Health Care

Ratings deterioration to moderate as cash flows improve

January 14, 2025

This report does not constitute a rating action.

What's changed?

Ratings deteriorated. Lower-rated companies in the health care services subsector led the overall sector ratings to deteriorate. Still, we maintain a stable outlook on the sector.

Revenues normalized. Demand is steady, inflationary pressures moderated, but cash flows are anemic given the Change Healthcare cyberattack and claim delays.

A record number of defaults for the third year in row. Leverage for many companies remained too high and shortfalls in free cash flow generation led to restructurings and defaults.

What are the key assumptions for 2025?

Demand to remain solid. We project industry growth of 4%-7% across the sectors.

EBITDA margins and cash flows to improve, especially for the health care service providers.

Increasing mergers and acquisitions (M&A), even among the heavily private-equity owned, highly leveraged, speculative-grade service providers.

What are the key risks around the baseline?

Inflationary and labor pressures return. Labor costs continue to be a long-term challenge.

Increasing reimbursement and cash flow pressures. Rising health care spending, driven partly by increased utilization of health care, inflationary pressures, and growing use of GLP-1s may lead to tougher pricing negotiations and increased claim denials, pressuring margins and cash flows.

Incoming U.S. administration brings uncertainty. We do not expect rating actions in the near term but consider any potential increased legislative risks to be a credit negative.

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Ratings Trends: Health Care

Chart 1

Ratings distribution by region

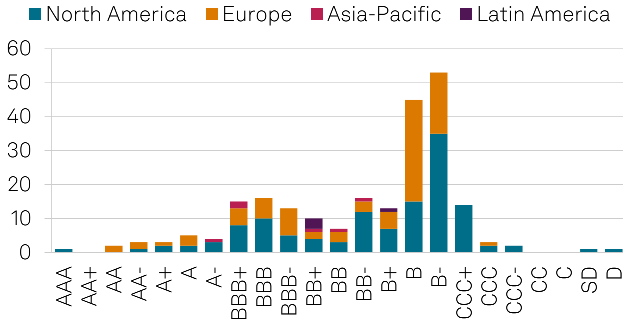


Chart 2

Ratings distribution by subsector

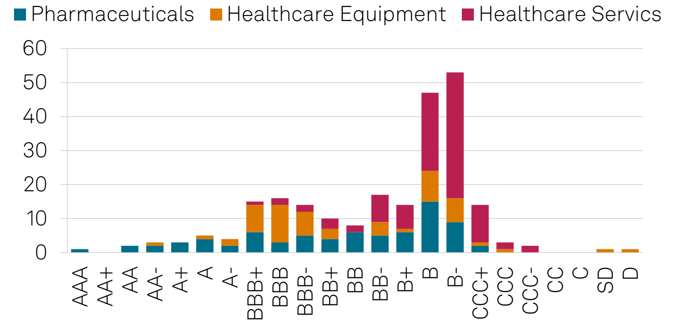


Chart 3

Ratings outlooks

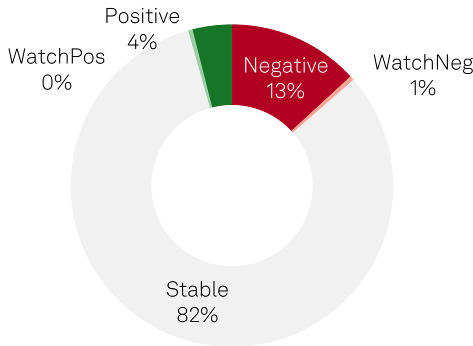


Chart 4

Ratings outlooks by subsector

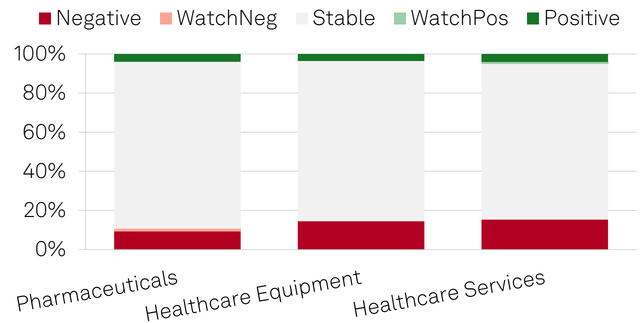


Chart 5

Ratings outlook net bias

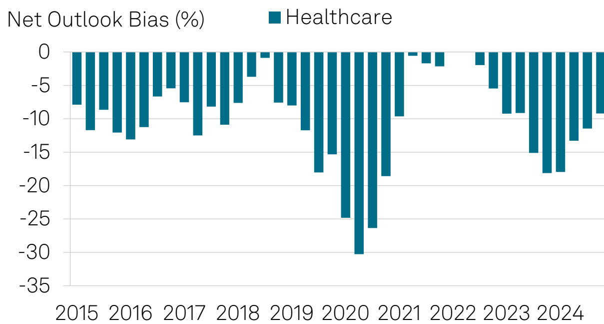
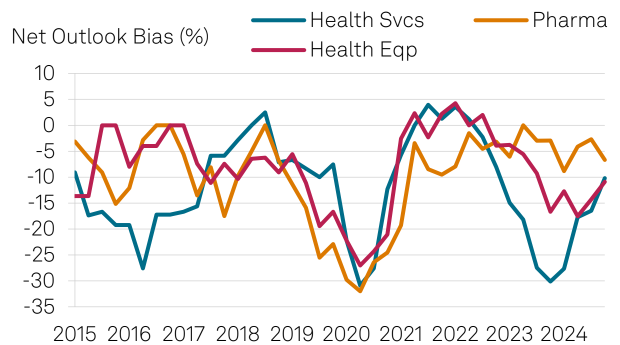


Chart 6

Ratings net outlook bias by subsector



Source: S&P Global Ratings. Ratings data measured at quarter-end.

Industry Outlook

Ratings trends and outlook

We maintain an overall stable outlook on the health care sector. The majority of pharmaceutical and medical device and product companies have a stable outlook. A negative bias still exists for health care services companies, as they grapple with elevated leverage, leaving little room for operating shortfalls that contributed to downgrades and defaults. However, we expect continued improving operating environment, including normalization of demand, moderating labor and inflationary costs, and a more favorable interest rate environment. Therefore, we believe the ratings deterioration will slow.

Sector credit metrics will likely stabilize in the first half of 2025. Health care ratings continued to deteriorate in 2024, almost entirely due to low-end speculative-grade entities (rated 'B+' and below) concentrated in the health care services subsector. Many of these issuers are largely owned by private-equity firms that typically have a more aggressive financial policy and a higher tolerance for leverage. In 2024, many of them struggled to generate adequate sustained free cash flows amid still elevated interest rates and an improving, but still inflationary, environment. The No Surprises Act and Medicaid redetermination process, as well as the Change Healthcare cybersecurity breach that significantly delayed claims processing and cash collections, disrupted cash flows in the first half of 2024, further weighing on ratings. Indeed, for the speculative-grade rated health care companies, which account for most of our rated universe, downgrades outpaced upgrades by a ratio of 2:1 and unfavorable outlook revisions outpaced favorable outlook revisions by 3:1.

We expect cash flows will improve in the first half of 2025 as the effects of the Change Healthcare cybersecurity breach dissipate and the delays in claim processing normalizes. As a result, we expect ratings deterioration will slow in 2025 and may revise our outlook to stable from negative for the health care services sector in the first half.

In the meantime, we believe demand is stable, with patient and procedure volumes and acuity largely normalized. We project 4%-7% revenue growth across the major subsectors. Insurance coverage rates continue to be at all-time highs, with the level of uninsured at 8%, supporting demand. While the incoming Trump administration may allow COVID-era subsidies that have helped people gain coverage via the Affordable Care Act (ACA) to expire and lead to an increase in uninsured rates, we believe the overall growth and aging of the population will continue to drive utilization.

S&P Global Ratings-adjusted EBITDA margins for the services subsector have improved due to moderating inflationary pressures and implementation of efficiency measures. Still, labor costs remain elevated, and we expect they will remain so long term, given continued shortage of health care professionals (see "Despite Some Improvement, Weaker Health Care Services Companies Continue To Struggle," published May 2, 2024).

We expect defaults will moderate in 2025. The health care sector saw a third year of record number of defaults in 2024. Despite improving conditions, leverage for many companies remained too high and shortfalls in free cash flow generation led to restructurings and defaults. However, we believe sector defaults will moderate in 2025, given interest rate cuts, lessening inflationary pressures, and improving free cash flows. Still, defaults will likely remain above historical levels because of high labor costs and the borderline unsustainable capital structures of many speculative-grade companies (see "Record-High Health Care Defaults Will Moderate In 2025, Though Higher Than Normal," published Nov. 20, 2024).

The outlook for medical devices and products remains stable. We forecast the subsector will return to revenue growth in 2024, increasing 3.7%. We also forecast profitability will modestly improve by 70 basis points (bps) to aggregate S&P Global Ratings-adjusted EBITDA margin of 25.2%, largely due to easing of inflationary pressures and dissipating supply chain challenges; we consequently revised our outlook on Koninklijke Philips N.V. to stable.

We expect revenue for the medical devices and products sector will increase 4.2% in 2025 and EBITDA margin will expand in aggregate by 100 bps. We continue to view the health care equipment development sector favorably, despite stretched health care budgets in the largest markets of U.S. and Europe, with increasing need for cost efficiency driving the use of advanced technology.

Our outlook for the pharmaceutical sector remains stable, given our expectation for healthy revenue growth through 2027 for many companies due partly to increasing sales of GLP-1s (weight loss drugs), oncology treatments, and new classes of Alzheimer's treatments. We forecast growth despite headwinds from patent expirations, increasing biosimilar competition, and the looming Medicare drug price negotiations as part of the Inflation Reduction Act (IRA) that go into effect starting 2026.

M&A activity in the pharmaceutical sector will likely increase from the unusually low levels we saw in 2024, given its strategic importance to product pipelines and portfolios, and to future revenue growth. Many Big Pharma and biotech companies used the year to build or rebuild debt capacity at their current rating levels, following the flurry of M&A in 2023, including Pfizer's $43 billion acquisition of Seagen Inc., Merck's $10.8 billion acquisition of Prometheus Biosciences, and Amgen's $26 billion acquisition of Horizon Therapeutics, among others. Going forward, improving interest rates and the likelihood of lessened scrutiny from the Federal Trade Commission (FTC) could contribute to increased acquisitions (see "Pharmaceutical Industry 2024 Credit Outlook Is Stable As Revenue Growth Mitigates Pressures," published June 24, 2024).

We expect no immediate ratings actions to stem from the Trump administration. The incoming U.S. president's tone on health care policy and some of his proposed appointees to head key health care agencies could ultimately increase the degree of legislative risk on the sector. However, we don't expect major changes to ratings in the near term to stem from this. We are monitoring areas such as changes to the ACA, Medicaid funding, the support of Medicare Advantage, Medicare drug price negotiation, FTC scrutiny of M&A, and the implementation of tariffs and their potential impact to supply chains. We are also following the priorities of the new head of Department of Health and Human Services (HHS). For example, shifts in the federal government's stance on vaccines could result in lower sales for pharmaceutical companies that have significant vaccine sales, such as those for shingles, pneumonia, and RSV (see "The Health Care Credit Beat: Republican Red Wave A Net Negative For Health Care," published Dec. 2, 2024).

Main assumptions about 2025 and beyond

1. Demand remains healthy for health care.

Patient and procedure volumes and acuity have largely normalized, and we project 4%-7% annual revenue growth across the subsectors.

2. EBITDA margins improve, but labor remains a challenge.

We expect flat to slight improvement for all major subsectors as inflationary and labor pressures moderate. However, labor costs continue to be a long-term challenge.

3. Health care service providers' cash flow to improve.

Cash flow generation has not reflected the improvement in sales and EBITDA margins for health care services. We project improvement as the effects of No Surprises Act and Change Healthcare cyberattack dissipate.

Demand remains steady, with mid-single-digit percent growth rates across all subsectors. With the exception of a few service lines and geographies, we believe patient and procedure volumes and acuity have normalized and that the backlogs of delayed procedures have largely run through the system. The health care labor cooled somewhat, which has enabled providers to increase hiring to handle the growing treatment capacity, and they project single-digit percent revenue growth. Given the normalization of patient and procedure volumes, we also expect stable demand for medical device and product companies. For the pharmaceutical sector, the projected growth of sales of GLP-1s and new classes of cancer drugs will lead to solid 5%-6% revenue growth for the sector in 2025, despite patent expirations and continued pricing pressure.

EBITDA margins will improve in 2025. We project median EBITDA margins will remain flat to slightly improved across the subsectors. Given moderating inflationary pressures, especially on labor costs, and the implementation of efficiency efforts, we also project flat to slightly improved margins for service providers at 16%. For pharmaceutical companies, we project slight EBITDA margin improvement to 28%. Medical device and product companies will also see margin improvement to median EBITDA margin of 25% because supply chain pressures and shipping costs have eased.

Labor will remain a long-term challenge for health care service providers because we expect shortages of nurses and physicians will persist beyond 2025 and possibly through the balance of the decade. Labor costs growth will likely remain elevated, though moderated. We expect efficiency measures and a greater usage of permanent staffing versus more expensive temporary staffing will enable service providers to stabilize or slightly improve EBITDA margins.

Still, cash flows in the subsector are likely to improve. Cash flow generation for service providers was weak in 2024 because of the effects of No Surprise Acts and the Change Healthcare cybersecurity breach. The denial and delay of claims processing by insurers have also resulted in increased collection times. We project these effects will dissipate and normalize in the first half of 2025. This, along with more favorable interest rates, will lead to improving cash flows.

Credit metrics and financial policy

We expect credit metrics for the health care industry will improve in 2025, absent a major pickup in M&A activity, supported by our expectation for stable demand, revenues growing 4%-7% annually, margins further improving as inflationary pressures ease, and interest rate cuts. We believe M&A activity will increase in 2025 compared to 2024, pressuring credit metrics; however, we believe the increase will be gradual and costs will not likely match the highs of prior years.

Labor costs will likely remain a longer-term challenge given physician and nursing shortages and highlighted by health care costs continuing to outpace overall labor market growth. We are also monitoring the reimbursement environment because a tougher reimbursement environment would result in lower margins and cash flows, especially at a time when providers are still facing a tough labor market and inflationary pressures.

M&A activity will pick up. M&A was relatively muted in 2024 for an industry that's typically among the most active in such activity. This, along with continued solid growth and strong EBITDA margins and operating cash flows, enabled the pharmaceutical industry's S&P Global Ratings-adjusted leverage to improve and capacity for future M&A at the current ratings to increase.

We believe M&A in the health care services subsector will return in earnest sometime in 2025 driven by the strategic need for economies of scale and higher reimbursement rates from payors. However, we believe capacity is limited given the still very high leverage at many companies.

Key risks or opportunities around the baseline

1. EBITDA margin pressure intensifies.

If inflationary pressures, labor, or reimbursement challenges become larger issues, margins could be squeezed.

2. Free cash flow generation improvement fails to materialize.

If unforeseen negative developments occur, such as the Change Healthcare cyber security breach in 2024, cash flows could again be tight, leading to ratings deterioration.

3. M&A activity returns more aggressively than expected.

We could see ratings deterioration as a result.

4. A bigger focus on supply chains.

Capacity limitations could slow sales growth of GLP-1s, and possible tariffs could upset supply chains, adding costs to the health care system.

5. Legislative policy risks could rise.

The incoming Trump administration's health care policies could have ratings ramifications for the industry.

Margin pressure could intensify. We project further improvement in 2025 on median S&P Global Ratings-adjusted EBITDA margins for the three major subsectors—health care services, medical devices, and pharmaceuticals—after being stable or slightly improved in 2024. However, issuers will be under constant pressure to find efficiencies, with employers and governments scrutinizing health care spending, major health insurers looking to lower their medical cost ratios, and labor costs remaining elevated.

Health care services providers will have to continue to look for efficiencies to improve margins. They continue to have high exposure to labor costs (35%-55% of cost base), relatively low margins (mid-teens percent), and tight labor supply over the long term. Inflationary pressures have moderated, and labor cost growth continues to slow, in part due to companies' efficiency measures and declined usage of more-expensive temporary staffing. However, if labor costs spike up, margin improvement could stall.

Also, reimbursement levels, which have been relatively stable, could also become pressured, as health insurers look to lower their medical cost ratios and employer health plan sponsors see their annual health care costs grow by high-single-digit percent (with some approaching double digits). If companies fail to achieve additional efficiencies, we could see margin improvement for this more vulnerable group stall and even fall.

Free cash flow generation levels could remain low. Cash flow generation for the speculative-grade rated health care companies was relatively weak in 2024, contributing to liquidity issues and overall ratings deterioration. This is highlighted by the 2:1 downgrade-to-upgrade ratio among speculative-grade rated health care companies and a record level of defaults. We project cash flows will improve in 2025. However, for many issuers in the sector there is little cushion to downgrade thresholds. Also, we have seen reports of insurers increasing the rejection rate of both pre-approval and reimbursement claims, which could slow cash collections. Furthermore, any shortfall in demand or margins could weigh on cash flow generation and quickly lead to further ratings deterioration, especially for service providers.

M&A activity could be more aggressive than expected. Consolidation continues to be strategically important for much of the highly fragmented health care industry, and we expect M&A across all the subsectors. Health care service providers will use it to gain efficiencies and increase negotiating leverage on reimbursement rates. For pharmaceutical companies, M&A has deepened and diversified their pipelines and portfolios, especially given loss of exclusivities (LOEs) and looming Medicare drug price negotiation going into effect 2026. Medical device and product companies have not been as active on the M&A front, though we expect an increase in activity in the sector in the intermediate term and believe several companies are actively looking.

We are monitoring potential supply chain risks that are more likely to affect the pharmaceutical sector than the medical device and products industries. The fastest growing pharma segment is obesity, which could reach about $130 billion in annual sales by 2030. Existing players in the market, notably Novo Nordisk and Eli Lilly, continue to focus on scaling up production capacity. The bargaining power has somewhat rebalanced in favor of contract development and manufacturing organizations (CDMOs), especially those with skills on biologic molecules. For example, we recently lowered our ratings on German pharmaceutical issuer Cheplapharm due to operating issues, mostly related to its supply chain.

Players with lower dependence on CDMOs tend to perform better because they can better control in-house production, but they need to substantially invest in fixed assets. For example, Novo Nordisk is acquiring Catalent Inc. to expand production capacity for its diabetes and obesity franchises, which would result in total capacity investment of 125 billion DKK (about $17.6 billion) since 2021.

Potential legislative risks. Every recent incoming U.S. presidential administration has brought uncertainty to the health care industry, and the incoming Trump administration is no exception. But since the Republicans will control the White House and both chambers of Congress, the speed at which potential legislation could be enacted could be greater, and the risk for the industry is greater as a result.

Potential legislation includes changes to the Inflation Reduction Act (which includes Medicare Drug Price negotiations provisions), subsidies as part of Affordable Care Act, tariffs, and tax law changes. And proposed appointees to lead various government agencies and departments, including Robert F. Kennedy Jr. to HHS, could significantly change the tone regarding federal mandates on vaccinations and research and development funding, which could have credit implications on pharmaceutical companies.

Related Research

- Health Care Credit Beat: Republican Red Wave A Net Negative For Health Care, Dec. 2, 2024
- Record-High Health Care Defaults Will Moderate In 2025, Though Higher Than Normal, Nov. 20, 2024
- Code And Care: Navigating Private Credit Risk In The Software And Health Care Services Industries, Nov. 19, 2024.
- Health Care Credit Beat 2024: Highlights From Our 2024 Health Care Hot Topic Event, Oct. 11, 2024
- How Business Strength Varies Across Top Branded Pharmaceutical Companies (2024 Update), Aug. 6, 2024
- Health Care Credit Beat: U.S. Supreme Court's Chevron Decision Holds Mixed Implications For Industry, July 19, 2024
- How Will AI Transform The Health Care Industry?, June 27, 2024
- Despite Some Improvement, Weaker Health Care Services Companies Continue To Struggle, May 2, 2024
- Pharmaceutical Industry 2024 Credit Outlook Is Stable As Revenue Growth Mitigates Pressures, Jan. 24, 2024

Industry Forecasts: Health Care

Chart 7
Revenue growth (local currency)

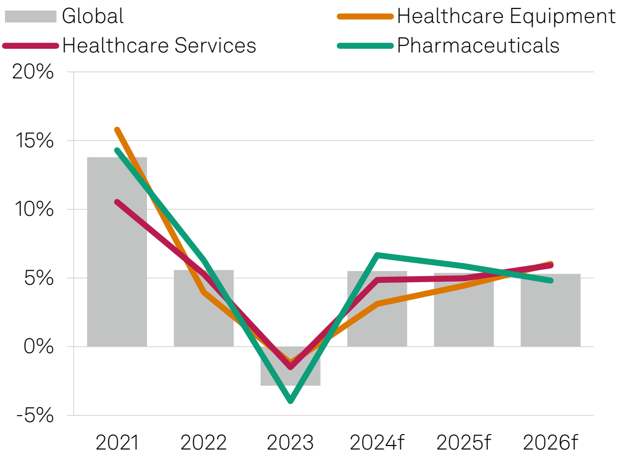


Chart 8
EBITDA margin (adjusted)

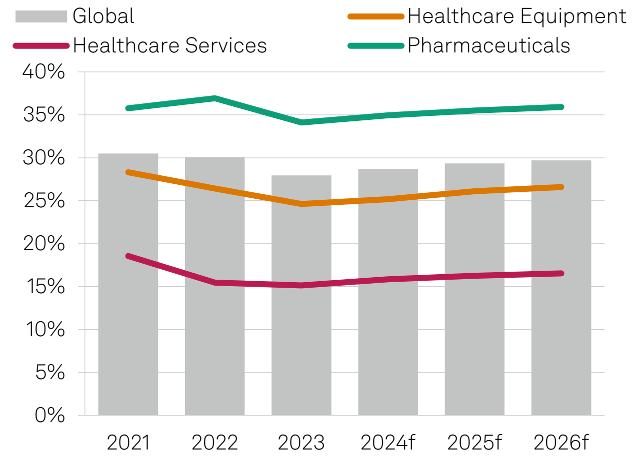


Chart 9
Debt / EBITDA (median, adjusted)

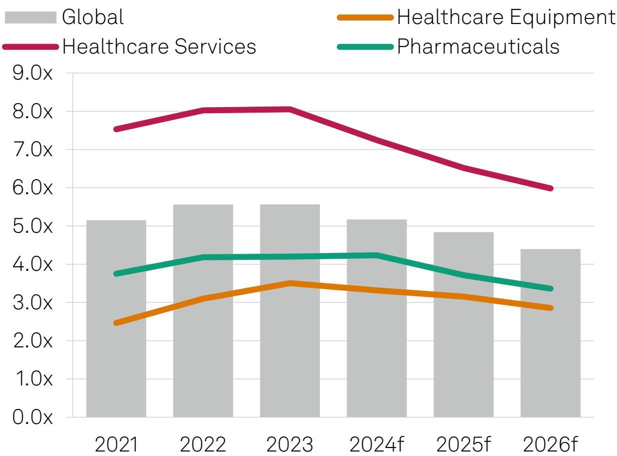
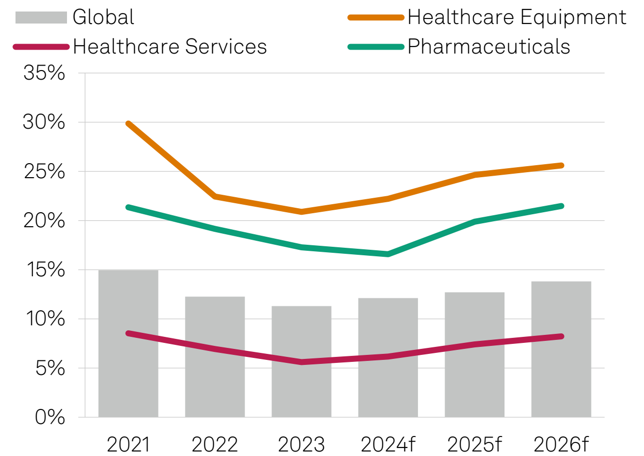


Chart 10
FFO / Debt (median, adjusted)



Source: S&P Global Ratings. f = forecast.
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations.

Cash, Debt, And Returns: Sector

Chart 11

Cash flow and primary uses

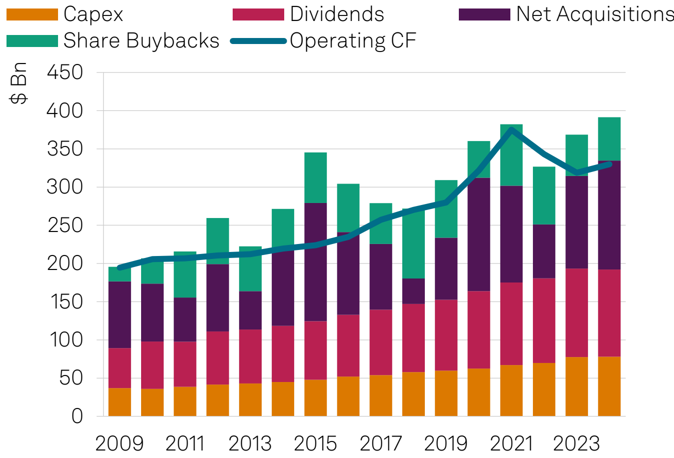


Chart 12

Return on capital employed

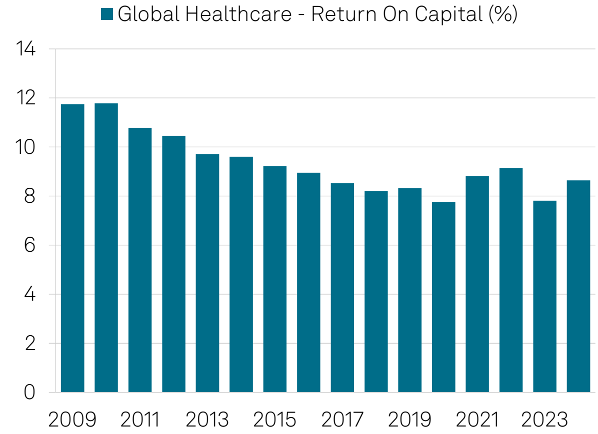


Chart 13

Fixed- versus variable-rate exposure

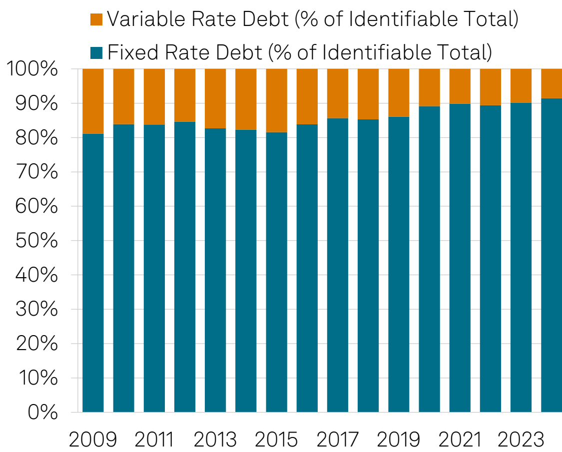


Chart 14

Long-term debt term structure

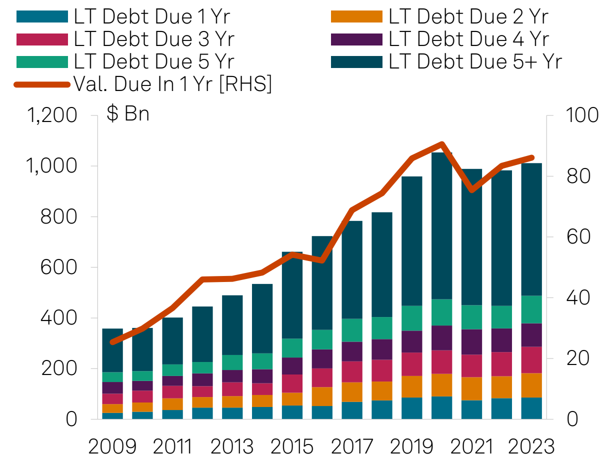


Chart 15

Cash and equivalents / Total assets

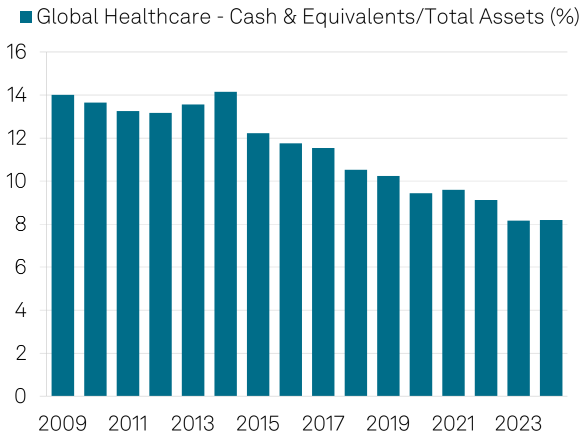
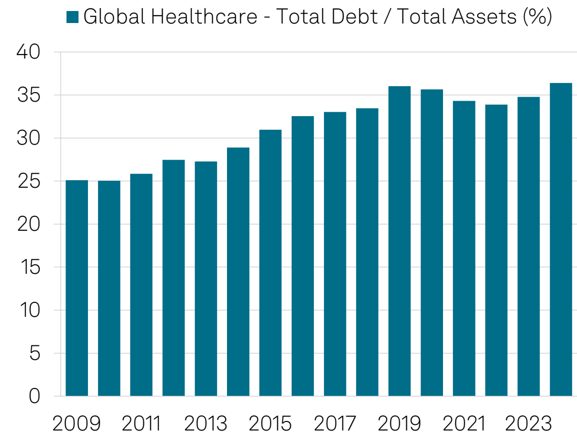


Chart 16

Total debt / Total assets



Source: S&P Capital IQ, S&P Global Ratings calculations. Most recent (2024) figures use the last 12 months' data.

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