

Beaumont well equipped to handle downgrade of bonds, McTevia tells Oakland Business Review

Beaumont growth causes downgrade of \$655 million in bonds

By Gary Gosselin | Oakland Business Review

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The growth of Beaumont Hospitals has resulted in the downgrading of \$655 million in bonds, likely costing the hospital system additional interest expense.

Fitch Ratings downgraded the bonds to A+ from AA- largely due to construction of two Oakland County hospitals and acquisition of Bon Secours Health System in Grosse Pointe.

Fitch also assigned an A+ rating to the expected issuance of an additional \$500 million of fixed-rate and \$207 million of variable-rate bonds. Fitch gave a stable outlook to both bond issues.

Moody's assigned an A1 rating in August to the bonds, a downgrade from Aa3 with a stable outlook.

"We are disappointed, but it was not unexpected," said Beaumont CFO Dennis Herrick. "We are putting on some debt in relation to projects at both (Royal Oak and Troy) campuses, and the Grosse Pointe acquisition and the medical school (with Oakland University).

"They were each received well, but together and coupled with the competitive market and the downturn in the Michigan economy ..."

The downgrade will likely have a 25-30 basis point effect on the bond issuance in mid-to-late September, he said, which will cost the hospital system about \$1.5 million in added interest expense annually.

"Obviously, access to capital is not going to be hurt by the downgrade. The biggest challenge is it increases our debt load," Herrick said. "We thought in the short term it might hurt, but we felt we needed to take certain steps strategically for the long term."

Fitch said the downgrade reflected Beaumont's increased pro-forma debt burden of about \$912 million - the anticipated negative impact from new hospitals in Novi and West Bloomfield and the expected drag on earnings related to the acquisition of the money-losing, 289-bed Bon Secours.

"It's pretty obvious that they have been in the midst of a very aggressive growth mode. Sometimes institutions grow beyond their financial capacity," said Jim McTevia, of McTevia & Associates, a Bingham Farms-based business advisory firm.

"But, the Beaumont operation is pretty efficient and well managed, so there's no question they've done a lot of due diligence," he said.

The health system can absorb the added costs easily, he said, and should have no problem bouncing back in a couple years.

St. John Health System will open its 200-bed Providence Park Hospital in Novi on Sept. 5 while Henry Ford Health System is anticipated to open its 300-bed hospital in West Bloomfield next spring.

Herrick said as expansion projects come online and as Bon Secours becomes more stable, those will garner more revenue, and he hopes those will help gain an upgrade in the ratings by 2010 or 2011.

That outlook matched the Fitch assessment, which calls for depressed earnings in 2008 and 2009.

Bon Secours lost \$3.6 million for the first half of 2008 compared to a \$10.7 million loss the same period last year, Herrick said, and admissions are up 17 percent for the period, so progress is being made.

"We would hope they would be generating positive cash flow by the beginning of 2010," he said, "but they have depreciation and interest expense, so it will take longer (for earnings) after interest and depreciation."

The key in Grosse Pointe is investment in updating the facility and winning back the confidence of the staff and doctors, to bring patients back to Bon Secours.

The Fitch outlook also incorporates the expected issuance of \$175 million of additional debt in 2009 to continue funding capital projects at the Royal Oak and Troy campuses.

The Beaumont system maintains 1,696 staffed beds and recorded operating revenue of \$1.85 billion in fiscal 2007.