

19 JAN 2022

## Fitch Affirms CAN Community Health, FL's Revs at 'BB-'; Outlook Stable

Fitch Ratings - New York - 19 Jan 2022: Fitch Ratings has affirmed CAN Community Health, Inc., FL's (CAN) 'BB-' Issuer Default Rating (IDR), and has affirmed the 'BB-' ratings on CAN's series 2020 taxable bonds.

The Rating Outlook is Stable.

### SECURITY

The bonds are secured under a master trust indenture (MTI) by a pledge of and security interests in the gross revenues and effectively all assets of obligated group (OG), including its stock in owned pharmacy businesses.

The bonds also feature a debt service reserve fund equal to at least the next two semi-annual interest payments. In addition to restrictive covenants, the bonds also feature a quarterly cash sweep equal to 25% of excess cash flow (EBITDA less debt service payments) to a trustee-held account for debt payments; cash accumulated in this account can be released in the future under certain conditions.

### ANALYTICAL CONCLUSION

The 'BB-' ratings reflect CAN's healthy business profile and good growth prospects, but anchored by currently high leverage, risk from its debt structure, and high dependence on the federal 340B drug discount program. Fitch expects CAN's fundamental credit profile, with healthy cash flow and a likely deleveraging trajectory, could support higher 'BB' category ratings over time. However, the ratings are constrained by currently high leverage and refinancing risk related to the three-year put option (March 2024 tender date) on the bonds.

CAN has a solid position in a relatively narrow but stable market segment. It provides medical care, pharmaceuticals and other services related to human immunodeficiency virus (HIV), hepatitis C (HCV) and other sexually transmitted diseases (STDs). Access to heavily discounted drugs through the federal 340B program generates a strong margin on 340B drug sales, although total margins are lower after subsidizing other types of patient care, medication and various mission-related services.

Leverage remains high, but consistent with the current rating level, and is likely to improve over the next few years, even if CAN's cash flow grows more slowly than in its prior projections. Fitch believes CAN is well-positioned to maintain strong revenue and cash flow growth from continued development of its 340B patient base and related high-margin 340B pharmaceutical sales.

## KEY RATING DRIVERS

### Revenue Defensibility: 'Midrange'

CAN's growing patient base, driven by its clinic network, supports its ability to achieve significant growth in pharmacy sales and total revenues. Good prospects for 340B volume growth, with a focus on increasing utilization of existing clinics, but with some further geographic expansion, together with strong margins on 340B sales, and the lifelong treatment of HIV through a pharmaceutical regimen, are key revenue defensibility considerations that outweigh CAN's weaker pricing power with limited ability to negotiate higher reimbursement for drugs or medical services. CAN's very high dependence on the 340B program and uncertainty about potential program changes also limit Fitch's revenue defensibility assessment to 'Midrange'.

### Operating Risk: 'Midrange'

Strong margins on the sale of 340B-discounted drugs and a highly variable cost structure for pharmacy activity are tempered by CAN's continued growth plans. While growth plans have shifted to focus more heavily on utilization in existing clinics, new clinics will also entail some additional near-term capex and higher operating costs through integration or ramp-up periods. CAN's total margins are markedly lower, though still adequate, due to its mission-driven need to use 340B margins, in line with the program's purpose, to subsidize less profitable but impactful services.

### Financial Profile: 'Weaker'

CAN's Fitch-adjusted leverage (net of unrestricted cash and cash swept to the trustee, and including Fitch-capitalized operating leases at 8x expense) remains high, above 6x at FYE (June 30) 2021. Fitch expects net leverage will improve toward 3x or better, or to around 4x to 5x in a moderate stress scenario, over the next few years due to growing total cash flow and a quarterly sweep of 25% of excess cash flow to the trustee.

Liquidity is a neutral consideration and does not constrain the ratings despite a liquidity cushion ratio below 0.33x. CAN's concentration in the relatively working capital-efficient pharmacy businesses, and its focus on a narrower range of specialized drugs, largely by direct mail delivery, support efficient inventory management. Strong margins on 340B drugs also help fund related working capital requirements, and the organization generates adequate consolidated debt service coverage.

### Asymmetric Risk Additive Considerations

The three-year put option on the bonds is a risk-additive debt feature that will constrain the ratings until resolved. CAN's unrestricted cash position is improving as expected but will not likely be sufficient to pay down the bonds if tendered, exposing CAN to refinancing risk by March 2024.

In context of CAN's limited market access track record and currently below-investment grade fundamental profile, the potential need to explore refinancing options as early as calendar 2023 results in the ratings weighting nearer-term expectations, including still-higher leverage, more heavily than CAN's likely medium-term or longer-term performance.

The put feature does not constrain the ratings below the 'BB' category due to improvement, both to date and expected over the next one to two years, in CAN's leverage and liquidity. In addition, certain structural protections, including a reasonable notice period ahead of a put, debt service reserve fund, sweep of 25% of annual excess cash flow to the trustee, and lien on stock in owned pharmacies support the rating.

These ratings do not incorporate recovery prospects or collateral value, but Fitch believes CAN's financial trajectory and bond security features together improve the likelihood of timely and orderly refinancing if the put option is exercised.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Growth in cash flow resulting in some cash accumulation and stronger net leverage (Fitch-adjusted) sustained at 3x-4x or better through Fitch's stress analysis;

--Resolution of refinancing risk.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Failure to achieve and maintain net leverage below about 6x or better over the next one to two years.

--Significant 340B compliance issues, loss of program eligibility or material changes to the program that limit CAN's access to or margins from discounted drugs through the program.

--Failure to form a credible plan for refinancing the bonds in advance of the March 2024 put, if notified by holders that they may or will exercise that option.

## **Best/Worst Case Rating Scenario**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **CREDIT PROFILE**

CAN is a not-for-profit 501(c)(3) corporation that provides a continuum of medical, social, and educational services essential to the health and well-being of those infected with HIV/AIDS, HCV, STDs and other diseases, and that seeks to enhance public awareness of these diseases. CAN was

established in Sarasota, FL in 1991 and now owns or operates 35 clinics in Florida, South Carolina, Arizona, New Jersey, Virginia and Texas.

A key part of CAN's current strategy is to become a pharmaceutical provider for its patients. According to management, this approach has significantly improved drug regimen adherence and patient health outcomes, as well as driven revenue growth. CAN opened its first owned pharmacies mid-2018 and now generally places a pharmacy in each new clinic.

In the same year, CAN acquired two pharmacies with mail-order experience and which already served significant numbers of CAN patients: JTJ Medical Supply (80% owned), which operates Mail-Meds (MM) and specializes in providing HIV drugs by mail, and Tampa Family Pharmacy (TFP, now 100% owned), which specializes in HCV drugs. In December 2020, CAN also acquired Midland, a medical and pharmaceutical provider in South Florida, with series 2020 bond proceeds.

#### Obligated Group Structure; Fitch Looks to Consolidated Entity

In addition to the CAN parent, the OG will include MM, TFP, MidlandCAN, LLC, the individual Midland entities acquired in 2020, and CANTransport, LLC, which owns CAN's airplane. Other non-obligated affiliates are not material to the consolidated entity but include Sarasota-Bradenton Aviation, Inc. (35% interest), which owns and operates a hangar; MetroCAN, LLC, a 50% joint venture with a mission-aligned not-for-profit, Metro Inclusive Health, Inc., to develop and operate a medical office building; and Midland Cares, Inc., a Midland-related entity that helps populations facing economic or social barriers access care and community-based services.

Fitch focuses on the consolidated entity because current OG members make up the bulk of consolidated assets and activity. In addition, members could be withdrawn from the OG in the future, and certain financial covenants relate to a combined group that could in the future include designated or restricted affiliate members beyond the OG.

#### **Asymmetric Risk Additive Considerations**

Management and governance considerations are currently neutral to the ratings despite recent CEO turnover and a lawsuit related to the change. The new CEO, remaining CFO and other key leaders are experienced with CAN and in the sector, and CAN does carry insurance relevant to potential losses. CAN does not believe the suit will result in material financial repercussions.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

#### **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

#### **ESG Considerations**

CAN has an ESG Relevance Score of '4' for Exposure to Social Impacts due to high reliance on the

federal 340B drug discount program, which has a negative impact on the credit profile, and is relevant to the ratings in conjunction with other factors. Access to the program, which entails significant regulatory scrutiny and a high compliance burden, is a key component of CAN's strategy and financial performance. There have also been disputes over specific provisions of the program and proposals to reform or narrow the program.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

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## Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
CAN Community Health, Inc. (FL)	LT IDR	BB- ● Affirmed	BB- ●

ENTITY/DEBT	RATING	RECOVERY	PRIOR	
<ul style="list-style-type: none"> <li>CAN Community Health, Inc. (FL) /General Revenues/ 1 LT</li> </ul>	LT	BB- 	Affirmed	WD

#### RATINGS KEY OUTLOOK WATCH

POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

#### Applicable Criteria

[Public Sector, Revenue-Supported Entities Rating Criteria \(pub.01 Sep 2021\) \(including rating assumption sensitivity\)](#)

#### Additional Disclosures

[Solicitation Status](#)

#### Endorsement Status

CAN Community Health, Inc. (FL) EU Endorsed, UK Endorsed

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