

MOODY'S

INVESTORS SERVICE

Rating Action: Moody's affirms Prospect Medical's B1 CFR; rates new term loan Ba3; outlook to negative

Global Credit Research - 03 Jun 2016

New York, June 03, 2016 – Moody's Investors Service ("Moody's") today affirmed Prospect Medical Holdings, Inc.'s (Prospect Medical) B1 Corporate Family Rating and B1-PD Probability of Default Rating. Moody's also assigned a Ba3 (LGD 3) rating to the company's proposed \$650 million senior secured term loan B. The proceeds of the new term loan B, along with drawings under a \$100 million asset based revolving credit facility (not rated by Moody's) will be used to refinance Prospect Medical's existing debt and fund three previously announced acquisitions in Connecticut and Pennsylvania. The rating outlook was revised to negative from stable.

"Prospect Medical's pro forma adjusted debt to EBITDA will increase to a relatively high 5.3 times as the company completes a number of acquisitions that will nearly double its annual revenue," said Dean Diaz, a Senior Vice President at Moody's. "However, earnings growth at existing and newly acquired facilities will contribute to a reduction in leverage over the next 12 to 18 months," continued Diaz.

The affirmation of Prospect Medical's B1 Corporate Family Rating reflects Moody's expectation that the company will benefit from additional scale and diversification provided by the addition of seven facilities and two states. Moody's also believes that the company will refrain from any additional large, transformational acquisitions until recently acquired facilities are fully integrated and leverage is reduced.

The negative rating outlook reflects Moody's consideration of the risks associated with these transformational acquisitions. Risks include the challenges the company may have trying to scale existing infrastructure in the integration process, the need to improve operating results at the acquired facilities, and the establishment of operations and physician relationships in new markets. Further, the high leverage resulting from the financing of the transactions decreases the company's ability to absorb setbacks or disruptions in operating results at the current rating level.

Following is a summary of Moody's rating actions.

Ratings assigned:

Senior secured term loan B due 2022 at Ba3 (LGD 3)

Ratings affirmed:

Corporate Family Rating at B1

Probability of Default Rating at B1-PD

Senior secured notes due 2019, at B1 (LGD 3) (rating to be withdrawn upon the planned redemption of the notes)

The rating outlook was revised to negative from stable.

RATINGS RATIONALE

Prospect Medical's B1 Corporate Family Rating reflects the company's moderate, though improving scale, its high financial leverage, high concentration of revenue and EBITDA in only a few markets, and significant reliance on California and Texas Medicaid programs. Moody's anticipates that Prospect Medical will remain acquisitive in order to continue to gain scale and improve geographic diversification. However, Moody's expects that earnings and cash flow growth from both existing and recently acquired hospitals will allow the company to reduce leverage over the next 12 to 18 months.

The ratings could be downgraded if operational or integration challenges cause a significant deterioration in financial metrics or the company undertakes a material debt funded acquisition or shareholder distribution. More specifically, ratings could be downgraded if Moody's expects debt to EBITDA to be sustained above 4.5

times or if liquidity weakens.

Prospect Medical's ratings could be upgraded if the company can successfully integrate its planned acquisitions and improve operations at newly acquired facilities without disruption. Moody's would also have to see the company increase scale and enhance revenue and earnings diversification while reducing financial leverage. More specifically, the ratings could be upgraded if Prospect Medical reduces and maintains debt to EBITDA at around 3.5 times.

Headquartered in Los Angeles, California, Prospect Medical Holdings, Inc. provides health care services through a network of acute care and behavioral hospitals. Through its Medical Group business unit, the company provides administrative management of health care services to independent physician organizations that cover members through a network of primary care doctors and specialists. Prospect Medical recognized revenues of approximately \$1.4 billion in the twelve months ended March 31, 2016. The company is owned by certain funds of private equity firm Leonard Green & Partners L.P. and members of the company's management team.

The principal methodology used in these ratings was Business and Consumer Service Industry published in December 2014. Please see the Ratings Methodologies page on www.moody's.com for a copy of this methodology.

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