S&P Global:
U.S. Not-For-Profit Health Care: Rating Trends, 2018 Outlook and Hot Topics

NAHEFFA Conference

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Agenda

1 Not-For-Profit Health Care Rating Trends

2 2018 Outlook

3 Hot Topics

4 Health Care & Higher Education Commonalities

5 Appendix A – NFP Acute Care Health Care Organization Criteria Details

6 Comments | Questions

Rating Trends

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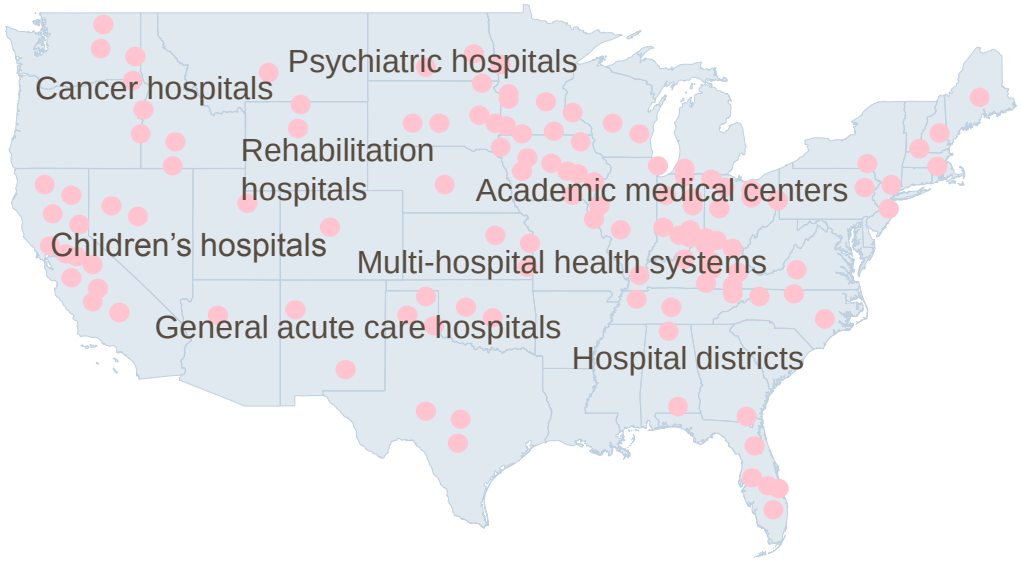
U.S. Public Finance Healthcare Ratings Universe

- Not-for-profit, acute care stand-alone hospitals and health care systems (approximately 570 ratings), long-term care and human service providers



Recent criteria update:

Revised criteria for U.S. and Canadian Not-for-Profit Acute Care Health Care Organizations released

March 19, 2018

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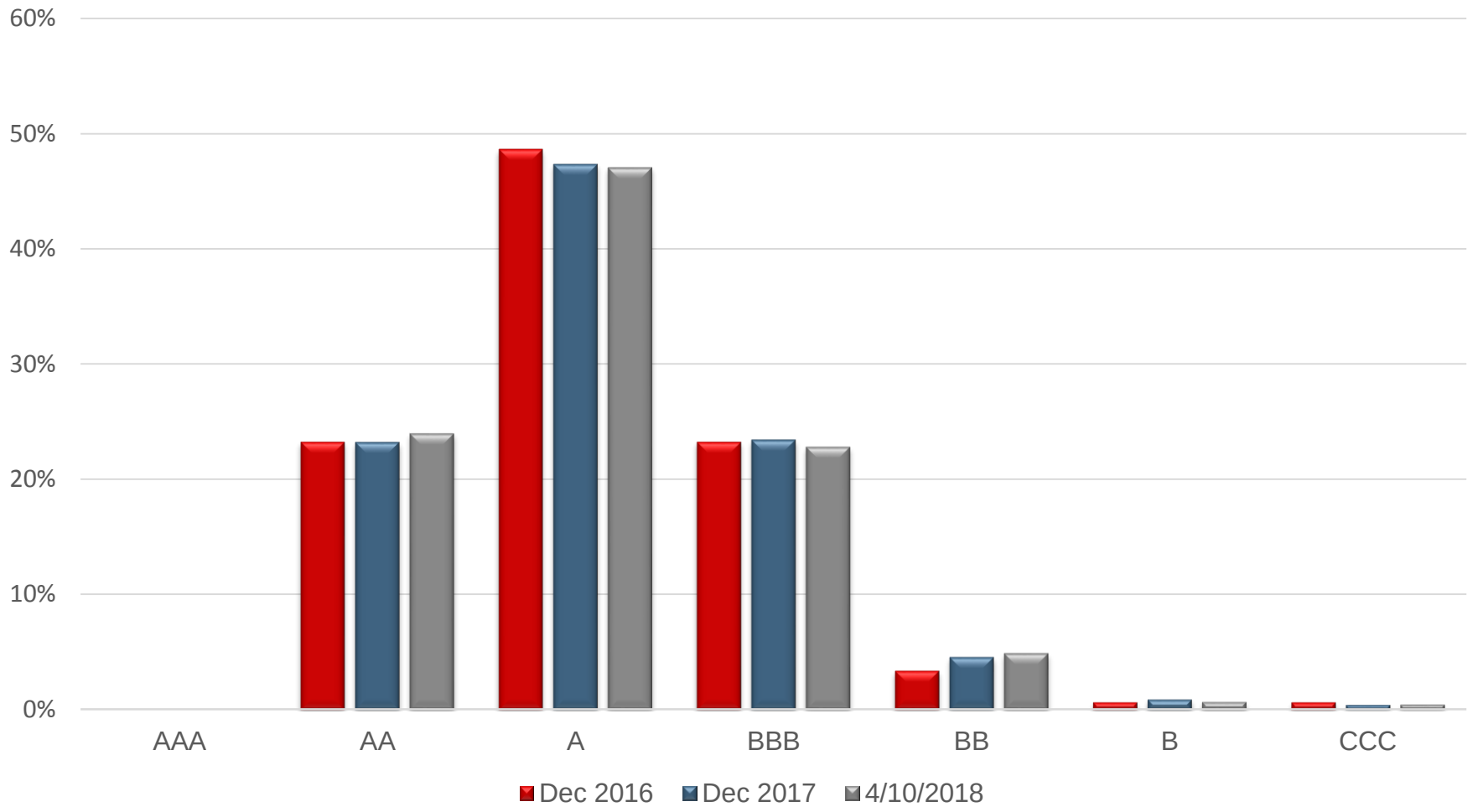
Not-for-Profit Health Care Rating Distribution

Three-Year Glance



Acute care only; Ratings as of 4/10/2018; Source: S&P Global Ratings

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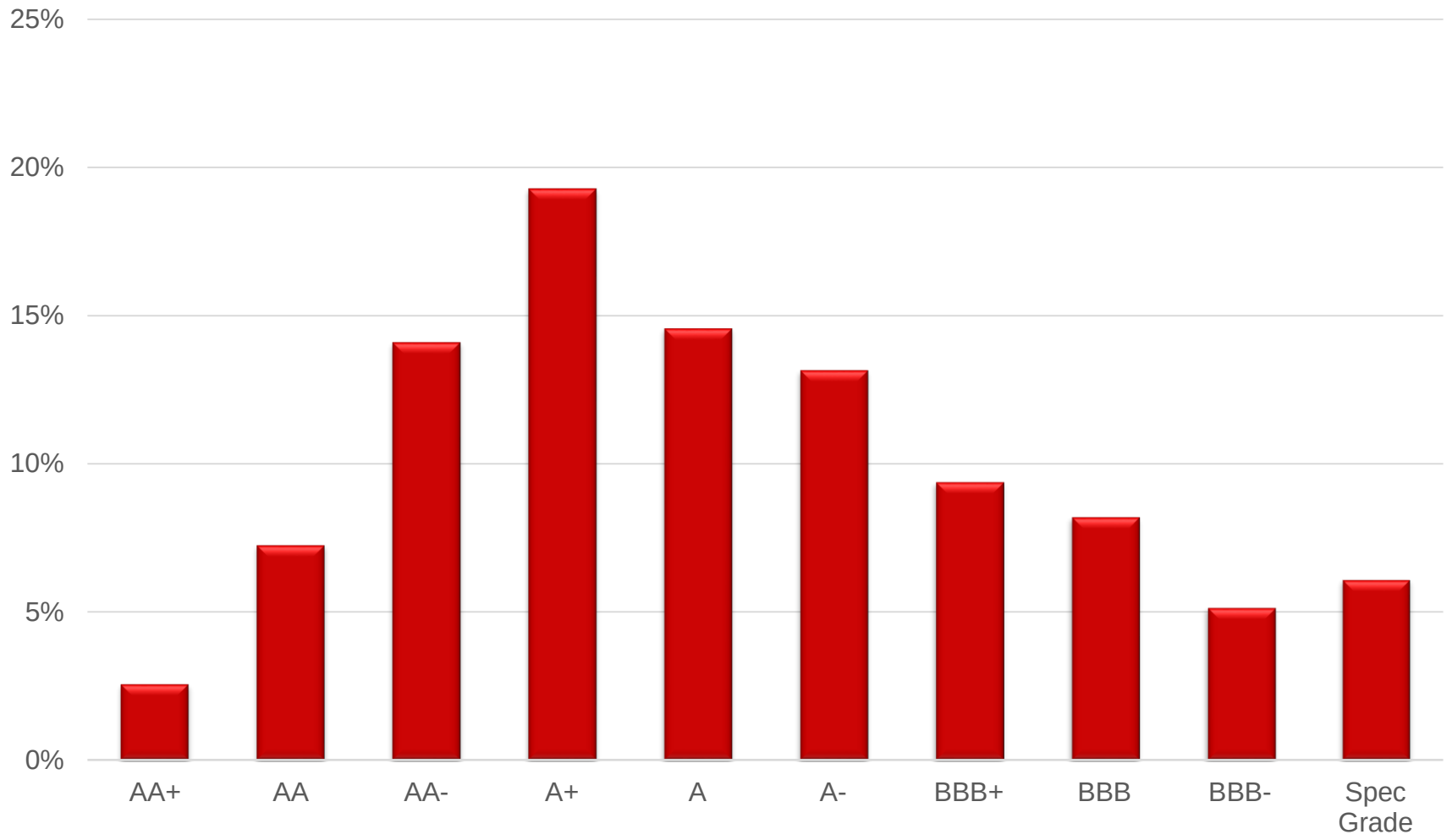
Not-For-Profit Health Care Rating Distribution



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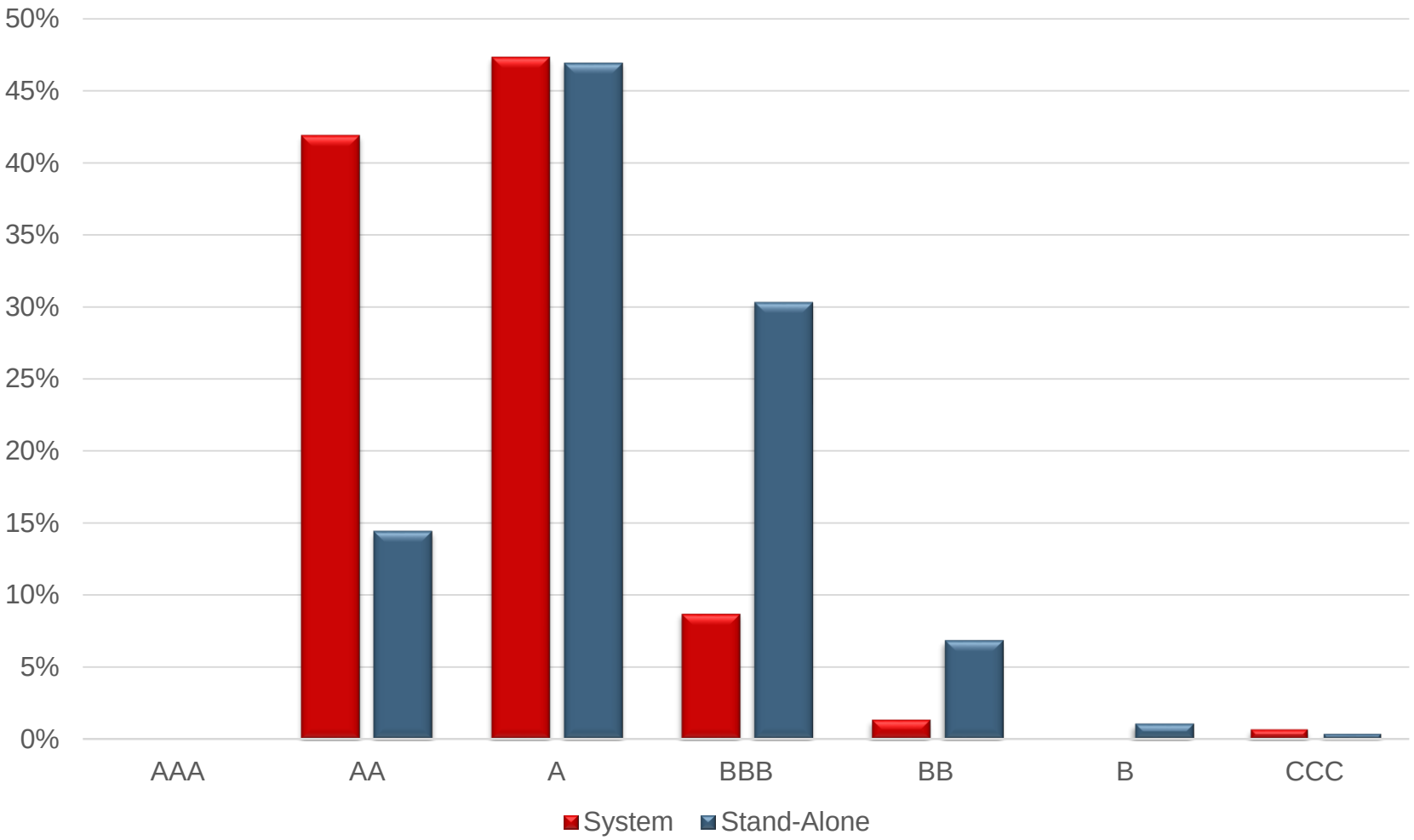
Not-For-Profit Health Care System vs. Stand-Alone Rating Distribution



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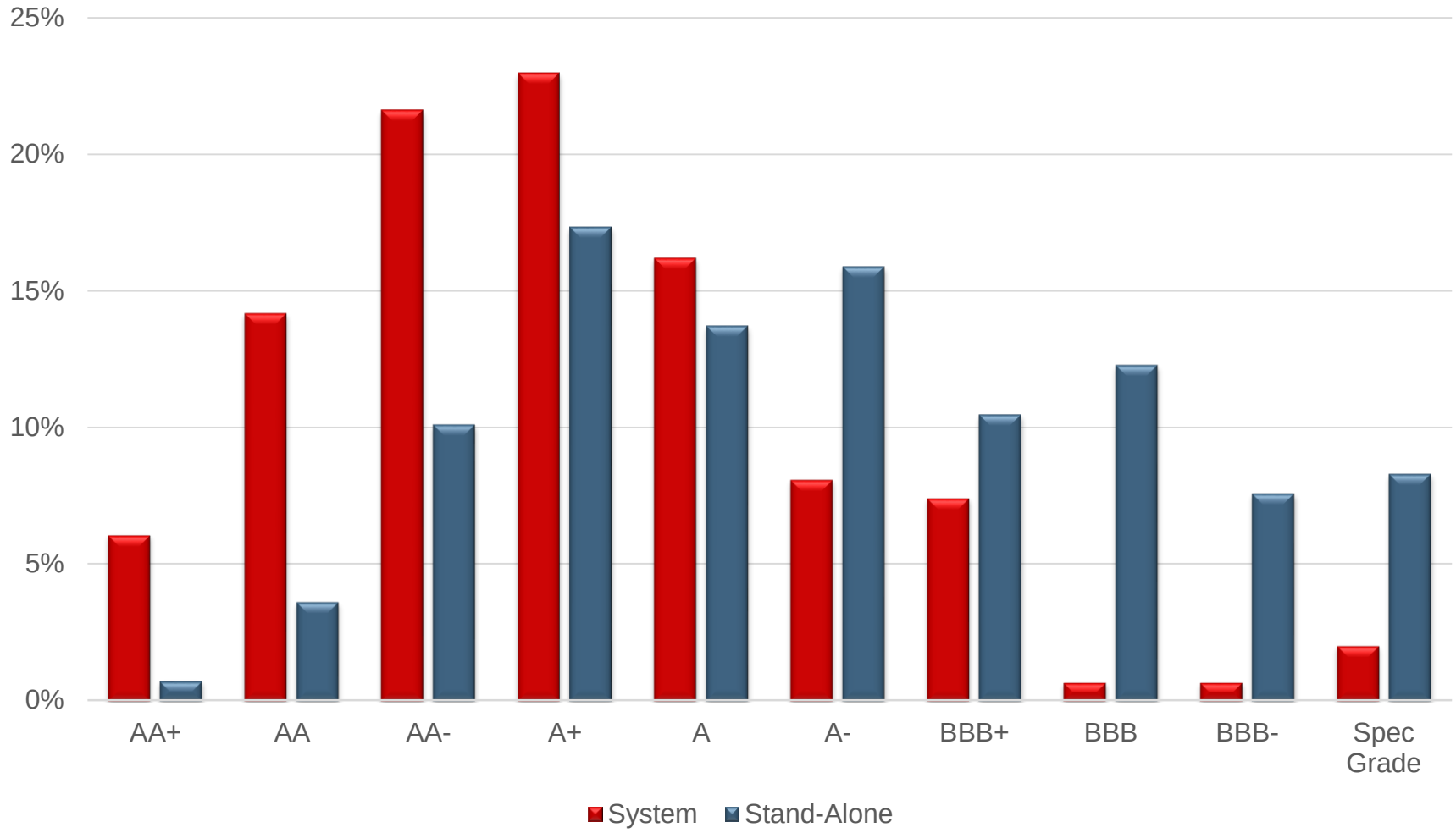
Not-For-Profit Health Care System vs. Stand-Alone Rating Distribution



Acute care only; Ratings as of 4/10/2018; Source: S&P Global Ratings

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2018 Rating Actions Reflect Stability

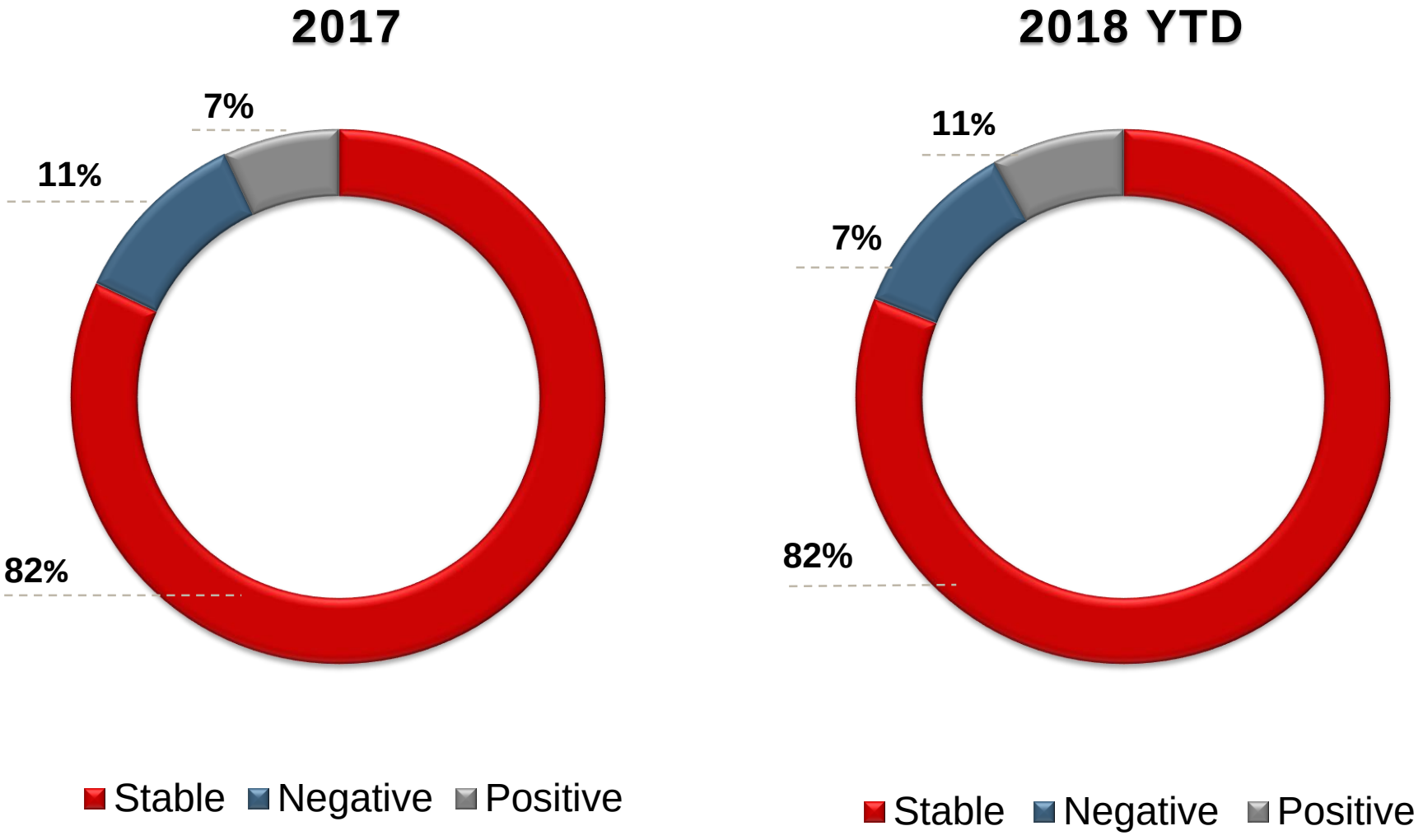
- Overall, credits remain quite stable
- 77 total affirmations for the health care sector

Upgrades/ Downgrades (count)	2017	2018 YTD
Upgrade	32	12
Downgrade	41	9

Upgrades/ Downgrades (%)	2017	2018 YTD
Upgrade	44%	57%
Downgrade	56%	43%

Acute Care Only; Ratings as of 4/10/2018; Source: S&P Global Ratings

Not-for-Profit Health Care Outlook Distribution



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2018 Outlook

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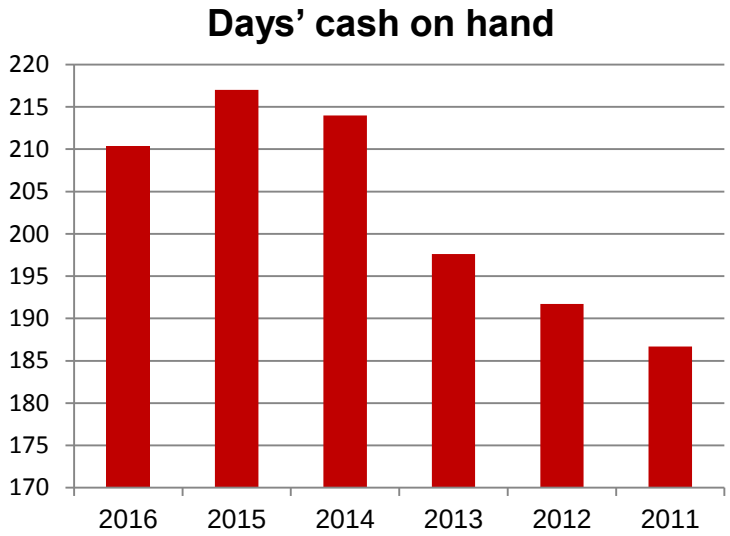
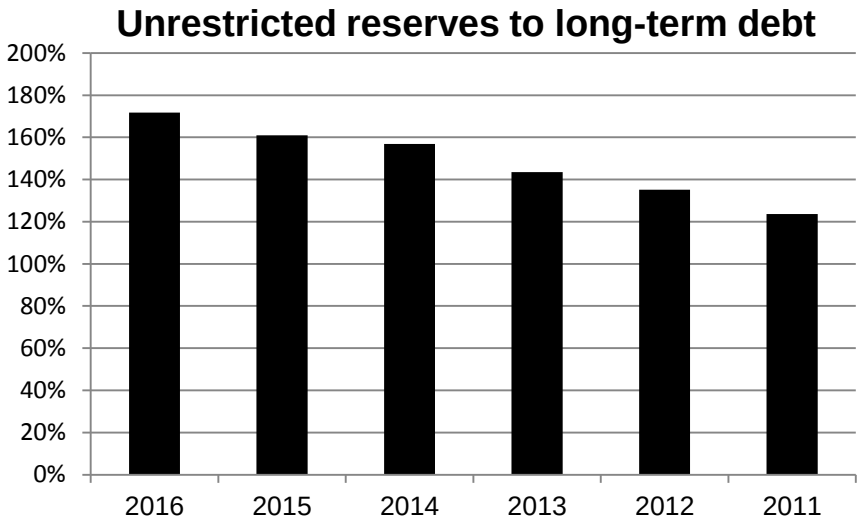
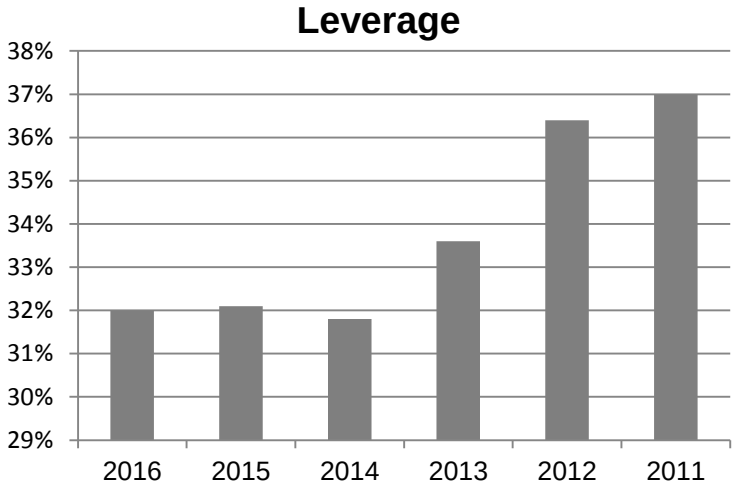
2018 Stable Outlook Reflects Healthy Balance Sheets and Enterprise Profiles

- **Unrestricted reserves remain robust given favorable investment markets**
  - For many credits, more reliance on non-operating income
  - Steady unrestricted reserve increases year over year for several years
  - Continued growth through fiscal 2017 and to-date through fiscal 2018
- **Solid enterprise profiles**
  - Recent M&A often supports a more robust business position in competitive markets
  - Business strength also supported by investments in expanded non-acute footprint, including ambulatory growth and physician integration, leading to broadened patient reach
- **We believe the sector has inherent credit flexibility to respond to industry challenges in 2018 and beyond, although credit gap persists**
- **We expect rating affirmations to prevail in 2018**

Balance Sheet Strengthening In Recent Years...







All data as of April 2018; Figures represent median for all not-for profit acute health care credit ratings based on audited fiscal year.

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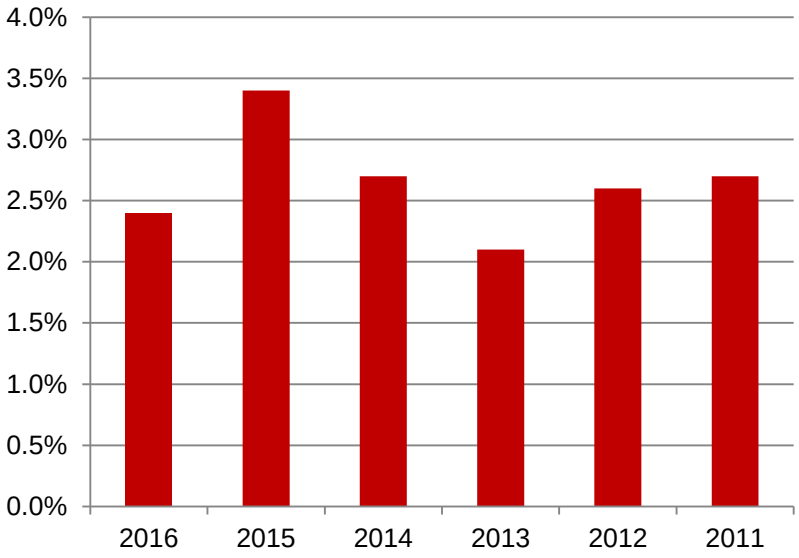
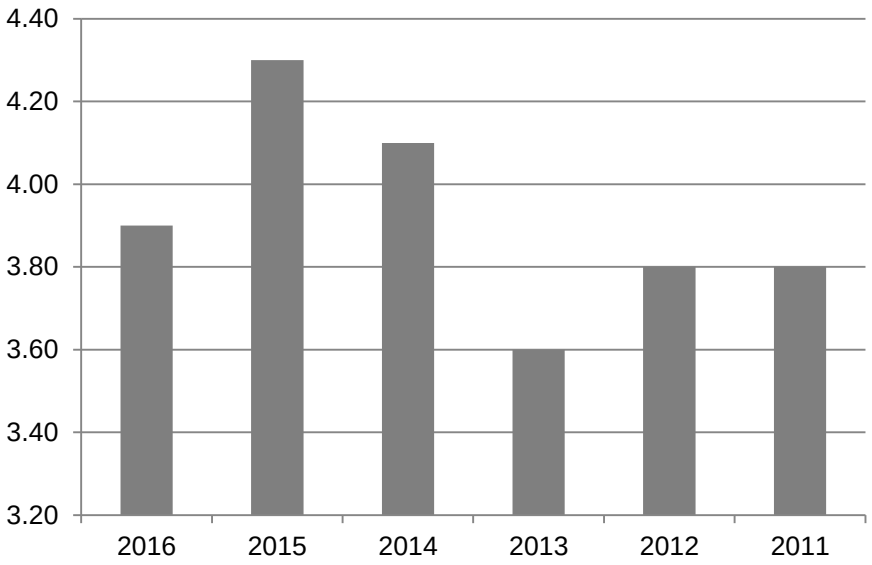
…While Financial Performance Softened

Operating margin



MADS coverage



All data as of April 2018; Figures represent median for all not-for profit acute health care credit ratings based on audited fiscal year.

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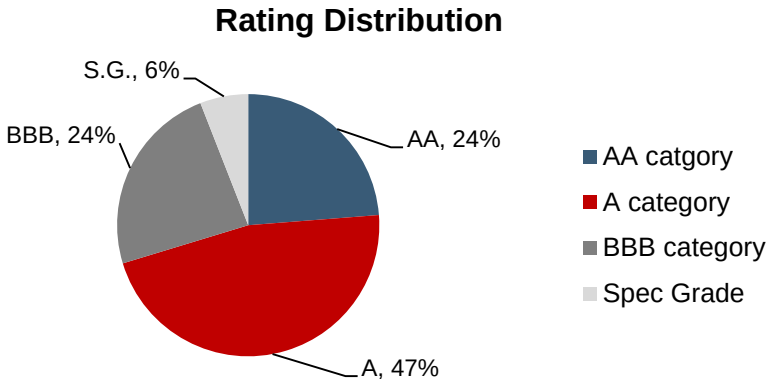
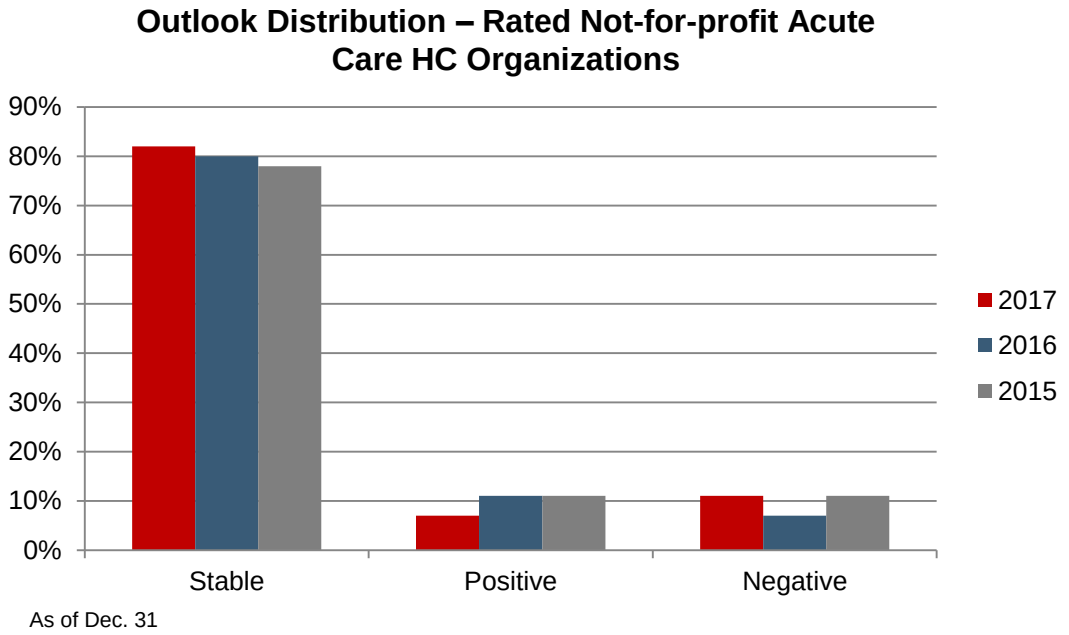
2017 Rating & Outlook Distribution Support Current Stable Outlook

- **Ratings:**
  - ‘A’ category ratings accounted for almost half of our rated universe
  - 24% for each ‘AA’ & ‘BBB’
  - ~6% speculative grade
- **Outlooks:**
  - Greater than 80% stable and growing
  - Negative outlooks outpaced positive
- **Current rating and outlook distribution shows relative strength and stability**





As of Dec. 31

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Mounting Pressures Remain On the Near Term Horizon…

- **Volume trends impacting revenues/operating profitability:**
  - Growth in outpatient contributing to slower inpatient trends,
  - Movement towards value with minimal adjustments in payment models to reflect reform of delivery system and slower inpatient trends
- **Expense pressures continue to out pace revenue growth:**
  - Cost growth driven by pharmaceuticals, supplies, and labor shortages
- **Reimbursement changes:**
  - Payor mix tipping toward governmental for many
  - Repeal of the individual mandate has the potential to cause rise in the number of people without health insurance
  - Insurers, consumers, and price consciousness beginning to drive changes to lower payment models
- **Operating margin pressure remains in 2018 and expected to continue**
  - M&A and key strategic investments could provide support for some credits
- **Management teams in permanent cost containment/revenue enhancement mode**

Hot topics…

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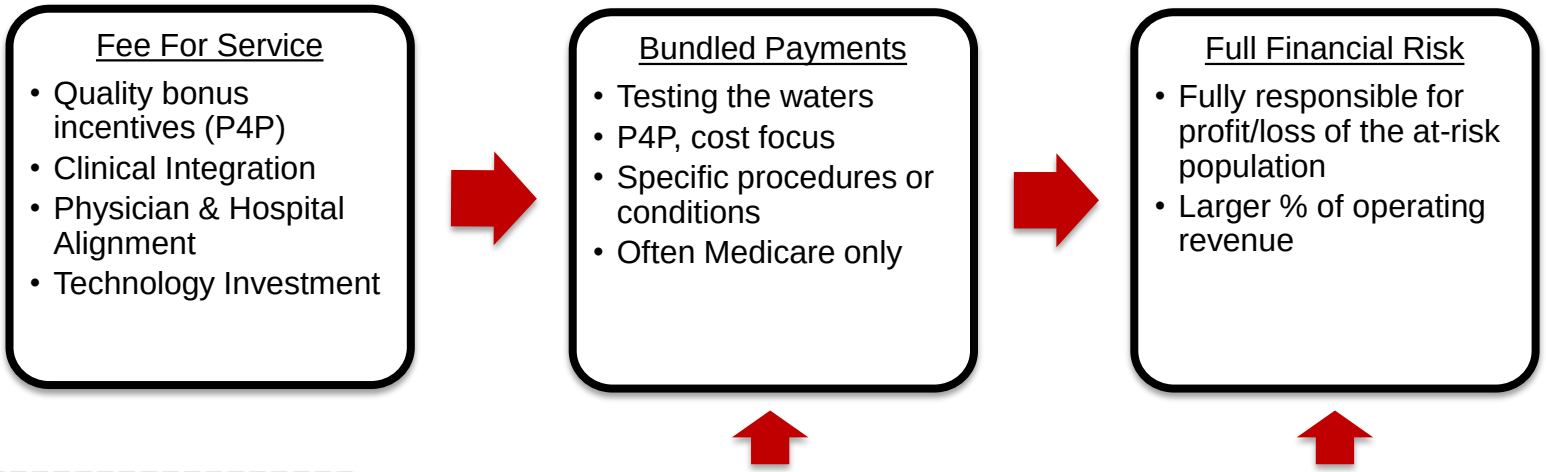
Mergers & Acquisitions:

- **M&A activity remains at a slightly moderated pace:**
  - Smaller more opportunistic M&A will continue - particularly in decentralized markets
  - Larger mergers expected at a slower pace - demonstrate the value proposition/benefit of the merger
- **Why merge:**
  - Providers continue to seek size and scale (traditional cost savings & market clout), as well as diversity or expertise in different services (e.g., health plan, physician management);
  - Non-overlapping markets provided for cost savings without impacting volumes – part of widen the funnel strategy;
  - Expanding a geographic "footprint" for longer-term transition to population health management
- **New observations:**
  - Market disruption with new entrants (Apple, Amazon, Optum, Aetna/CVS)
  - Push back from regulators, particularly in previously consolidated markets and/or where the participants cannot demonstrate the value proposition of the merger.
- **Growth in affiliation strategies in lieu of full M&A and "non-traditionals":**
  - Joint ventures/joint operating agreements; clinical networks – often first step to something more permanent; management contracts – also often first step to something more permanent;
  - Affiliations with payers; urgent care/emergent care centers

Population Health Is Evolving At A Varied Pace:



Rating Agency Interests:

- Magnitude of risk (% of operating revenue at-risk)
- Profit or loss, by program or payor
- Strategies for growth
- Regulatory pressures through evolution

Upside Potential and Downside Risk

- **Often begins with upside potential only**
- **P4P and lower cost**
- **Requires larger sample of covered lives**
- **Often smaller % of overall operating revenue**

Provider Sponsored Health Plan

- **Full acquisition of multi-product health plan**

OR more gradual:

- **Starts Medicare or Medicaid only**
- **Add employees**
- **Add other employers**

Other Trends We Continue To Monitor

- **Administrative and legislative changes:**
  - Full repeal and replace appears less likely, with recognition of slow chipping away at the original Affordable Care Act
  - Last year's considerations to change how the Medicaid program is funded (block grants) could strain revenues and profitability for providers, although much less focus in 2018
  - Ongoing administrative and legislative changes related to the Medicare and Medicaid programs remains a distraction and a threat which could pressure provider revenue (340b program, changes to Medicaid waivers, work requirements, etc.)
- **"Disruptors" could challenge broader credit quality over time**
  - Entrants of non-traditional players into the health care space require management teams to consider strategic responses (CVS and Aetna, Amazon, Apple, and other niche players)
  - "Disruptive" technology changes could change how care is delivered and reimbursed

Health Care & Higher Education Commonalities

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Commonalities Between Health Care and Higher Education

- **Key Performance Indicators:**
  - Demand, healthcare evaluates patient demand where higher education evaluates enrollment
  - Reliability of payment sources, including any special funding
  - Management of unrestricted cash reserves compared to debt repayment demands
  - Pension and contingent debt exposure

- **Assessment of management and governance**
  - Management's strategy
  - Financial policies
  - Effectiveness at achieving goals

Commonalities Between Health Care and Higher Education

- **Affordability**
  - Healthcare: ongoing efforts to provide quality care at a lower cost, ahead of the competition
  - Higher education: measured tuition increases and balance of tuition discounts
- **Pricing**
  - Healthcare: provider sources of payments are typically diversified across governmental and non-governmental payors with discounted pricing that differs by payment source
  - Higher education: Tuition discounts differ based on student quality and need
- **Cyber Security**
  - Healthcare: providers store medical history but also personal information (SSN#, address, family details)
  - Higher education: personal information, financial details

Q&A

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Appendix – Revised Criteria Details

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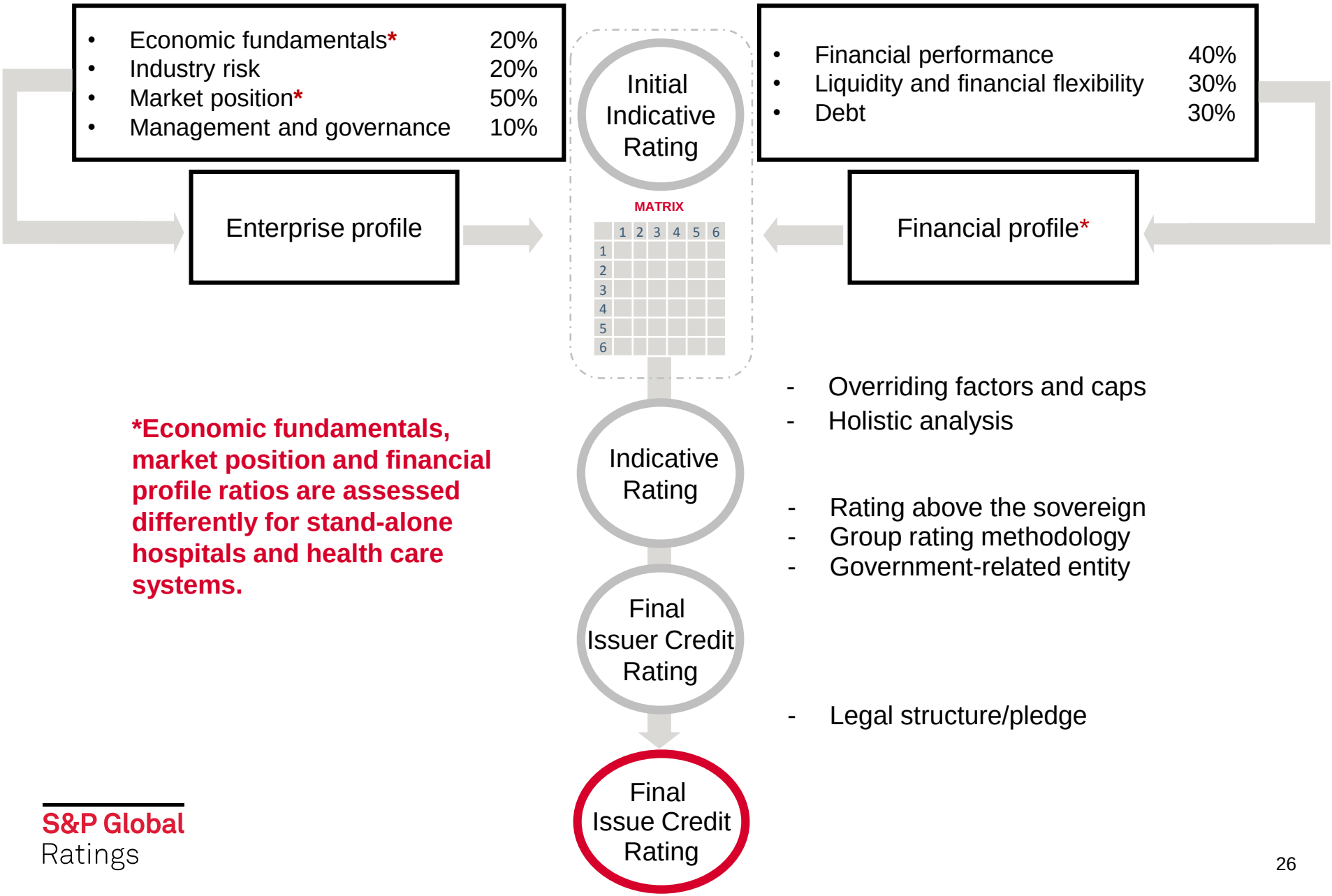
Analytical Framework



***Economic fundamentals, market position and financial profile ratios are assessed differently for stand-alone hospitals and health care systems.**

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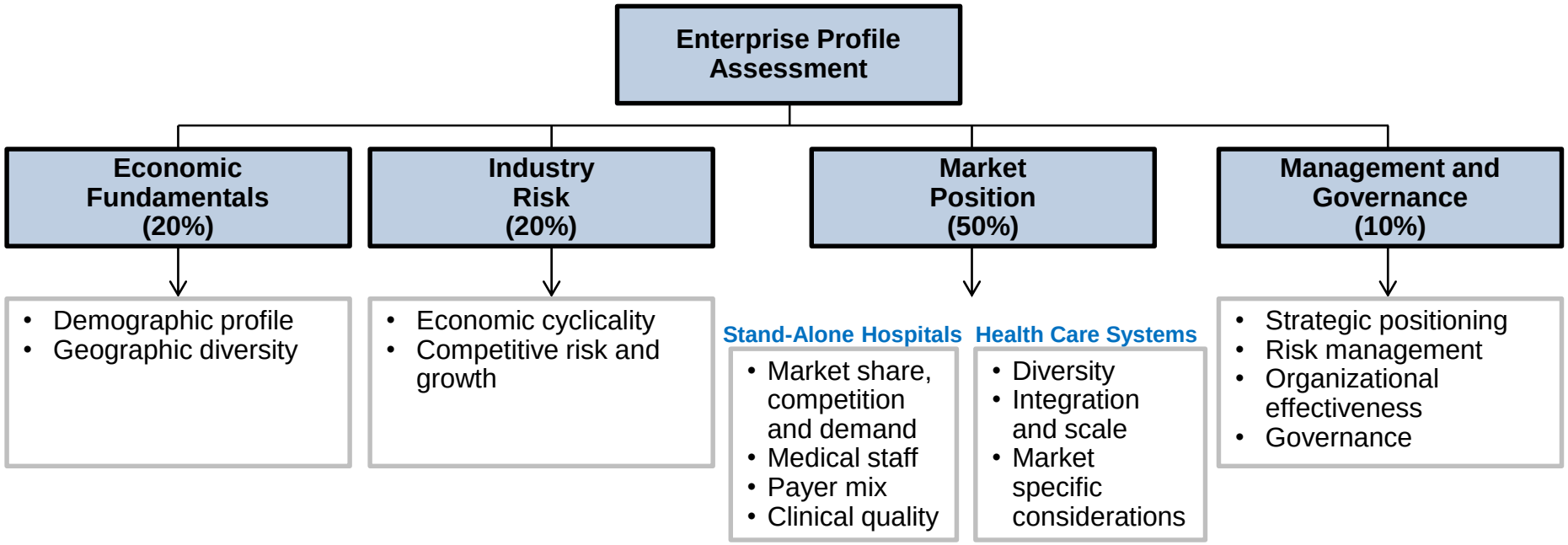
Analytical Framework for Enterprise Profile



- Assesses operating environment and incorporates broad industry and organization-specific factors.
- Assessments for each factor range from 1 (strongest) to 6 (weakest) based on a combination of quantitative and qualitative factors.

Economic Fundamentals: Stand-Alone Hospitals vs. Health Care Systems

Stand-alone Hospitals

Economic fundamentals are based on primary service area population and a preponderance of other considerations.

Examples

Positive economic considerations:

- Population growth
- Employment growth
- Per capita personal income growth
- Stabilizing institutional influence

Negative economic considerations:

- Population decline
- Employment decline
- Per capita personal income decline
- Heavy employment concentration in an individual sector

Health Care Systems

Health care systems are inherently less reliant on specific market demographics. We assess economic fundamentals based on a macro assessment of economic characteristics vs. national trends.

Examples

Extremely Strong or Very Strong

- Operating in one or a few distinct markets with heavy demographic growth, particularly when the strengths of key markets offset the weak conditions in others

Strong or Adequate

- Operating in one or a few distinct markets with stable demographics, and the strengths of key markets offset the weak conditions in others

Vulnerable or Highly Vulnerable

- Reliance on one or multiple service areas where overall economic characteristics are well below national trends or where declining trends are expected to continue

Market Position: Stand-Alone Hospitals vs. Health Care Systems

Stand-Alone Hospital Credit Factors

Market Share, Competition & Demand
- Population vs. market share

Medical Staff
- General medical staff characteristics
- Medical staff competition
- Recruitment, retention, and employment

Payer Mix
- Dictated by a hospital's location
- Concentration by payer (government vs. commercial)
- All payer consideration (e.g. Canadian providers, State of Maryland)

Clinical Quality
- Individual hospital clinical quality metrics from nationally recognized sources
- Quality performance incentives

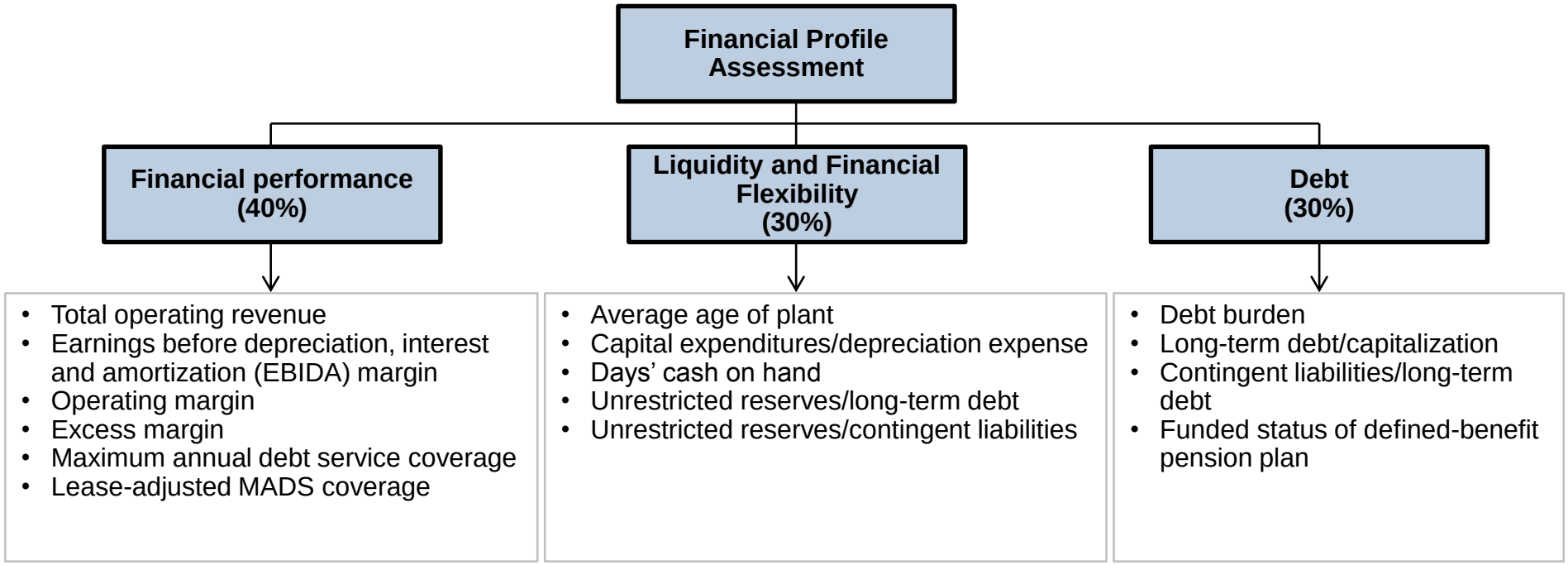
Health Care System Credit Factors

Diversity
- Geographic footprint
- Sources of revenue
- By business line

Integration & Scale
- Centralization of management, information technology, strategy and key operational functions

Market Specific Considerations
- Market leadership
- Competitive dynamics
- Relationships with third-party payers
- Quality
- Physician integration

Analytical Framework for Financial Profile



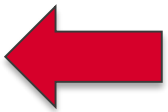
- Assesses the financial strength of health care organizations.
- Assessments for each factor range from 1 (strongest) to 6 (weakest) based on a combination of quantitative and qualitative factors.

Key Financial Profile Ratios

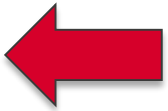
Financial Performance
- Total Operating Revenue
- EBIDA margin
- Operating margin
- Excess margin
- MADS coverage
- Lease-adjusted MADS coverage

Liquidity & Financial Flexibility
- Average age of plant
- Capital expenditures/depreciation
- Days' cash on hand
- Unrestricted reserves/long-term debt
- Unrestricted reserves/contingent liabilities

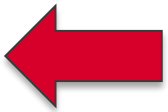
Debt
- Debt burden
- Long-term debt/capitalization
- Contingent liabilities/long-term debt
- Funded status of defined-benefit pension plan



Coverage ratios are key metrics, followed by margin ratios, especially the operating margin, which is a direct measure of revenues and expenses that are most within management's control.



Days' cash on hand and unrestricted reserves to long term debt are key metrics as they indicate levels of balance sheet flexibility, although a gauge of unrestricted reserves compared to contingent liabilities is equally important if reserves are relatively low.



Debt burden and long-term debt/capitalization are key metrics, as they provide an indication of an organization's relative debt levels. The funded status of the defined-benefit pension plan and contingent liabilities/long-term debt can also become important if metrics are particularly weak.

Thank you

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