Credit Ratings & Access to Capital in the New Healthcare Environment
Agenda

1. Outlook and Recent Rating Activity
2. Federal Policy and Budget Issues
3. Creating Value
Outlook and Recent Rating Activity
Our Not-for-Profit Hospital Ratings Contain No Aaa’s, 10% Spec Grade

- 466 not-for-profit hospitals and healthcare systems (~1,200 total hospitals)
  - Approximately $187.7 billion of total rated debt outstanding
  - Stand-alone hospitals (as small as 2,000 admissions)
  - Multi-state systems (with more than 400,000 admissions)
  - Median rating of A3

Our Not-for-Profit Hospital Rating Distribution
Healthcare ratings are lower than other muni ratings due to enterprise risk; 10% are speculative grade.
### 10 largest not-for-profit hospitals by revenues

<table>
<thead>
<tr>
<th>Name of Credit</th>
<th>Rating</th>
<th>Outlook</th>
<th>Operating Revenue ($'000)</th>
<th>Total Debt ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ascension Health  Alliance, MO</td>
<td>Aa2</td>
<td>Stable</td>
<td>15,485,711</td>
<td>5,200,00</td>
</tr>
<tr>
<td>Providence Health &amp; Services, WA</td>
<td>Aa2</td>
<td>Negative</td>
<td>10,608,249</td>
<td>3,429,330</td>
</tr>
<tr>
<td>University of Pittsburgh Medical Center, PA</td>
<td>Aa3</td>
<td>Positive</td>
<td>9,610,499</td>
<td>3,114,130</td>
</tr>
<tr>
<td>Sutter Health, CA</td>
<td>Aa3</td>
<td>Stable</td>
<td>9,191,000</td>
<td>3,012,510</td>
</tr>
<tr>
<td>Dignity Health, CA</td>
<td>A3</td>
<td>Stable</td>
<td>9,055,789</td>
<td>4,534,814</td>
</tr>
<tr>
<td>Partners Healthcare System, MA</td>
<td>Aa2</td>
<td>Stable</td>
<td>8,943,194</td>
<td>3,133,262</td>
</tr>
<tr>
<td>Catholic Health Initiatives, CO</td>
<td>Aa3</td>
<td>Stable</td>
<td>8,940,980</td>
<td>4,694,216</td>
</tr>
<tr>
<td>Mayo Clinic, MN</td>
<td>Aa2</td>
<td>Stable</td>
<td>8,595,100</td>
<td>2,424,800</td>
</tr>
<tr>
<td>Trinity Health Credit Group, MI</td>
<td>Aa2</td>
<td>Stable</td>
<td>8,456,153</td>
<td>3,362,452</td>
</tr>
<tr>
<td>Adventist Health System/Sunbelt Obligated Group, FL</td>
<td>Aa3</td>
<td>Positive</td>
<td>7,346,597</td>
<td>3,050,405</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td></td>
<td></td>
<td><strong>96,233,272</strong></td>
<td><strong>30,755,919</strong></td>
</tr>
</tbody>
</table>
## 10 smallest not-for-profit hospitals by revenues

<table>
<thead>
<tr>
<th>Name of Credit</th>
<th>Rating</th>
<th>Outlook</th>
<th>Operating Revenue ($'000)</th>
<th>Total Debt ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern Hospital District of Surry County, NC</td>
<td>Baa3</td>
<td>Stable</td>
<td>77,367</td>
<td>34,745</td>
</tr>
<tr>
<td>Aspen Valley Hospital District, CO</td>
<td>Baa2</td>
<td>Stable</td>
<td>70,656</td>
<td>22,229</td>
</tr>
<tr>
<td>Ohio Valley General Hospital, PA</td>
<td>Ba3</td>
<td>Negative</td>
<td>63,875</td>
<td>34,945</td>
</tr>
<tr>
<td>St. Anthony Regional Hospital, IA</td>
<td>Baa2</td>
<td>Stable</td>
<td>63,491</td>
<td>17,203</td>
</tr>
<tr>
<td>Memorial Hospital at North Conway, NH</td>
<td>Baa3</td>
<td>Stable</td>
<td>63,314</td>
<td>19,639</td>
</tr>
<tr>
<td>East Liverpool City Hospital, OH</td>
<td>Ba1</td>
<td>Negative</td>
<td>58,655</td>
<td>26,251</td>
</tr>
<tr>
<td>Sauk Prairie Memorial Hospital, WI</td>
<td>Ba1</td>
<td>Stable</td>
<td>57,835</td>
<td>1,263</td>
</tr>
<tr>
<td>Hopkins County Hospital District, TX</td>
<td>Ba3</td>
<td>Negative</td>
<td>56,428</td>
<td>33,309</td>
</tr>
<tr>
<td>Northern Montana Health Care, Inc., MT</td>
<td>Baa3</td>
<td>Stable</td>
<td>48,666</td>
<td>7,390</td>
</tr>
<tr>
<td>Keokuk Area Hospital, IA</td>
<td>Caa3</td>
<td>Negative</td>
<td>24,854</td>
<td>7,295</td>
</tr>
</tbody>
</table>

**Total:** 585,141  204,269
Healthcare ratings recently more balanced due to M&A

Not-for-Profit Healthcare

Number of Ratings

0 10 20 30 40 50 60


Upgrades Downgrades Upgrades-to-Downgrades

Moody's INVESTORS SERVICE

HFMA ANI June 2013
Negative outlook on the sector since 2008

Established Risks:
1. Revenue growth remains low by historical standards.
2. Challenges from transition to new payment methodologies.
3. Economic recovery is sluggish.

Developing Risks:
4. Supreme Court ruling allows states to opt out of Medicaid expansion.
5. Hospital-Insurer collaboration on the rise.
6. Growing acquisition of physician practices and other healthcare providers.

A return to a stable outlook will require greater clarity of healthcare reform regulations and greater understanding of the impact from exchanges.
Key indicator for outlook is revenue growth trend

Expenses Exceed Revenues

Source: Moody’s FY 2011 Medians and FY 2012 Preliminary Medians
Recession has dramatically changed the average revenue profile

Medicaid Rising While Commercial/Managed Care Decreasing

Source: Moody’s FY 2011 Medians, FY 2012 Preliminary Medians
Federal Budget and Policy
Sequestration Translates into $11 Billion in Cuts for Healthcare Providers

Sequester:

» 2% reduction in Medicare rates to the hospitals for the next decade; affecting those with outsized reliance on Medicare the most

» Seven of the top 15 credits with the highest Medicare exposure are in Florida

» No rating action at this time; hospitals are adept at cost reductions and swift, mid-course changes when necessary

<table>
<thead>
<tr>
<th>Hospital</th>
<th>Rating</th>
<th>Outlook</th>
<th>Medicare</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central FL Health Alliance</td>
<td>Baa1</td>
<td>Stable</td>
<td>70.2%</td>
</tr>
<tr>
<td>Citrus Memorial Hospital, FL</td>
<td>B3</td>
<td>Negative</td>
<td>69.9%</td>
</tr>
<tr>
<td>Kuakini Health System, HI</td>
<td>Ba1</td>
<td>Stable</td>
<td>68.8%</td>
</tr>
<tr>
<td>Eisenhower Medical Center, CA</td>
<td>Baa2</td>
<td>Stable</td>
<td>65.8%</td>
</tr>
<tr>
<td>Baxter Regional Medical Center, AR</td>
<td>Baa2</td>
<td>Stable</td>
<td>65.0%</td>
</tr>
<tr>
<td>Deborah Heart and Lung Foundation, NJ</td>
<td>B1</td>
<td>Negative</td>
<td>61.7%</td>
</tr>
<tr>
<td>Munroe Regional Medical Center, FL</td>
<td>Baa1</td>
<td>Stable</td>
<td>61.4%</td>
</tr>
<tr>
<td>Jefferson Regional Medical Center, PA</td>
<td>Baa2</td>
<td>Stable</td>
<td>59.4%</td>
</tr>
<tr>
<td>Martin Memorial Medical Center, FL</td>
<td>Baa1</td>
<td>Stable</td>
<td>59.0%</td>
</tr>
<tr>
<td>NCH Healthcare System, FL</td>
<td>A2</td>
<td>Stable</td>
<td>58.5%</td>
</tr>
<tr>
<td>East Jefferson General Hospital, LA</td>
<td>Baa3</td>
<td>Stable</td>
<td>58.2%</td>
</tr>
<tr>
<td>Yavapai Regional Medical Center, AZ</td>
<td>Baa2</td>
<td>Positive</td>
<td>58.1%</td>
</tr>
<tr>
<td>Flagler Healthcare System, FL</td>
<td>A3</td>
<td>Stable</td>
<td>57.9%</td>
</tr>
<tr>
<td>Ohio Valley General Hospital, PA</td>
<td>Ba3</td>
<td>Negative</td>
<td>57.8%</td>
</tr>
<tr>
<td>Beebe Medical Center, DE</td>
<td>Baa3</td>
<td>Stable</td>
<td>56.7%</td>
</tr>
</tbody>
</table>
Ongoing & new funding/regulatory pressures outweigh provider benefits under ACA

Benefits:
» Significant reduction in uninsured will be effective in 2014:
  – Individual mandate to obtain insurance
  – Require most employers with 50+ employees to offer health insurance
  – Expand Medicaid eligibility to 133% of poverty level
  – Prohibit insurers from denying adults coverage based on pre-existing conditions

Challenges:
» Tighter Medicare/Medicaid reimbursement:
  – Reductions in annual Medicare market basket updates
  – Readmission rate penalties began 10/1/2012
  – Value-based payments and patient satisfaction reductions began 10/1/2012
  – Medicare bundled payment pilot program begins 1/1/2013
  – Cuts to DSH funding (2014)
2013 – 2014 will be pivotal years

**Deficit Negotiations**
- Further reductions
  - Healthcare is on the chopping block; Republicans and Democrats have proposed cuts
- Changes to eligibility?

**Reform**
- Medicaid Expansion?
  - States can opt out at any point
  - Early surprises on commitments from AZ, AK, and others
- Individual Mandate
  - Will people sign up? Pay penalty or purchase?
- Insurance Exchanges
  - Regulations still being written
  - How well will the products reimburse?
  - Highly complex, likely to be unforeseen hurdles

**Volumes/Insurance**
- Changing modalities
  - Outpatient growing at expense of inpatient
  - Explosive growth in observation stays
- Commercial insurance
  - Greater risk sharing
  - Narrow networks, tiered products
2015 will show growth in Medicare and Medicaid
New indicators to evaluate new healthcare world

» Twenty new indicators introduced in February 2013 that measure exposure to payment risk and new ways of measuring demand

» Demand indicators include unique patients and covered lives

» Risk indicators include risk-based payments (%) and Medicare readmission rates (%)

» Anticipate analysis in August 2013 medians
## New indicators for healthcare

### A. Payor Mix (% of gross revenue)

<table>
<thead>
<tr>
<th>Payor Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicare (%)</td>
<td></td>
</tr>
<tr>
<td>Medicare managed care (%)</td>
<td></td>
</tr>
<tr>
<td>Total Medicare (%)</td>
<td></td>
</tr>
<tr>
<td>Medicaid (%)</td>
<td></td>
</tr>
<tr>
<td>Medicaid managed care (%)</td>
<td></td>
</tr>
<tr>
<td>Total Medicaid (%)</td>
<td></td>
</tr>
<tr>
<td>Total Commercial (%)</td>
<td><strong>NEW</strong></td>
</tr>
<tr>
<td>Self-Pay (%)</td>
<td></td>
</tr>
<tr>
<td>Other (%)</td>
<td></td>
</tr>
</tbody>
</table>

### B. Reimbursement Methods (% of net patient revenue)

- **NEW** Traditional Capitation (per member per month) (%)
- **NEW** DRG (%)
- **NEW** Percent of charges (%)
- **NEW** Fee schedule (%)
- **NEW** Per diem (%)
- **NEW** Risk based or other (%)

### C. Sources of Revenue (% of net patient revenue)

- **NEW** Inpatient revenue
- **NEW** Outpatient revenue

### D. Other Payor Mix Data

- **NEW** Single largest payor, excluding Medicare and Medicaid
- **NEW** Number of covered lives:
  - **NEW** Medicare
  - **NEW** Medicaid
  - **NEW** Commercial
New indicators, continued

<table>
<thead>
<tr>
<th>E. Hospital Utilization Data</th>
<th>F. Physician Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Licensed beds</td>
<td>Number of employed physicians</td>
</tr>
<tr>
<td>Staffed beds</td>
<td>Worked RVUs for employed physicians</td>
</tr>
<tr>
<td>Number of hospitals</td>
<td>Active medical staff (independent and</td>
</tr>
<tr>
<td>Unique patients</td>
<td>employed)</td>
</tr>
<tr>
<td>Inpatient admissions</td>
<td></td>
</tr>
<tr>
<td>Patient days</td>
<td></td>
</tr>
<tr>
<td>Emergency room visits</td>
<td></td>
</tr>
<tr>
<td>Outpatient visits</td>
<td></td>
</tr>
<tr>
<td>Outpatient surgeries</td>
<td></td>
</tr>
<tr>
<td>Total surgeries</td>
<td></td>
</tr>
<tr>
<td>Open heart surgeries</td>
<td></td>
</tr>
<tr>
<td>Observation stays</td>
<td></td>
</tr>
<tr>
<td>Medicare readmission rate (%)</td>
<td></td>
</tr>
<tr>
<td>Readmission rate (%)</td>
<td></td>
</tr>
<tr>
<td>Newborn admissions</td>
<td></td>
</tr>
<tr>
<td>Medicare case mix index</td>
<td></td>
</tr>
<tr>
<td>Total case mix index</td>
<td></td>
</tr>
</tbody>
</table>

NEW
3

Creating value
Creating value: four contemporary management objectives

1. Achieve breakeven performance with Medicare rates

2. Build scale through non-traditional methods

3. Improve patient experience

4. Cultivate informed leadership
#1: Achieve breakeven performance with Medicare rates

$750 Billion of Waste in U.S. Healthcare System

- Unnecessary Services: 25.3%
- Inefficient Care Delivery: 17.3%
- Excess Administrative Costs: 13.7%
- Inflated Prices: 7.3%
- Prevention Failures: 10.0%
- Fraud: 28.0%

Medicare reductions:
- Readmission rate penalties
- Adverse events

Source: Institute of Medicine: Best Care at Lower Cost: The Path to Continuously Learning Health Care in America.
Note: $750 billion adjusts for overlap among the categories.
Medicare deficit margins reported since 2003

Overall Medicare Margins Show Continued Loss

Strategies from across the US:

1. Compute financial “gap” if all patients were paid on Medicare rates
2. Develop multi-year cost reduction strategies that go beyond “low-hanging fruit” and challenge the historical business model based on volumes
3. Open lower-cost clinical decision units for observation stay patients
4. Better discharge planning with patient and family members

Source: Medpac
#2: Build scale through non-traditional methods

- Determining optimal size can be different depending on hospital location and services and mission

- Rating impact of non-traditional consolidations will depend on capital investment and impact on performance

- Scale and efficiencies can be gained through non-traditional consolidation strategies
## Four examples of non-traditional mergers

<table>
<thead>
<tr>
<th>Goal:</th>
<th>Example:</th>
<th>Credit Impact:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain scale by leveraging Centers of Excellence</td>
<td>Wal-Mart partners with 6 hospitals’ for tertiary care</td>
<td>Likely favorable given increased demand</td>
</tr>
<tr>
<td>Create collaborative of independent hospitals</td>
<td>BJC Collaborative comprised of 4 sizable health systems</td>
<td>Likely favorable if savings demonstrated</td>
</tr>
<tr>
<td>Create network of rural hospitals to achieve savings</td>
<td>Aspen Valley Hospital joins the Western Health Alliance</td>
<td>Demonstrated savings through group purchasing</td>
</tr>
<tr>
<td>Grow scale through shared savings or management agreements</td>
<td>Novant Health shared savings model Memorial University Medical Center</td>
<td>Likely favorable if scale and efficiencies demonstrated</td>
</tr>
</tbody>
</table>
Explosive traditional M&A activity will continue

» 2010 - 2011: Entrance of new investors and unique partners in non-for-profit healthcare
  – For-profit Vanguard Health System (B2) acquired Detroit Medical Center (Ba3)
  – Private equity Cerberus Capital Management acquired Caritas Christi Health Care (rated Baa2)
  – Catholic Providence Health in Services (Aa2) merged with secular, market leading Swedish Health Services (A2)

» 2012 - 2013: M&A activity continues
  – University of Colorado Hospital Authority merged with Poudre Valley (both now rated A1) and leased Memorial Hospital in Colorado Springs
  – St. Joseph (A1) merged with Presbyterian Hoag (Aa3)
  – Ascension Health (Aa2) merging with Marian Health (NR)
  – Trinity Health (Aa2) merging with Catholic Health East (A2)
  – Sherman Hospital (Baa1) merging into Advocate Health Care System (Aa2)

Ratings will be reviewed shortly after merger even if obligated groups remain separate
#3: Improve patient experience

Strategies from across the US:

- Expand care teams with 1 physician and 2 or 3 physician assistants; advance care teams for chronic diseases
- Open urgent care access points and expand hours
- Establish “care navigators” to ensure the patient receives attention post acute care
- Execute service contracts with physicians to ensure service standards
- Partner with local employers to manage utilization in lower-cost settings

The local hospital down the street is no longer the competition … the drugstore on the corner is.
Information technology improves the patient experience

- In 2005, IT represented one-fifth of capital spending
- In 2012, IT represents one-quarter to one-third of capital spending
- Data mining plays a critical role in health management; those systems that have long invested in IT are well ahead of others that are just starting
- Progressive health systems build a distinct brand based on uniform customer experience
- Next frontier: data-analytics capabilities and predictive modeling of patient populations

Source: Moody’s FY 2011 Medians and FY 2012 Preliminary Medians
#4: Cultivate informed leadership

Management and Governance is one of the five key factors in Moody’s rating methodology.

- Market Position (45%)
- Operating Performance (30%)
- Legal Security and Debt Structure
- Balance Sheet and Capital Management (25%)
- Management and Governance
Characteristics of progressive leadership

- New expertise on the board:
  - engineering
  - manufacturing
  - consolidation
- Consideration of partners
- Evaluation of all services & facilities for repurposing
- Assessing the business model

Source: US Not-for-Profit Hospital Rating Methodology, January 2012.
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