Research Update:

Envision Healthcare Corp. Upgraded To 'CCC' From 'SD'; Outlook Negative

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PRIMARY CREDIT ANALYST

David P Peknay
New York
+ 1 (212) 438 7852
david.peknay
@spglobal.com

SECONDARY CONTACT

Alessio Di Francesco, CFA
Toronto
+ 1 (416) 507 2573
alessio.di.francesco
@spglobal.com

Rating Action Overview

- U.S. physician staffing and ambulatory services company Envision Healthcare Corp. recently completed the second of a series of two restructurings that consisted of a 'collateral transfer'(via an unrestricted subsidiary designation) in April, and a priming up tiering loan exchange in early August.
- Similar to the April transaction, we view the latest one as distressed due to the large discounts to par and maturity extensions that we believe investors were compelled to accept.
- Despite the completion of these two transactions, we believe the company's capital structure could still be unsustainable because of the still high leverage and challenging business prospects. Further, its unsecured notes continue to trade at a significant discount, which we believe substantially increases the likelihood for further open market repurchases.
- We raised our issuer credit rating on Envision to 'CCC' from 'SD' (selective default). The outlook is negative.
- At the same time, we raised the rating on Envision's existing first-lien term loan ('fourth-out') to 'CC' from 'D', and senior notes to 'CC' from 'D'. The recovery rating is '6' for both issues.
- We assigned ratings to three new issues: 'B' rating to its first-lien term loan (first-out tranche) with expectations for full recovery (100+%); 'CCC' rating to its first-lien term loan (second-out tranche) with average recovery expectations (30%-50%; rounded estimate: 40%); and 'CC' rating to its first-lien term loan (third-out tranche) with negligible recovery expectations (0%-10%; rounded estimate: 0%).
- The negative outlook reflects our view that the capital structure could still be unsustainable, and there remains an elevated risk for further distressed activity.

Rating Action Rationale

Our 'CCC' issuer credit rating reflects still very weak credit measures, and our view its capital structure may still be unsustainable. The two restructurings resulted in reduced debt for Envision (excluding the debt at the unrestricted AmSurg LLC subsidiary), but increased debt on a consolidated basis. Ultimately for Envision, the restructurings extended debt maturities, and put a lot of cash on the balance sheet from the proceeds of new debt issued at Amsurg, providing Envision with the flexibility to improve its operations. Debt leverage remains very high and the company will likely face cash flow deficits over the near term. We also believe Envision faces a number of business challenges.

Envision's physician services business continues to struggle. Business prospects for Envision's physician services business have deteriorated, as same-contract revenue is always contending with chronic rate pressure on its in-network business. Furthermore, the recently implemented No Surprises Act seems to be having a more adverse impact on providers than what was broadly anticipated. Rates for out-of-network business have declined, complicating the negotiating relationships with the payors. Furthermore, Envision is experiencing a significant amount of lost revenue from contract terminations, though a significant amount of it is intentional.

Outlook

The negative outlook reflects our view that the capital structure remains unsustainable and that there is a potential for an event of default or another distressed debt exchange over the next 12 months.

Downside scenario

We could lower our rating on Envision if it pursues another debt exchange or restructuring we view as distressed.

Upside scenario

We could raise our rating on Envision if we view a distressed exchange or further restructuring as less likely. This would likely entail a significant improvement in business prospects, particularly the reimbursement environment.

Company Description

U.S.-based Envision is a national provider of physician-led services, and ambulatory services. The company is one of the largest providers of outsourced physician services to hospitals, ambulatory surgery centers, and other health care facilities, primarily in anesthesia, radiology, women's and children's services, and emergency medicine. The company (including the now-unrestricted subsidiary Amsurg), generates about 83% of revenue from physician services and 17% from ambulatory services. It is one of the largest providers of ambulatory surgery, owning and operating 256 facilities. Envision was acquired by KKR in October 2018.

Our Base-Case Scenario

- Including the unrestricted subsidiary, Amsurg LLC, we expect a revenue decline of 7%-8%.
- EBITDA margin in 2022 of 4%, increasing to 6% in 2023.
- Cash flow deficits of $400 million to $500 million in 2022, and $200 million to $300 million in 2023.

Based on these assumptions, we arrive at the following credit measures:

- Debt to EBITDA of 29x in 2022, and 20x in 2023;
- Funds from operations (FFO) to debt of negative 2%-2.5% in 2022, and negative 2.5%-3.5% in 2023; and
- EBITDA interest coverage of 0.5x in 2022, and 0.6x in 2023.

Liquidity

We view Envision's liquidity as less than adequate, reflecting our view that the company is unlikely to absorb low-probability adversities under its new capital structure and that it lacks standing in credit markets. Furthermore, while we expect sources of cash to be sufficient to cover its uses over the next 12 months, its cash will decline as it funds large cash flow deficits.

Principal liquidity sources

- Unrestricted cash (excluding cash held at a joint venture or captive insurance entity) of about $1.25 billion as of the end of the second quarter ending June 30, 2022; and
- Annual cash funds from operations (FFO) of at least $30 million.

Principal liquidity uses

- Some working capital outflow;
- Capital expenditures of $140 million to $160 million over the next 12 months;
- Annual distributions to noncontrolling interests of at least $200 million;
- At least $50 million annually to self-fund malpractice coverage; and
- $429 million outstanding under Envision's ABL facility that matures in October 2023.

Covenants

Requirements

With the recent termination of Envision's revolving credit facility there are no financial maintenance covenants under its bank facility.

The $550 million asset-based revolver is also subject to a springing financial covenant requiring the fixed-charge coverage ratio not to exceed 1x when excess liquidity, which includes cash on hand, availability under the ABL facility is less than the greater of $55 million and 10.0% of the lesser of the then-applicable borrowing base and the then-total effective commitments under the facility. We believe there is about $429 million drawn under its $550 million ABL facility (not including about $120 million of outstanding letters of credit).

Environmental, Social, And Governance

ESG credit indicators: E-2, S-3, G-3

Social and governance factors are a moderately negative consideration in our credit rating analysis. As one of the largest players in the physician staffing industry, Envision generates a portion of its revenue from out-of-network services. In our view, this could result in significant patient bills that may be disputed and undergo lengthy negotiation with powerful payors. Governance factors are a moderately negative consideration in our credit rating analysis. Our assessment of the company's financial risk profile as highly leveraged reflects corporate decision-making that prioritizes the interests of the controlling owners. In line with our view of the majority of rated entities owned by private-equity sponsors. Our assessment also reflects the generally finite holding period and focus on maximizing shareholder returns.

Issue Ratings - Recovery Analysis

Key analytical factors

- We evaluate recovery prospects for Envision on a consolidated basis, including its unrestricted AmSurg subsidiaries (hereafter AmSurg), which have a stand-alone debt structure and do not directly support Envision's other debt following the April 2022 restructuring which transferred 83% of Envision's ambulatory services business (and related collateral) via a designation of AmSurg LLC as an unrestricted subsidiary. Hereafter we distinguish between AmSurg and the remainder of the company as RemainCo.
- Envision closed on a second restructuring on Aug. 5, 2022, where (1) RemainCo fully repaid its cash flow revolver, (2) converted its term loan B into a four levels of seniority, including a $300 million new money first-out tranche, and (3) AmSurg raised a new $300 million super-senior cash flow revolver.
- RemainCo's current debt structure consists of a $550 million (unrated) ABL facility, a $3.72 billion first-lien term loan B (with four tranches with different repayment priorities), $981 million of unsecured notes, $1.35 billion in first-lien intercompany loans due to AmSurg, and about $11 million in ambulatory surgery center debt.
- At the unrestricted AmSurg subsidiary, there is a $300 million super-senior revolving credit facility, a $1.3 billion first-lien facility (not rated), a $1.35 billion second-lien facility (not rated), plus about $44 million in Ambulatory Surgery Center debt. We believe all value at this entity will be fully absorbed by its debt, preventing any residual value from flowing to RemainCo.
- The four-tranche term loan B and intercompany loan from AmSurg are pari passu first-lien debt and will share equally in a bankruptcy scenario. The tranches within the term loan B will then

divvy up their share of the company value according to the seniority of the tranches.

- Our '1+' recovery rating on the first-out tranche of the term loan B facility indicates the expectation for full (100%) recovery in the event of default given its small size relative to its position in the capital debt stack.
- Our simulated default scenario contemplates a default in the first half of 2023, due to liquidity pressures. We assume EBITDA at this point is roughly in line with the company's fixed-charge obligations, including debt service requirements and minimum capital expenditures.
- We believe Envision would remain a viable business and would reorganize rather than liquidate following a payment default. Consequently, we valued the company as a going concern.
- We assume the gross enterprise value of the company at default is split 60/40 between the restricted and unrestricted groups. The restricted group (RemainCo) comprises the physician services business and about 17% of the ambulatory services while the unrestricted group (AmSurg LLC) comprises about 83% of the ambulatory services business.
- For our recovery analysis, we assume the ABL facility is 80% drawn, reflecting current usage rates; mandatory principal amortization is made, up to the default year; and six months of accrued and unpaid interest on funded debt (in addition to accrued interest that is paid-in-kind on RemainCo's incremental term loan and AmSurg's second-lien debt).
- We assume the ABL facility has a priority claim on working capital assets at RemainCo and that it is fully collateralized in a default scenario.
- We value the company using a 6x multiple on our projected emergence EBITDA, which is 0.5x above the standard multiple used for the health care services industry to reflect our view of Envision's relatively larger scale and better diversification compared to peers due to its ambulatory services business.
- We note that further potential capital structure changes over the coming weeks or months could further shift debt amounts and relative priorities and that these changes could raise or lower our estimated recovery for Envision's secured claims. Potential changes include, but are not limited to, debt repurchases below par or the partial or full repayment of its intercompany loan.

Simulated default assumptions

- Simulated year of default: 2023
- EBITDA at emergence: $673 million
- EBITDA multiple: 6.0x

Simplified waterfall

- Gross enterprise value: $4.04 billion
- Net enterprise value (after 5% administrative costs): $3.83 billion
- Valuation split in % (Remainco/AmSurg LLC): 60%/40%
- Value available to RemainCo claims: $2.3 billion
- ABL priority lien: $453 million

- Total value available to RemainCo first-lien lenders: $1.85 billion
- Secured first-lien claims (term loans, and intercompany loans (not rated)): $5.82 billion
- Value absorbed by the intercompany loan from AmSurg LLC: $524 million
- Value available to Term Loan B claims: $1,324 billion
- First-lien term loan (first-out tranche): $315.57 million
- --Recovery expectation: 100%
- First-lien term loan (second-out tranche): $2.270 billion
- --Recovery expectation: 30%-50%; rounded estimate: 40%
- First-lien term loan (third-out tranche): $1.061 billion
- --Recovery expectation: 0%-10%; rounded estimate: 0%
- First-lien term loan (fourth-out tranche): $158 million
- --Recovery expectation: 0%-10%; rounded estimate: 0%
- Value available to unsecured lenders: $0
- Deficiency claims from secured creditors: $3.46 billion
- Total unsecured claims: $4.452 billion

--Recovery expectation: 0%-10%; rounded estimate: 0%

Note: All debt amounts include six months of prepetition interest.

ESG credit indicators: E-2, S-3, G-3

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012

- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Upgraded; Outlook Action

	To	From
Envision Healthcare Corp.		
Issuer Credit Rating	CCC/Negative/--	SD/--/--
Envision Healthcare Corp.		
Senior Secured	CC	D
Senior Unsecured	CC	D
New Rating		
Envision Healthcare Corp.		
Senior Secured		
US$1.029 bil Third Out Term bank ln due 03/31/2027	CC	
Recovery Rating	6(0%)	
US$2.196 bil Second Out Term bank ln due 03/31/2027	CCC	
Recovery Rating	4(40%)	
US$300 mil New Money First Out Term bank ln due 03/31/2027	B	
Recovery Rating	1+(100%)	