North Carolina Medical Care Commission
Rex Healthcare; Hospital

Primary Credit Analyst:
Jennifer Soule, Boston (1) 617-530-8313; jennifer_soule@standardandpoors.com

Secondary Credit Analyst:
Karl Propst, Dallas (1) 214-871-1427; karl_propst@standardandpoors.com

Table Of Contents
Rationale
Outlook
Finances: Strong Operations And Debt Service Coverage; Moderate Balance Sheet
Volumes: Growth Across Key Service Lines
Overview Of Rex Healthcare And University Of North Carolina Health Care Systems Relationship
Related Criteria And Research
North Carolina Medical Care Commission
Rex Healthcare; Hospital

Credit Profile

US$170. mil hosp rev bnds (Rex Healthcare) ser 2010 dtd 10/26/2010 due 06/30/2041

<table>
<thead>
<tr>
<th>Long Term Rating</th>
<th>A+/Stable</th>
<th>New</th>
</tr>
</thead>
</table>

North Carolina Med Care Comm, North Carolina
Rex Healthcare, North Carolina

North Carolina Med Care Com (Rex Healthcare)

<table>
<thead>
<tr>
<th>Unenhanced Rating</th>
<th>A+(SPUR)/Stable</th>
<th>Affirmed</th>
</tr>
</thead>
</table>

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services assigned its 'A+' long-term rating to North Carolina Medical Care Commission’s $168.5 million series 2010A bonds and affirmed its 'A+' underlying rating (SPUR) on its series 1998 bonds, issued for Rex Healthcare. The outlook is stable.

The rating affirmation, in our opinion, reflects:

- Strong financial operating performance through fiscals 2009 and 2010, with operating margins of 3.8% and 6.1%, respectively. Operating performance in each year well exceeded management’s budgeted expectations;
- Strong regional economy (Wake County general obligation (GO) debt rating; ‘AAA’), which includes the state capital of Raleigh and its access to the renowned Research Triangle Park; and
- A beneficial affiliation with the University of North Carolina Health Care System (UNCHCS), whose flagship University of North Carolina Hospitals at Chapel Hill is rated ‘AA-’.

Offsetting credit factors include management’s extensive capital plans expected to cost approximately $385 million over the coming five fiscal years as well as the organization’s light balance of days’ cash on hand when compared with our medians for the rating. Rex's master facilities plan includes a new central energy plant, the North Carolina Cancer Hospital at Rex to enhance the organization’s existing services, a new multilevel front entrance, and a new heart and vascular center. Management expects to fund the project with a combination of bonds and operating cash flow. It is our understanding that only the series 2010 issuance will be required to fund these projects, and any additional funding will likely come from operating cash flow and potentially from future donations.

Rex Hospital is a 431-licensed-bed, acute-care facility located in Raleigh, N.C. in Wake County. Raleigh, Wake County, and North Carolina all carry ‘AAA’ GO ratings and boast strong population growth, above-average household incomes, and a stable employer base. Rex benefits from its relationship with the larger University of North Carolina Health Care System (unrated), which includes both Rex Healthcare and UNC Hospitals (AA-/Positive), as well as two physician groups, a relationship with the UNC School of Medicine, and the smaller Chatham Hospital. Rex maintains its own debt obligations and UNCHCS is not part of the Rex obligated group. The obligated group includes Rex Healthcare Inc., which does not conduct active operations but serves as the parent corporation, and Rex Hospital Inc. Rex Hospital Inc. comprises 98% of the Rex system’s overall net patient service

Standard & Poor's | RatingsDirect on the Global Credit Portal | August 19, 2010

815835 | 301442211
revenue, 98% of the system's operating earnings, and 97% of its total asset base. Nonobligated entities include a foundation, an oncology center, and other small entities we consider less significant to the system's overall financial profile.

The current debt issuance includes approximately $168.5 million in bonds, which will fund the refinancing of Rex's existing 1998 debt (approximately $76.0 million); reimburse the organization for $50 million of capital expenses ($25 million for each fiscal year 2010 and 2011); fund the construction of a new energy plant ($26.6 million); contribute to the cost of the North Carolina Cancer Hospital at Rex project; and cover the cost of issuance. Once the series 1998 bonds are fully defeased, we will withdraw our rating on the bonds. All Rex's long-term debt has a fixed interest rate and Rex is not party to any swap agreements.

We do not view the current series 2010 debt issuance as a negative credit consideration, given Rex's strong operating performance, its favorable cash flows through recent periods, as well as its demographic and volume growth projected for the coming years. We also view Rex's management team favorably, with a young but experienced group of leaders throughout the organization. In addition, it has historically been our opinion that Rex held the capacity for additional debt before this issuance.

**Outlook**

The stable outlook reflects our view of Rex's continued hold of the leading market share in Wake County, although management is keenly aware of its tight competition in the area. Standard & Poor's expects Rex to continue reporting strong financial performance, as reflected in its projections through fiscal 2015, with consistent cash flow supporting its capital plans. If Rex meets these expectations, it is likely we will affirm the current rating. However, the rating could come under pressure if Rex's financial profile were to deteriorate significantly, including a sharp decline in operating performance, a large increase in debt, or a drop in liquidity. Based on Rex's current growth trajectory, we do not expect the latter scenario at this time.

**Finances: Strong Operations And Debt Service Coverage; Moderate Balance Sheet**

Rex's operating performance has been strong and consistent with an operating margin of 6.1% for fiscal 2010 (unaudited), which compared favorably with the 4.0% margin budgeted by management for the period as well as with the strong 3.8% reported for fiscal 2009. Management attributes the strong results to volume growth; various cost-containment efforts, without a reduction in staff; and favorable payor reimbursement increases. Management indicated expense reductions included careful hiring throughout the organization, the freeze of merit increases in fiscal 2010, as well as a reduction in supply costs as part of its group purchasing arrangement with UNCHCS. Management indicates these expense cuts, excluding the savings from the merit increase freeze of approximately $5.0 million, generated approximately $10 million in annualized savings for the organization. Excess revenues over expenses of $48.1 million in fiscal 2010 resulted in strong pro forma coverage of maximum annual debt service (MADS of $17.1 million in 2011) of 4.7x -- if annual operating lease expenses of approximately $5.6 million are included as a form of debt service, MADS coverage is reduced to 4.0x, which we still consider strong. The debt service schedule provided by management assumes the refinancing of its Wakefield construction loan through 2039, versus the balloon payment in 2012 under its current finance agreement.

Management indicates it will likely complete its fiscal 2010 audit before the final issuance of the series 2010 bonds.
-- it is our expectation there will be few if any audit adjustments to the numbers cited in this analysis.

Management’s projections over the next five fiscal years include operating margins between 4% and 5% and cash flow growth from operations in the range of $53.2 million to $94.5 million through fiscal 2015. We currently feel these projections appear viable, given the population growth expected in Rex’s service area, its recent addition of facilities throughout the region, and the organization’s strategic expansion plans based on service demand. However, the impact of various factors outside of management’s control, including health care reform, recessionary pressures, and changing market dynamics, will likely contribute significantly to the realization of management’s expectations. We will continue to monitor management’s progress toward achieving its goals as part of our future reviews.

Liquidity through fiscal 2010 was $186.6 million, or light level of days’ cash on hand for the rating of 134; however, these results were greater than the $143.9 million reported for fiscal 2009 and the $154.2 million reported for fiscal 2008. The current bond issuance includes approximately $50 million for routine capital in fiscals 2010 and 2011, which management will use to preserve cash through its capital plan over the coming years. A pro forma view of cash, including the $50 million, reflected a liquidity balance of $236.6 million, or an improved but still light 170 days’ cash on hand. Pro forma debt leverage with this bond issuance was moderate for the current rating at 32% based on fiscal 2010 results. Cash to pro forma debt for the current issuance is, in our opinion, adequate for the rating at 148%. Rex closed its defined benefit pension plan to new employees in February 2009 and reported underfunding of $22.6 million, or funding of 86.8% of its liability as of Jan. 1, 2010 -- the most recent data available. While new to Rex, management is researching the possibility of a capital campaign to support Phase I of its 2030 vision. An exact financial target and use of the funds is early in the development phases. Management indicates they created their current capital plans, including the projects previously highlighted, with a modular approach in mind. According to management, this approach should allow the organization flexibility in future periods, including the elimination or reduction in scope for each project, if they determine financial results are not strong enough to warrant the capital investment.

Rex recently changed investment managers and now reports an investment mix of 44% equities, 9% real assets, 14% hedge funds, 32% fixed income, and 1% cash through June 30, 2010, which is in line with the targets outlined in management’s investment policy.

Volumes: Growth Across Key Service Lines

Rex’s volume in recent years has shifted to outpatient services, however, management reports discharge growth through fiscal 2010 and incremental growth in its areas of focus, including emergent care (at the hospital and its express care centers), surgeries, cardiac services, and primary care visits. Some of Rex’s radiation oncology services appear to have declined as of late, however, management attributes this to the opening of a new facility owned in partnership with Johnston Memorial, known as the Rex/Johnston Memorial Radiation Oncology facility.

Overview Of Rex Healthcare And University Of North Carolina Health Care Systems Relationship

Rex Healthcare Inc. became part of the UNCHCS in 2000. UNC Hospitals is a 799-licensed-bed academic medical center located in Chapel Hill; it serves patients throughout the state. It is the hub of the UNCHCS. Rex Healthcare benefits from this affiliation through group purchasing savings, as well as with its managed-care negotiations. Rex
Healthcare Inc. continues to operate as a separate, private, not-for-profit entity. UNCHS has not assumed or guaranteed Rex Healthcare's debt. As the sole member of Rex Healthcare, UNCHCS has a number of reserved legal powers that effectively give it operating control of Rex Healthcare Inc. and its affiliated members.

Related Criteria And Research

USPF Criteria: Not-For-Profit Health Care, June 14, 2007