte-Mecklenburg Hospital Authority to issue the series 2021A VRDBs to refund its existing series 2011A bonds. This series is expected to be supported by a letter of credit from Royal Bank of Canada and will be formally rated in a separate analysis, though it has been incorporated into our review.

The series 2021B-E bonds are secured by revenues of the Charlotte-Mecklenburg Hospital Authority obligated group. The Wake Forest Baptist obligated group does not secure the bonds.

Although the Charlotte-Mecklenburg Hospital Authority, doing business as Atrium Health, and Wake Forest Baptist currently maintain separate obligated groups, both are now a part of a larger consolidated system called Atrium Health, Inc. following the finalization of a strategic combination between the two organizations on Oct. 9, 2020. Given the terms of the integration agreement and our expectation that the systems will now operate as one entity, we rate both systems based on the group credit profile of Atrium Health, Inc. and our view that legacy Atrium Health and Wake Forest Baptist are core to the combined system, per our group rating methodology criteria.

This analysis and all future analyses will focus on the enterprise and financial profile characteristics of Atrium Health, Inc. as a whole, and all metrics cited are for the entire system unless stated otherwise. All subsequent references to Atrium Health in this report refer to the combined system, whereas legacy Atrium Health refers to the Charlotte-Mecklenburg Hospital Authority inclusive of Navicent Health. The combined system will use Atrium Health as its master brand.

Credit overview

The rating actions and stable outlook reflect our view that the combined system of Atrium Health retains credit strengths firmly consistent with the 'AA-' rating level. Though the consolidation of Wake Forest Baptist has a moderately dilutive effect on Atrium Health's financial profile, we believe the addition of WFB's Winston-Salem-based service area, as well as its academic and research programs and a new school of medicine to be located in Charlotte, greatly enhances Atrium Health's position within the highly competitive North Carolina health care market. Moreover, we believe legacy Atrium Health's stand-alone financial profile had exceptional cushion at the rating heading into the

strategic combination; though some of this cushion has been diminished with the strategic combination and added debt, we believe the combined system retains moderate flexibility at the rating as it continues to weather the COVID-19 pandemic and begins earnest integration efforts.

In addition to the added revenue and market diversity from the addition of WFB, which generated \$3.6 billion in operating revenue in its fiscal 2020 (ended June 30), compared with legacy Atrium Health's \$7.5 billion in its fiscal 2019 (ended Dec. 31), the system also includes a growing arm of Georgia operations anchored by legacy Atrium Health's strategic combination with Macon, Ga.-based Navicent Health, effective Jan. 1, 2019. Navicent Health, which is included in all relevant metrics from the date of acquisition, generated \$895 million in operating revenue in its fiscal 2019. Atrium Health currently has a letter of intent to acquire Rome, Ga.-based Floyd Medical Center through a member substitution over the coming months. This would bring three new acute-care campuses into the system and just under \$500 million in operating revenue. The addition of Floyd Medical Center is fully incorporated into this review. We believe Atrium Health will continue its organizational growth through mergers, acquisitions, and various types of affiliations, and we expect these plans to continue to develop throughout and beyond our two-year outlook horizon.

Our analysis of Atrium Health financials is based on internal S&P Global Ratings consolidation of legacy Atrium Health and Wake Forest Baptist audited financial statements and their Sept. 30, 2020, balance sheets--this data is reflected in the table at the conclusion of this report. The audited statements carry different fiscal years and, unlike Wake Forest Baptist, Atrium Health reports under Governmental Accounting Standards Board (GASB) guidelines, given its governmental status. Though our consolidation is imperfect, we believe it produces an appropriate historical pro forma for if the systems had been operating as one entity. We expect a consolidated system audit to be produced for the fiscal year ended Dec. 31, 2021, and expect it to be aligned with Financial Accounting Standards Board (FASB) guidelines. We understand there could be reporting changes as the financials are consolidated and change accounting treatment, but we do not expect this to have a material impact on our view of Atrium Health's financial profile.

The historical pro forma financial results for Atrium Health over the past three years are generally at, or above, our system medians for the rating. Atrium Health's operating margin has trended between 2% and 3%, supporting maximum annual debt service (MADS) coverage from 4x to 5x. Balance-sheet metrics are solid for the rating, partly aided by the addition of Navicent Health's robust unrestricted reserves into legacy Atrium Health's fiscal 2019. Consolidated days' cash on hand is just below 300 days' and is estimated to have held steady through Sept. 30, 2020, even when excluding all Medicare advance payments and short-term borrowings, such as CP. Following the issuance of the series 2021B-E bonds, we anticipate pro forma debt metrics that are marginally weaker than current levels, but overall quite consistent with recent years and in line with the rating, with leverage near 30% and unrestricted reserves to long-term debt in excess of 200%.

Both legacy systems have responded to COVID-19 well, in our view, with each maintaining positive operations per S&P Global Ratings' calculation. Legacy Atrium Health has posted a 0.4% operating margin through the nine months ended Sept. 30, 2020, supported by about \$300 million in Coronavirus Aid, Relief, and Economic Security (CARES) Act grants. Wake Forest Baptist finished its fiscal 2020 ended June 30 with a 0.3% operating margin, including about \$115 million in CARES Act grants--WFB's operating margin improved further through the first quarter of its fiscal 2021.

Overall, we expect consolidated calendar 2020 results to be weaker than previous years, given softer volumes and incremental expenses pressure stemming from the pandemic, but management is budgeting for fiscal 2021 results more in line with previous years, and we believe current volumes and monthly results support this expected recovery.

While we believe there remain many uncertainties, namely related to COVID-19 and early integration efforts, we believe Atrium's Health's combined balance sheet and bolstered business position will continue to support the rating through times of softer operating performance, especially in the nascent years of the new organization. That said, Atrium Health does have healthy capital spending plans over the coming years, including capital commitments and signature projects related to Wake Forest Baptist. We expect all of the above to be manageable at the current rating, but we note system management is currently refining its consolidated long-range financial plan, which should be available by next review.

The stable outlook reflects our view of the combined Atrium Health, inclusive of Wake Forest Baptist and legacy Atrium Health. We believe the system's robust financial profile and growing geographic diversity will support the rating throughout the COVID-19 pandemic and any early integration challenges. Moreover, we anticipate considerable benefits from the combination of WFB's well-regarded academic and research programs with Atrium Health's size, scale, and operating model. We expect management to continue to deploy capital with discipline, balancing its numerous capital projects with stability of existing unrestricted reserves.

The rating is based on our view of Atrium Health's credit strengths:

- Strengthened business position and market presence, with meaningful revenue diversity spread across three distinct markets in North Carolina and Georgia, anchored by 19 acute-care hospitals of various size, as well as a deep portfolio of ambulatory and clinic sites placed across the service areas;
- Expansive and diverse medical staff of over 5,000 active physicians, including employed and independent physicians, residents, and fellows, and Wake Forest University School of Medicine faculty, to be supported by a new second school of medicine located in Charlotte;
- Robust balance sheet, with unrestricted days' cash on hand near 300 days', coupled with pro forma debt metrics that we expect will remain in line with median levels; all references to unrestricted reserves and long-term debt exclude \$400 million in CP outstanding and about \$620 million in combined Medicare advance payments;
- Solid historical operating results that, although pressured in calendar 2020, have remained positive and are expected to recover over the coming year;
- Depth of knowledge within the management team, with top executive positions filled with candidates across both systems and legacy Atrium Health incumbents retaining the CEO and chief financial officer (CFO) roles over the combined system; and
- Governance structure that we believe will allow for unified leadership and strategic direction, though WFB's academic component and certain reserve powers held by Wake Forest University do add some complexity, at least during the initial years.

The above strengths are partly offset, in our view, by the following credit weaknesses:

- Integration risk over the coming years as legacy Atrium Health and Wake Forest Baptist are combined and begin to standardize processes and information technology (IT) systems; while there is a strong framework for the system's

integration planning, we believe a combination of this size and complexity does carry additional challenges and risks;

- Uncertainty related to COVID-19 and its impact on system operating performance, whether due to cooled non-COVID-19 patient demand, future case surges, or sustained expense pressure for protective equipment or contract labor, though this has been managed well to date;
- Expected increases in capital spending over the next several years, which we think could pressure reserve growth, though the near-term impact will likely be muted, given the added series 2021 bond funds and our expectation for continued operating recovery; we do not believe days' cash on hand and pro forma cash-to-debt need to grow substantially to maintain the current rating; and
- Significant exposure to supplemental funds from state and federal funding sources, totaling a more than \$400 million net benefit for the system, with some added uncertainty associated with the allocation and level of these funds as a result of North Carolina's move toward Medicaid managed care.

Environmental, social, and governance factors

We view Atrium Health's social risk as lower than that of sector peers, as the system operates in several markets with healthy demographic trends such as population and employment growth, though we expect the COVID-19 pandemic and current recessionary pressures to affect this over the medium term. The core mission of health care facilities is protecting the health and safety of communities, which is further evidenced by its responsibilities to serve the potential COVID-19-related surge in patient demand. We believe the pandemic exposes the entire sector to additional social risks that present financial pressure in the short and medium term, and we will evaluate these risks as the situation evolves. We analyzed Atrium Health's environmental and governance risks and determined that both are in line with the industry as a whole. Atrium Health does include multiple governing boards with various levels of authority and specific legacy appointment structures. This is described in greater detail below.

Stable Outlook

Downside scenario

Though we consider Atrium Health to have cushion at the rating, we could revise the outlook to negative if operations do not trend in line with expectations, whether failing to recover from the pandemic or turning negative. While we believe the system's enterprise profile and balance sheet provide some cushion for Atrium Health's COVID-19 recovery and integration efforts, performance consistently below expectations could pressure the rating, particularly given the heightened capital spending plans expected over the coming years.

Upside scenario

We believe Atrium Health's enterprise profile could support a higher rating over time. This would be predicated on meaningful progress integrating Wake Forest Baptist and the realization of expected benefits of the strategic combination. We would also expect a recovery in consolidated performance to at, or above, 3% operating margin and 5x MADS coverage, with steady balance-sheet growth and deleveraging from expected pro forma levels toward those more commensurate with 'AA' rated systems. Given leadership's growth plans, uncertainty related to future transactions, partnerships, or capital projects could preclude a higher rating.

Enterprise Profile--Very Strong

Strategic combination creates new system

In April 2019, legacy Atrium Health and WFB announced their intent to combine and create a new academic health system. Definitive agreements were finalized in late October 2019 and the strategic combination closed in October 2020. The combination has a high level of strategic and operational integration, supported by an integration agreement with a perpetual nature and no expiration date or easy paths to dissolution. The agreement also outlines specific capital commitments from Atrium Health to WFB over the agreement's first decade, including routine capital, academic support, and strategic projects such as a new patient tower in Winston-Salem and the new school of medicine in Charlotte. This commitment, totaling about \$3.4 billion, is expected to be supported by the cash flow of the total Atrium Health enterprise, including WFB, and this has been considered in the current long-range financial plan.

Atrium Health will be led by a 16-member board, with 13 members appointed by legacy Atrium Health and three members appointed by Wake Forest Baptist. The board structures of each organization will continue to exist, but most authority has been delegated to the new Atrium Health board. A notable exception to this exists with academic affairs. WFB will retain its responsibilities and authority relating to academic programs, in collaboration with Atrium Health.

The Charlotte-Mecklenburg Hospital Authority is governed by a board of commissioners of no greater than 30 members. Board members are appointed by the chairman of the county commissioners of Mecklenburg County, based on nominees from the authority's board. Wake Forest Baptist was created from a July 1, 2010, integration agreement between North Carolina Baptist Hospital (NCBH), Wake Forest University (WFU), Wake Forest University Health Sciences (WFUHS), and Wake Forest University Baptist Medical Center (WFUBMC). NCBH and WFU each appoint six voting members of the WFB board, while two independent members are elected by the WFB board, and, most recently, three members are appointed by Atrium Health.

Legacy Atrium Health CEO Eugene Woods and CFO Anthony DeFurio will retain their current roles over the new system, and WFB CFO Bradley Clark will now lead system financial planning and treasury activities. Dr. Julie Ann Freischlag, having previously served as WFB CEO, will now serve as chief academic officer and regional CEO, in addition to continuing her duties as dean of Wake Forest University School of Medicine. In general, the new executive leadership team is composed of representatives from both systems, and we consider the team to be well-qualified and structured in a very practical way, given the strengths of each organization. That said, we believe leadership team will likely evolve over the coming years as the combination is digested.

In addition to integration efforts, Atrium Health's strategic focus over the coming years will be on connecting care through population health and expanded access, core market growth, continued build-out of its network across the southeast, medical education and research, and clinical excellence and commensurate organizational talent and culture. Concurrently, the strategic combination's integration framework will categorize based on shared services, clinical, and academic functions, then determining if the objective should be preservation, improvement, innovation, or elimination. We believe these plans are robust and that integration should be aided by legacy Atrium Health's experience integrating Navicent Health, the prolonged due diligence period that allowed ample time to prepare, and

also WFB being a member of Atrium Health's group purchasing organization, which laid a solid foundation for the combined system's IT strategy.

Bolstered business position across North Carolina and Georgia

Atrium Health continues to expand its footprint outside its historical Charlotte, N.C.-focused service area. In February 2018, the Charlotte-Mecklenburg Hospital Authority changed its enterprise name from Carolinas HealthCare System to Atrium Health as part of its long-term vision to expand the level of care it provides beyond the Carolinas. This shift was exemplified by the strategic combination with the Macon, Ga.-based Navicent Health, effective Jan. 1, 2019. Following the combination with WFB, the system now operates in two distinct markets in North Carolina and we expect the geographic gap between the two regions to narrow as Atrium Health increases investment around both service areas. Winston-Salem is about 80 miles north of Charlotte.

The system estimates an inpatient market share of about 51% in its 13-county core market surrounding Mecklenburg County, where competition comes largely from Winston-Salem-based Novant Health. The Charlotte market presence includes 11 acute-care facilities and is anchored by the 721-licensed-bed Carolinas Medical Center (CMC), which is the site of significant capital expansion and renovation. Market share is much more fragmented in WFB's service area, with the system garnering about 30% of the inpatient market within its nine-county primary service area. Competition primarily comes from Novant Health and Cone Health, both of which have fairly comparable shares of the market. WFB's position in the market is centered on the 885-licensed-bed North Carolina Baptist Hospital, doing business as Wake Forest Baptist Medical Center. This academic medical center is supported by four community hospitals, including High Point Medical Center, which was acquired from UNC Health in September 2018.

Navicent Health operates three acute-care hospitals within its primary service area located about 80 miles south of Atlanta. Navicent Health garners about 45% of its market. Floyd Medical Center, which includes three acute-care hospitals through various long-term lease agreements with local hospital authorities, is located 70 miles northwest of Atlanta and thus separate from Navient Health. We consider it likely that additional affiliates across Georgia and North Carolina will be added to the system over the coming years.

We believe Atrium Health operates in markets with meaningful competition for patients, physicians, and clinicians. The state continues to see heavy merger and acquisition activity, including Novant Health's plans to acquire Wilmington, N.C.-based New Hanover Regional Medical Center and concurrently partner with UNC Health across various markets, including Charlotte. In addition, Cone Health is under a letter of intent to merge with Norfolk, Va.-based Sentara Health. We believe the combined Atrium Health is better suited to respond to, and in many cases drive, the region's competitive dynamics than it was as two separate entities.

Large medical staff; academic programs expanding in Charlotte

Legacy Atrium Health's active medical staff of above 4,000 physicians includes a large employed physician network of about 1,800 primary and specialty physicians. The WFB active medical staff consists of more than 1,000 faculty physicians and about 500 nonfaculty employed physicians; the latter figure has grown significantly in recent years, following the acquisition activity and management's concerted effort to grow WFB's primary care base. The flagship academic medical center operates with a closed-staff model with nearly all attending physicians required to have faculty appointments at the Wake Forest University School of Medicine. The medical staffs at the four community

hospitals (Davie, Lexington, Wilkes, and High Point) are not subject to the faculty agreement and have open medical staffs. When combined, Atrium Health is currently home to over 1,000 residents and fellows.

Plans are underway for a second Wake Forest University School of Medicine campus located in Charlotte. It is expected that third- and fourth-year medical students could rotate to Atrium Health facilities in Charlotte as early as spring 2021, with a full school of medicine campus opening to follow at a later time. Though both of these plans would include moderate startup operating losses and costs related to construction of the new facility (estimated to be under \$100 million), we believe the longer-term benefit of these initiatives is compelling and one of the fundamental impetuses of the strategic combination.

Market demographics vary across regions

Across the greater Charlotte and Winston-Salem service areas, Atrium Health serves a population of over four million people. Both regions are projected to see population and employment growth over the next five years, but growth is much more pronounced in Charlotte. This growth is driving heavy capital investment and expansion projects by Atrium Health and other market participants and helps support healthy volumes and a strong payor mix with over 50% of legacy Atrium Health net patient revenue coming from commercial payors. In comparison, WFB's payor mix has a slightly higher Medicare mix (37%, compared with 30% at legacy Atrium Health) and reflects the varying demographics across the two areas. Though we believe COVID-19 and the associated recessionary pressures could pressure the system's payor mix over the outlook period, we also believe the region's economy and growth trajectory heading into COVID-19 will remain a credit strength.

Atrium Health's smallest affiliate, Navicent Health, serves a population of about 475,000 within its primary service area, which is expected to see slight population decline over the coming years.

For the past several years, the state of North Carolina has been in the process of shifting from traditional Medicaid to managed care. This shift has been delayed several times but is currently scheduled to occur in summer 2021. This transition is likely to affect Atrium Health's meaningful supplemental funding receipts and will likely aim to depress total Medicaid reimbursement. Medicaid coverage has not been expanded in North Carolina under the Affordable Care Act, and disagreement about this has led to budget impasses at the state level--this has affected the Medicaid managed care transition and could continue to do so. We will continue to monitor this situation as it evolves.

Table 1

Atrium Health, N.C. -- Enterprise Statistics

	--Pro forma historical results--		
	Period 1*	Period 2*	Period 3*
Atrium Health fiscal year (ended Dec. 31)	2019	2018	2017
Wake Forest Baptist fiscal year (ended June 30)	2020	2019	2018
Inpatient admissions	232,486	190,771	174,659
Equivalent inpatient admissions	525,699	449,243	415,135
Emergency visits	1,090,855	971,840	943,917
Inpatient surgeries	63,143	55,159	53,008
Outpatient surgeries	109,442	98,555	93,145

Table 1

Atrium Health, N.C. -- Enterprise Statistics (cont.)			
	--Pro forma historical results--		
	Period 1*	Period 2*	Period 3*
FTE employees	57,405	50,127	48,361

*Enterprise statistics are based on S&P Global Ratings internal consolidation of the three most recent audited fiscal years available for legacy Atrium Health and Wake Forest Baptist. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions. Navicent Health is included in legacy Atrium Health fiscal 2019 figures. FTE--full-time equivalent.

Financial Profile--Very Strong

Consolidated operations consistent with rating; positive but tighter during the pandemic

Heading into calendar 2020 and the COVID-19 pandemic, we believe pro forma operating performance from Atrium Health was stable and consistent with the rating. Each of the last three years, legacy Atrium Health generated a healthy and stable operating margin near 3.8%. Performance through the nine months ended Sept. 30, 2020, produced \$22.3 million in operating income (or a 0.4% operating margin), buoyed by about \$300 million in recognized CARES Act grants, with an additional \$38 million held in reserve. We anticipate performance will continue to improve by its Dec. 31 year-end, given strong volumes, most of which are at or near pre-pandemic levels, with the exception of emergency department visits and observation cases.

Consolidated operations are weaker than the above levels when including the smaller WFB. After operating losses in its fiscal years 2018 and 2019 ended Jun. 30 (near a negative 1% operating margin each year), WFB's performance improved in fiscal 2020, ending with a 0.3% operating margin per S&P Global Ratings' calculation, which excludes investment earnings operations. This includes about \$115 million in recognized CARES Act grants.

As mentioned, our historical pro forma consolidation produces annual operating margins for the combined Atrium Health of 2%-3%. We understand management is forecasting for fiscal 2021 operations to remain within this range. We consider this achievable, but note greater uncertainty than typical years, given the potential for lingering COVID-19 pressures and any unexpected integration challenges. That said, we also expect to have greater detail on management's synergy targets at next review. Floyd Medical Center's integration is assumed in projections shared by management, and the impact on system performance is minimal.

Our MADS estimate of \$238 million is based on a combination of legacy Atrium Health's and WFB's debt service schedules. It also smooths the series 2021B \$300 million bullet payment across all years.

Atrium Health does rely on a significant amount of supplemental funding, including \$314 million from legacy Atrium Health's fiscal 2019 and \$118 million from WFB's fiscal 2020. We view such exposure negatively, as it adds greater risk and uncertainty to net revenue. Moreover, as North Carolina shifts to Medicaid managed care, the program's funds will be dispersed to providers differently than the status quo. The ultimate and long-term impact of this is unknown, but in general we believe the change is but one of the many industry challenges Atrium Health's leadership will continue to address over the coming years.

Unrestricted reserves provide meaningful cushion

We consider Atrium Health's unrestricted reserves--totaling \$8.4 billion as of Sept. 30, 2020--to be one of the principal strengths of the credit profile, providing cushion as the system weathers COVID-19, integrates legacy Atrium Health and WFB, and executes on its various capital projects across service areas. Days' cash on hand through Sept. 30, 2020, is estimated to be near 290 days', and we calculate pro forma unrestricted reserves-to-long-term debt of about 213%, with the series 2021B-E bond funds not included in unrestricted reserves, given they will be trustee-held. We believe it is likely that, over the coming years, these two metrics will weaken from current levels as capital is deployed and Floyd Medical Center's expense base is incorporated into Atrium Health. We believe the projections shared are inclusive of all known projects and capital commitments, including \$3.4 billion to WFB, \$1 billion to Navicent Health, and potentially \$650 million to Floyd Medical Center, most to be spent over the first decade of each affiliation. We also understand the forecasting process was simplified, given the recency of the deal closure, and a refined long-range financial plan should be available at next review. Regardless, we expect unrestricted reserve metrics will remain solid for the rating and believe leadership will scale spending as necessary to retain these strengths over the coming years.

We expect capital spending to increase in coming years, possibly close to \$1 billion annually, as Atrium Health continues to execute on capital projects aimed at creating capacity and modernizing facilities within the Charlotte market and begins long-contemplated projects within the Winston-Salem market. At the same time, the system is investing heavily in its IT systems, including converting legacy Atrium Health's electronic medical record (EMR) system to Epic and implementing its new Oracle enterprise resource planning (ERP) system. Legacy Atrium Health's revenue cycle system is already on the Epic platform, as is WFB. The largest projects underway or expected over the coming years include a redesign and expansion of the CMC campus, a new bed tower at the Pineville campus, the Epic IT system implementation, expected new greenfield hospitals in Lake Norman and west Union County (Union West), and the new patient tower at Wake Forest Baptist Medical Center. As mentioned, these projects are included in the system's long-range financial plan, but we expect some adjustments to timing in the plan's next iteration.

As of Sept. 30, 2020, Atrium Health has a combined \$621 million in Medicare advance payments (\$438 million at legacy Atrium Health and \$183 million at WFB). In addition, Atrium Health had \$400 million in CP outstanding as of Sept. 30, 2020, the maximum amount authorized under the program. This balance has since been reduced to \$250 million and is expected to fall closer to \$200 million over the coming year. All of the aforementioned liquidity sources are excluded from our calculation of unrestricted reserves.

Atrium Health has identified approximately \$1.5 billion of cash and fixed income assets as of Oct. 31, 2020, to guarantee the full and timely purchase price of its CP program and the \$100 million self-liquidity supported series 2018F VRDBs. Though \$250 million in CP is currently outstanding, no more than \$50 million in CP can mature during one business week. The identified assets--invested in highly rated money market funds, treasuries, agencies, and investment-grade debt--provide sufficient coverage in the event of a failed remarketing. Management has established clear and detailed procedures to ensure the ongoing maintenance of sufficient asset coverage and to meet liquidity demands on a timely basis. We will continue to monitor the liquidity and sufficiency of assets pledged by Atrium Health on a monthly basis.

Sound pro forma debt position; separate obligated groups

Atrium Health had long-term debt of \$3.4 billion outstanding as of Sept. 30, 2020, including bonds secured by the legacy Atrium Health and Wake Forest Baptist obligated groups, as well as debt held by Navicent Health and other smaller borrowings. We calculate pro forma leverage of just under 30%, which is in line with the rating. Moreover, our pro forma MADS estimate produces a debt burden of about 2.1%, which is also indicative of a manageable debt load. There are no further explicit new-money debt plans over the coming years following the series 2021B-E issuance, though there are several refunding plans and opportunities over the outlook horizon.

As mentioned, both entities maintain separate obligated groups. We believe it is likely that these groups will be consolidated over time, likely including all major affiliates, such as Navicent Health. Given our view that each obligated group is core to the group as a whole, the ratings are harmonized, despite the legal separation of security.

Atrium Health maintains four defined-benefit pension plans, including two from WFB and one from Navicent Health. In 2020, legacy Atrium Health's two smaller plans were merged into its main plan. Despite a weaker funded status, the actual net shortfall liability is manageable for the system. Legacy Atrium Health's primary plan had a net shortfall of \$353 million as of Dec. 31, 2019, while at the same time, its two smaller plans are overfunded on a net basis, as is the Navicent Health plan. WFB's two plans had a net shortfall of \$134 million as of June 30, 2020. All plans are closed to new entrants. We expect legacy Atrium Health's conversion to FASB reporting to affect pension metrics.

Table 2

	--Balance sheet as of Sept. 30--	--Pro forma historical results--			Medians for 'AA-' rated healthcare systems
	2020*	Period 1*	Period 2*	Period 3*	2019
Atrium Health fiscal year (ended Dec. 31)	N/A	2019	2018	2017	
Wake Forest Baptist fiscal year (ended June 30)	N/A	2020	2019	2018	
Financial performance					
Net patient revenue (\$000s)	N.A.	9,811,008	8,572,087	7,879,702	3,213,282
Total operating revenue (\$000s)	N.A.	11,046,929	9,569,676	8,785,706	3,320,191
Total operating expenses (\$000s)	N.A.	10,751,056	9,373,704	8,588,910	MNR
Operating income (\$000s)	N.A.	295,873	195,972	196,796	MNR
Operating margin (%)	N.A.	2.68	2.05	2.24	3.00
Net nonoperating income (\$000s)	N.A.	365,208	246,285	162,215	MNR
Excess income (\$000s)	N.A.	661,081	442,257	359,011	MNR
Excess margin (%)	N.A.	5.79	4.51	4.01	5.50
Operating EBIDA margin (%)	N.A.	8.52	8.22	8.54	9.20
EBIDA margin (%)	N.A.	11.44	10.53	10.20	10.90
Net available for debt service (\$000s)	N.A.	1,306,056	1,033,336	912,285	404,081
Maximum annual debt service (\$000s)	N.A.	237,582	237,582	237,582	MNR
Maximum annual debt service coverage (x)	N.A.	5.50	4.35	3.84	5.00
Operating lease-adjusted coverage (x)	N.A.	3.90	3.21	2.91	3.80
Liquidity and financial flexibility					
Unrestricted reserves (\$000s)	8,445,430	8,281,332	6,063,315	6,158,208	2,257,133

Table 2

Atrium Health, N.C. -- Financial Statistics (cont.)					
	--Balance sheet as of Sept. 30--	--Pro forma historical results--			Medians for 'AA-' rated healthcare systems
	2020*	Period 1*	Period 2*	Period 3*	2019
Unrestricted days' cash on hand	N.A.	295.6	248.8	276.0	258.80
Unrestricted reserves/total long-term debt (%)	250.8	242.2	188.2	230.2	224.70
Unrestricted reserves/contingent liabilities (%)	508.5	493.7	433.0	754.1	642.40
Average age of plant (years)	N.A.	11.3	10.0	9.9	10.40
Capital expenditures/depreciation and amortization (%)	N.A.	119.9	138.7	95.0	132.60
Debt and liabilities					
Total long-term debt (\$000s)	3,366,937	3,418,945	3,222,238	2,674,671	MNR
Long-term debt/capitalization (%)	26.0	26.6	31.1	26.9	27.40
Contingent liabilities (\$000s)	1,660,869	1,677,559	1,400,384	816,653	MNR
Contingent liabilities/total long-term debt (%)	49.3	49.1	43.5	30.5	31.50
Debt burden (%)	N.A.	2.08	2.42	2.66	2.20
Defined-benefit plan funded status (WFB) (%)	N.A.	71.80	76.95	83.01	83.80
Defined-benefit plan funded status (Atrium Health) (%)	N.A.	72.04	76.76	72.36	83.80
Pro forma ratios					
Unrestricted reserves (\$000s)	8,445,430	N/A	N/A	N/A	MNR
Total long-term debt (\$000s)	3,966,937	N/A	N/A	N/A	MNR
Unrestricted days' cash on hand	N.A.	N/A	N/A	N/A	MNR
Unrestricted reserves/total long-term debt (%)	212.9	N/A	N/A	N/A	MNR
Long-term debt/capitalization (%)	29.3	N/A	N/A	N/A	MNR
Miscellaneous					
Medicare advance payments (\$000s)**	620,889	182,832	N/A	N/A	MNR
Short-term borrowings (\$000s)**	400,000	0	30,000	30,000	MNR
CARES Act grants recognized (\$000s)	N.A.	114,517	N/A	N/A	MNR
Total net special funding (\$000s)	N.A.	431,930	382,508	317,849	MNR

*Financial statistics are based on S&P Global Ratings internal consolidation of the three most recent audited fiscal years available for legacy Atrium Health and Wake Forest Baptist, as well as Sept. 30, 2020, balance sheets. Navicent Health is included in legacy Atrium Health fiscal 2019 and 2020 figures. **Excluded from unrestricted reserves, long-term debt, and contingent liabilities. N.A.--Not available. N/A--Not applicable. MNR--Median not reported.

Credit Snapshot

- Atrium Health security pledge: The bonds are secured by revenues of the Charlotte-Mecklenburg Hospital Authority obligated group, which is composed of the authority and the Atrium Health Foundation. There are no designated affiliates at this time; hence, the combined group is the same as the obligated group. Navicent Health is not a member of the obligated group.
- Wake Forest University Baptist Medical Center security pledge: The bonds are secured by a general unsecured pledge of the obligated group, which includes North Carolina Baptist Hospital, Wake Forest University Health Sciences, and Wake Forest University Baptist Medical Center. Designated affiliates within the combined group include, among other entities, Davie Medical Center, Lexington Medical Center, and High Point Medical Center. Wilkes Medical Center is not a designated affiliate.
- Group rating methodology: We consider the obligated groups of legacy Atrium Health and WFB to both be core to the group credit profile of Atrium Health. The obligated groups remain separate and do not secure or guarantee any debt of the other.
- Organization description: Atrium Health is a 19-hospital health system operating mostly in North Carolina and Georgia. Atrium Health was created following the strategic combination of the Charlotte-Mecklenburg Hospital Authority (doing business as Atrium Health and also including Navicent Health) and Wake Forest University Baptist Medical Center (WFB) in October 2020. WFB itself was created following the formal integration of North Carolina Baptist Hospital (NCBH) and Wake Forest University Health Sciences (WFUHS) on July 1, 2010. Parties to the agreement also include Wake Forest University (the parent of WFUHS). Wake Forest University is not obligated, nor are its assets pledged on WFB's debt, and WFB is not obligated on Wake Forest University's debt.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of November 25, 2020)

Atrium Health hosp VRDB ser 2007B		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Atrium Health hosp VRDB ser 2007C		
<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
Atrium Health taxable hlth care comm pap rev bnds ser 2015B-1&2		
<i>Short Term Rating</i>	A-1+	Affirmed
Atrium Health JOINTCRIT		
<i>Long Term Rating</i>	AAA/A-1+	Affirmed
<i>Unenhanced Rating</i>	AA-(SPUR)/Stable	Affirmed
Atrium Hlth		
<i>Long Term Rating</i>	AA-/A-1+/Stable	Affirmed

Ratings Detail (As Of November 25, 2020) (cont.)

Atrium Hlth var rate hlth care rev bnds

Long Term Rating

AA-/A-1/Stable

Affirmed

Atrium Hlth var rate hlth care rev bnds

Long Term Rating

AA-/A-1/Stable

Affirmed

Many issues are enhanced by bond insurance.

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