KaufmanHall

State of the Industry

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State of the Industry

The Value of Liquidity for NFP Healthcare

"No one ever went bankrupt losing money, but they do go bankrupt when they run out of cash."

Liquidity Value

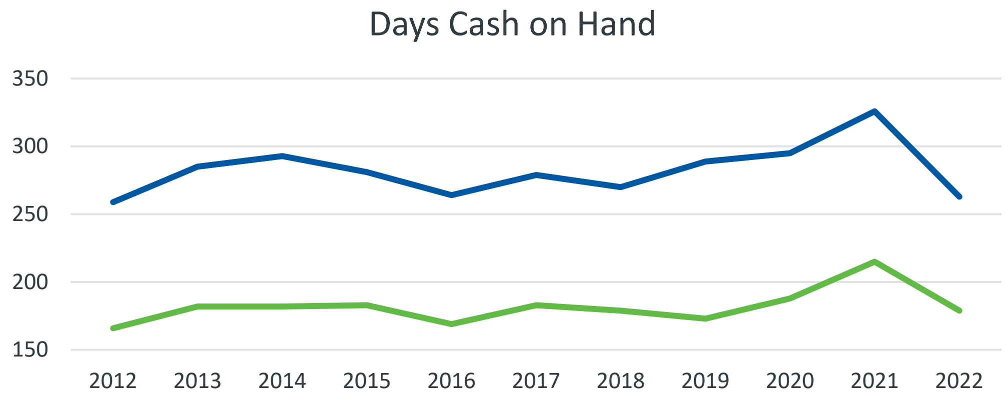
- Beyond operating performance, liquidity is the most important measurement of credit quality for lenders

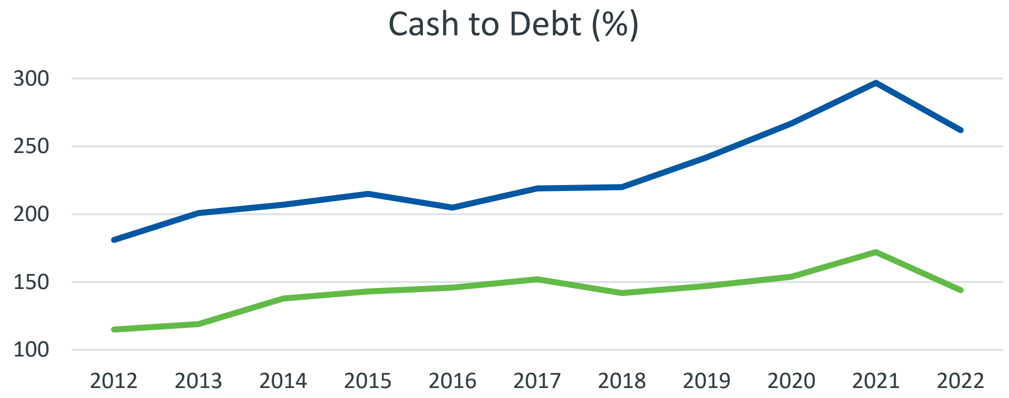
Key Liquidity Measurements

- Days Cash on Hand
- Cash to Debt
- Liquidity improved dramatically in 2021 in NFP healthcare, but declined 15-25% in 2022

Sample Project Spending – Effect on Liquidity

Quarter Ending	Project Draws	Cash and Investments[1]	Days Cash on Hand
9/30/2023	--	1,000,000	225
12/31/2023	25,000	975,000	219
3/31/2024	75,000	900,000	203
6/30/2024	100,000	800,000	180
9/30/2024	75,000	725,000	163
12/31/2024	25,000	700,000	158



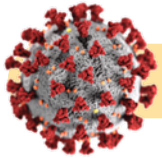


AA Median A Median

(1) Assumes no increase or decrease in cash from other areas (i.e. operations, investment gains or losses, other capital spending, etc.)

* Source: S&P U.S. Not-For-Profit Health Care System Medians, data for FY 2012 – FY 2022.

The Aftermath of the Pandemic



Crisis

An immediate operational and monetary shock.

CHARACTERIZED BY:

- Major stimulus spending (approx. $5 trillion)
- Accommodative Federal Reserve monetary policy
- Heavy focus on clinical and operational performance

Stabilization

Adjusting to the outcomes of the crisis stage.

CHARACTERIZED THUS FAR BY:

- Staffing shortages and surging inflation (including wages and supplies)
- Tightening monetary policy and rising interest rates, which is driving market volatility
- Concern on financial performance amidst renewed focused on strategic trajectory

Normalization

What will drive performance in a normalized future state?

EXPECTED TO INCLUDE:

- Recalibrated or stabilized workforce environment
- Return from an erratic interest rate environment
- Return of normalized strategic capital investments
- Revival of strategic initiatives driving the new core business

Every Component of the Business Model under Duress

2022/2023 challenge:
sustained credit and market headwinds challenge capital formation and resource allocation

OPERATING COMPANY HEADWINDS

- Long-tailed margin pressures drive sustained sector credit pressures
  — Volume, revenue, expense dislocation
  — Escalating and diversified competitive environment

FINANCE COMPANY HEADWINDS

- Baseline sector credit headwinds
- Market environment complicates external capital formation: elevated rates and spreads, flat curve; diminished investor appetite

INVESTMENT COMPANY HEADWINDS

- Volatility and return headwinds
- Pressure to elevate risk or use investments as a capital source
- Do investments remain "resiliency anchor"?

Financial “Twindemic” Hits Both Margins and Cash

Financial Performance Has Reached All-Time Low

- Intractable labor issues
- Unpredictable volume recovery
- High average length of stay
- Limited relief from payers; end of the CARES Act; sequestration re-starts

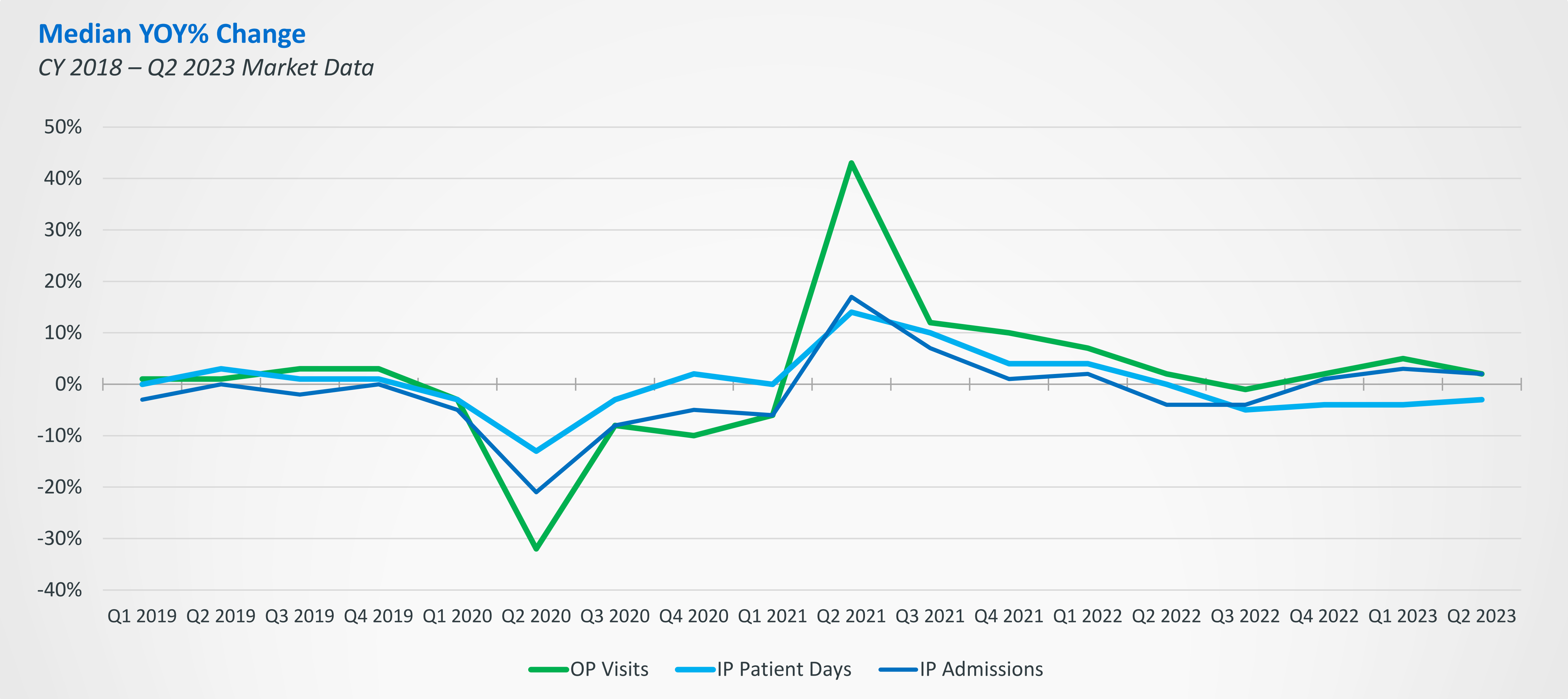
Financial Position Has Sharply Declined

- Use of cash to fund operations
- Investment losses
- Outsized daily operating expenses reduces cash on hand
- Payers slow to pay

Capital is a hospital’s oxygen and hospitals can no longer afford to hold their breath.

— Eric Jordahl, Moving Into and Through 2023

Volumes Show More Consistency as Pandemic Volatility Subsides



Source: Kaufman Hall *National Hospital Flash Report*

Volumes Remain Mixed Compared to Pre-Pandemic Levels

TODAY COMPARED TO PRE-PANDEMIC

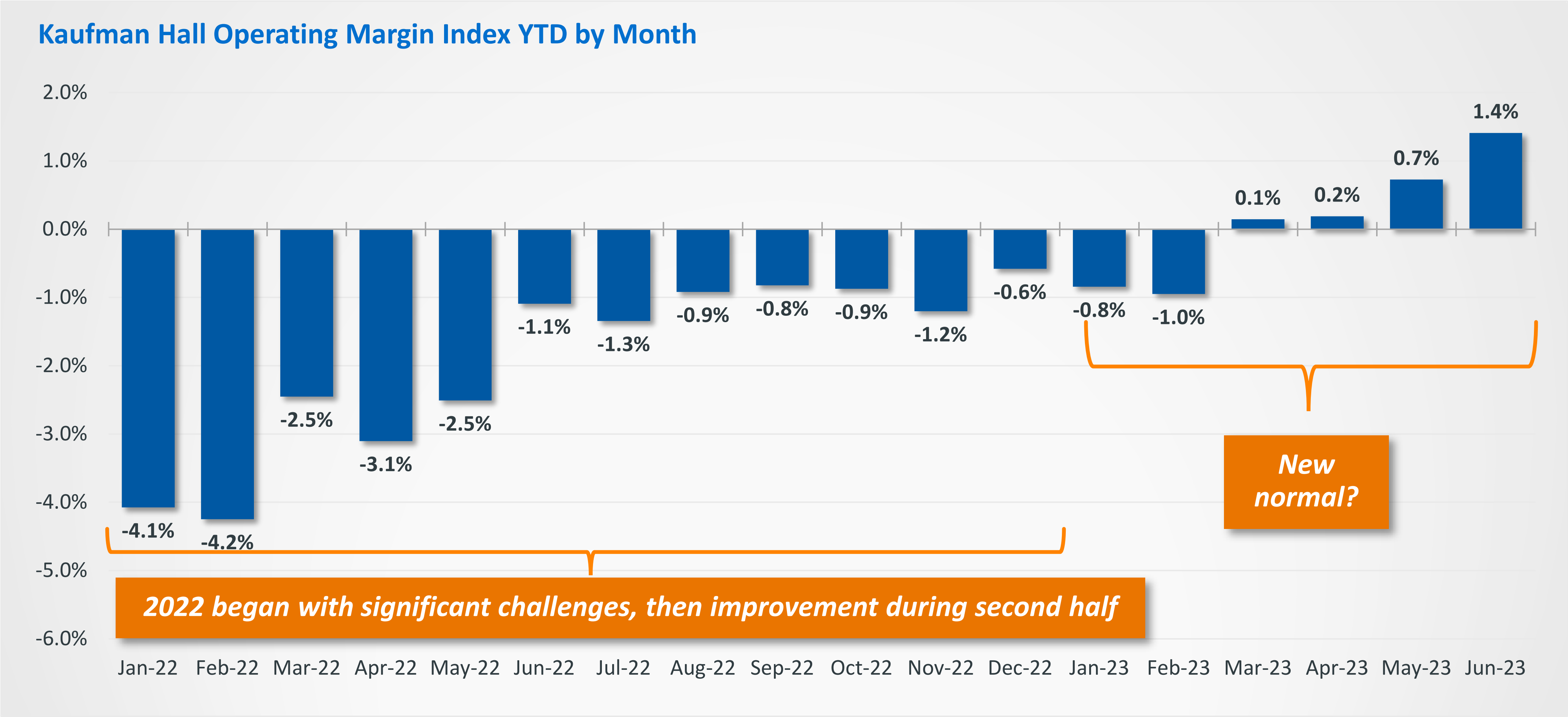
Median Volume Percent Change (May 2023 LTM vs December 2019 CY)

ADJUSTED DISCHARGES	AVERAGE LENGTH OF STAY	ED VISITS	OPERATING ROOM MINUTES
0%	9%	-1%	2%

1. **Volumes dropped while lengths of stay increased**
   Hospital volumes have continued to drop across the board—including inpatient and outpatient
2. **Inflation has continued to throttle hospital finances**
   Labor costs continue to rise, and the costs of goods and services continued to be well above pre-pandemic levels
3. **Effects of Medicaid disenrollment could be materializing.**
   Hospitals experiencing increases in bad debt and charity care could illustrate the effects of the start of widespread disenrollment from Medicaid following the end of the COVID-19 public health emergency

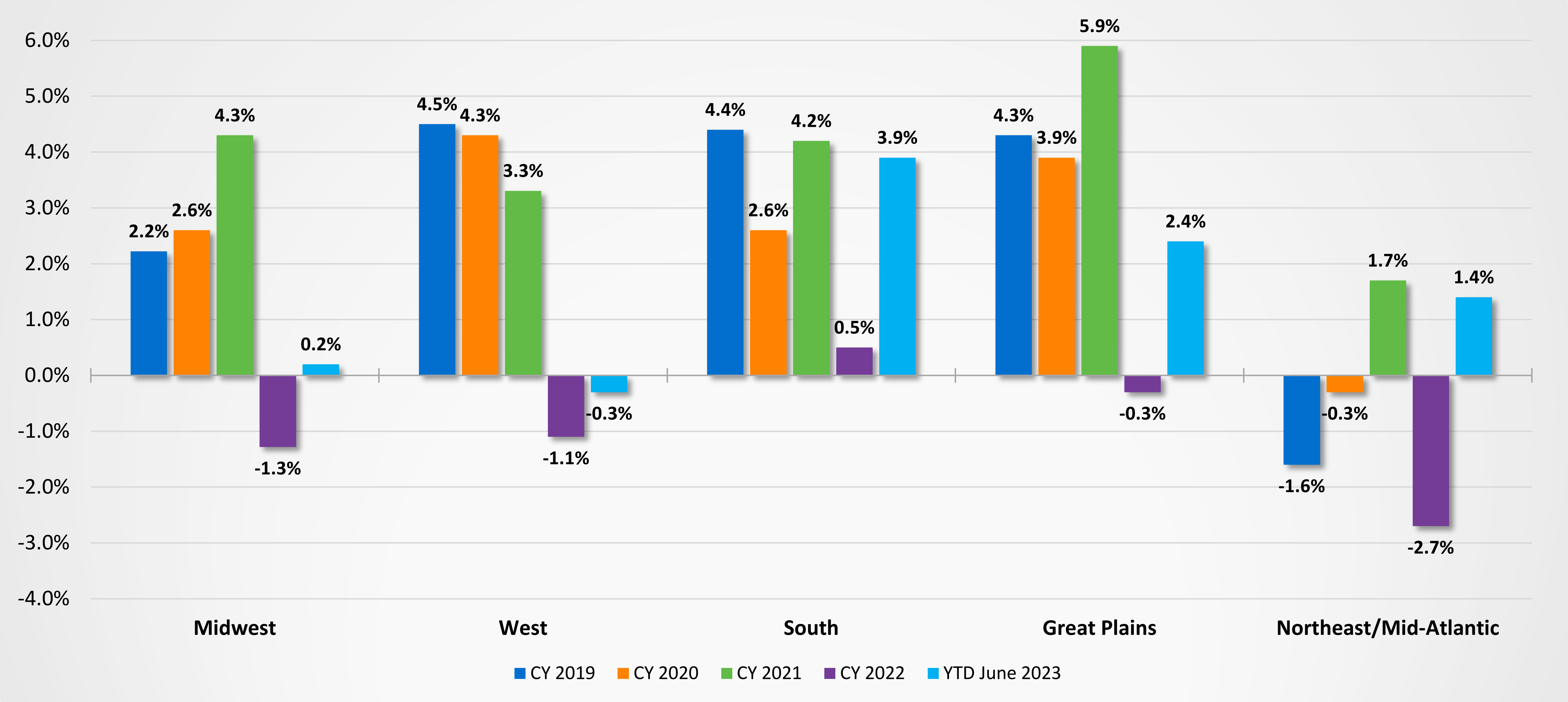
Source: Kaufman Hall *National Hospital Flash Report*

After a Difficult 2022, Have We Reached a Turning Point?



Source: Kaufman Hall *National Hospital Flash Report*

Operating Margin Trends Show Wide Array by Region



Source: Kaufman Hall; all values represent median for each respective region; operating margin includes CARES Act funds
Sample size: Midwest = 185; West = 149; South = 246; Great Plains = 91; Northeast/Mid-Atlantic = 128

Credit and Rating Agency Activity

All Rating Agencies Maintain Negative Outlooks on the Sector

Moody's

Outlook: Negative

S&P Global

Outlook: Negative

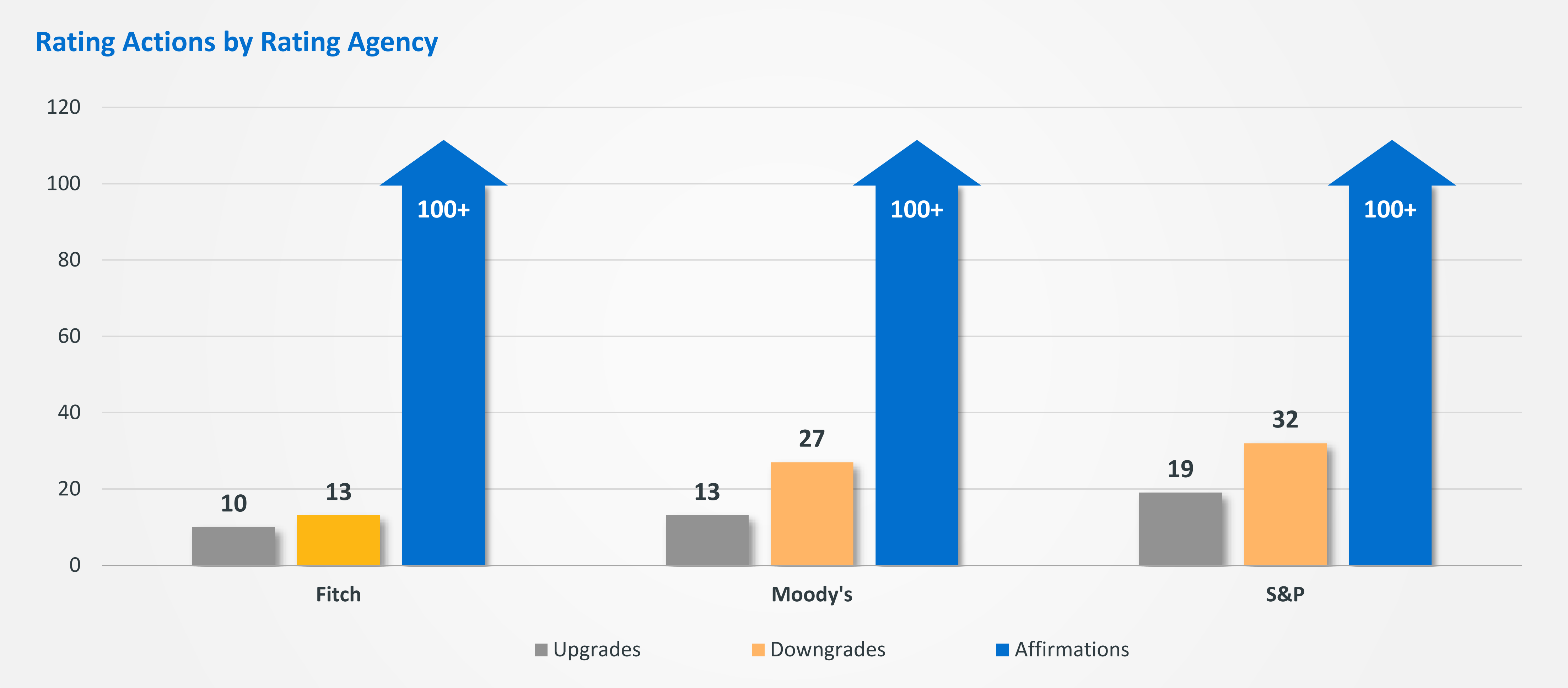
FitchRatings

Outlook: Deteriorating

- **The sector continues to experience severe labor shortages** and will be the largest driver of operating challenges
- **Operating performance will continue to be pressured in 2023**, as expense growth will likely outpace revenue growth; performance will have a longer runway to pre-pandemic margins
- **Revenue gains will be limited** by lingering pandemic strains, inability to meet demand because of labor constraints, deteriorating payer mix and the continued shift of care to low-cost settings
- **Unpredictable volumes** will make budgeting and forecasting increasingly difficult
- **Liquidity will decline** as market turbulence continues, cash flow is weak and capital spending increases following some delay during the pandemic
- **Organizations with strong balance sheets are less likely to experience a negative rating or outlook action**; weaker credits may continue to struggle
- Barring significant regulatory pushback, **M&A activity will continue** as providers seek size and scale to achieve stability
- **Partnership opportunities** for efficiencies and strategic investments are likely to evolve
- **Significant shifts in care delivery models are occurring**, with disruptors seeking to gain a speed-to-market advantage
- **The credit quality gap may continue to widen** between stronger and weaker providers
- **Legislative, regulatory and judicial activity will continue to add risk** to the sector including price and drug scrutiny and the end of the Public Health Emergency

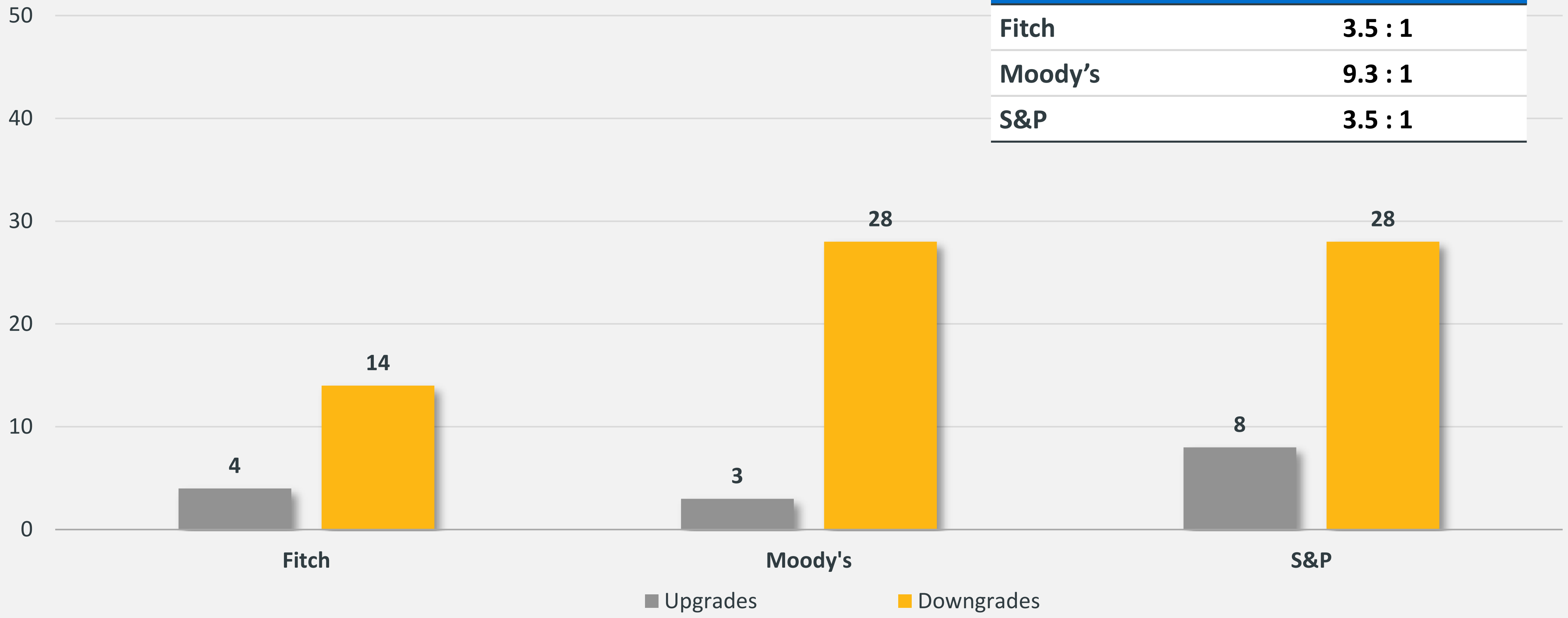
Sources: Fitch Ratings, Moody's Investors Service, S&P Global

Affirmations Remain the Majority of Rating Actions in 2022



Source(s): Fitch Ratings, Moody’s Investors Service, S&P Global

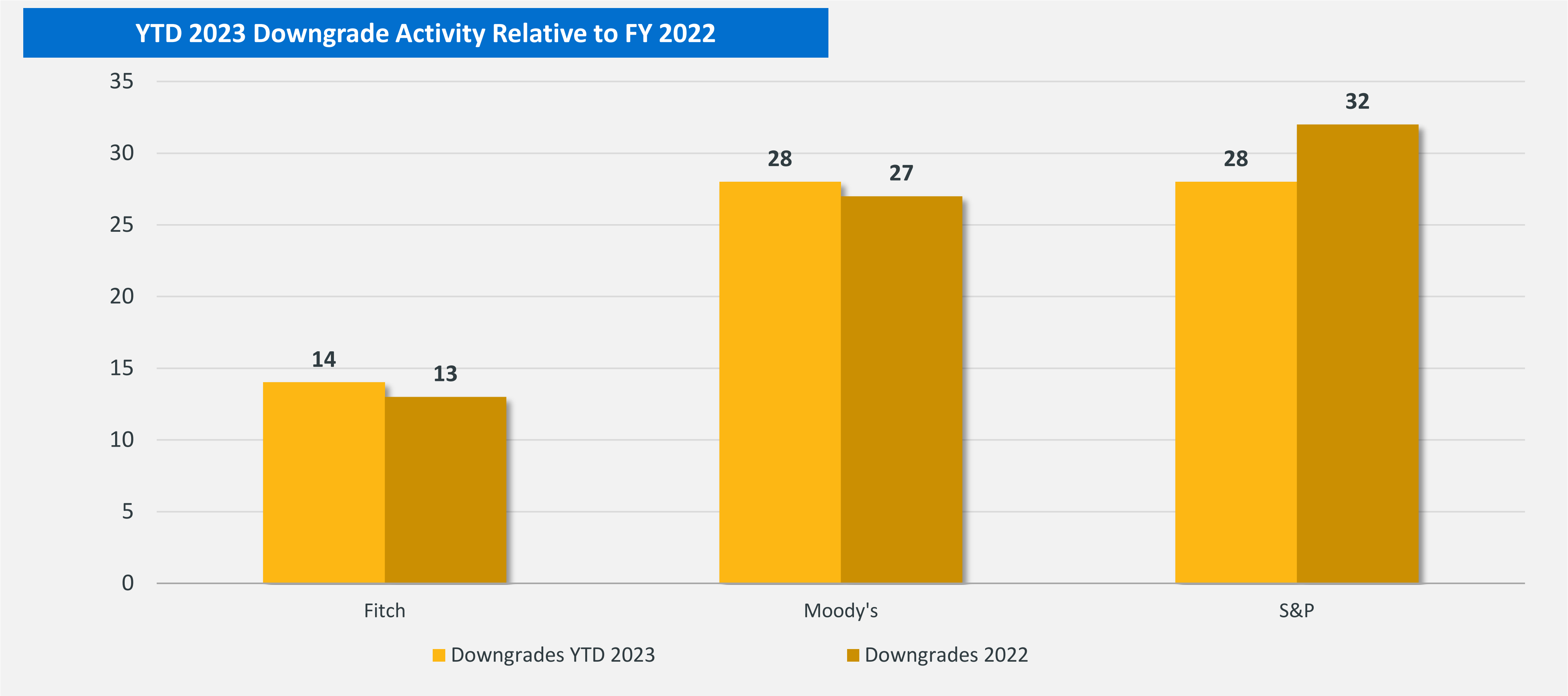
Downgrades Far Outweigh Upgrades through Early August 2023



Downgrades to Upgrades	
Fitch	3.5 : 1
Moody’s	9.3 : 1
S&P	3.5 : 1

Source: Fitch Ratings, Moody’s Investors Service and S&P Global

YTD Downgrades Approach or Exceed Full Year 2022 Downgrades



Source: Fitch Ratings, Moody's Investors Service and S&P Global through August 4, 2023

"Sound Bites" from the Kaufman Hall Rating Agency Webinar

FitchRatings	• At year end 2022, 6% of the portfolio had negative outlooks • As of June 30, 2023, 3% have negative outlooks
Moody's	• Pace of rating downgrades to slow during second half of 2023 as the earlier downgrades reflected 3Q and 4Q 2022 results • No material changes in number of negative outlooks
S&P Global	• Pace of rating downgrades to slow during second half of 2023 • Most outlook changes have been to in a negative direction with 24 to negative; only 5 to positive

What we know: Liquidity is Paramount to Long-Term Sustainability

Five Reasons

1. Cash for rainy day events
2. Gives access to bank lines
3. Source of capital when debt is limited
4. Serves as a financial cushion when debt increases
5. Key metric for the rating agencies

Five Examples

1. Mandated elective shutdowns
2. Spiraling cost of PPE, ventilators
3. Liquidity bridge before CARES, MAPP
4. Collateral for lines of credit to provide additional liquidity
5. “Triage” hospital ratings at risk

Market Update

Current Events Impacting Our Market

Macroeconomic Themes

- Amid a solid economy and tapering inflation, the Federal Reserve signaled a pause on further rate hikes after it raised its key interest rate by 25 basis points at the latest FOMC meeting in July
- Total nonfarm payroll employment grew by 187,000 in July while the unemployment rate remained largely unchanged at 3.5%
- Predictions of a 2023 recession have subsided as the Fed has made progress toward a "soft landing"

Fixed Income Markets

- Over the last three months, 30-yr UST has ranged from 3.81% to 4.38% and 30-yr MMD has ranged from 3.46% to 3.82%. 30-yr UST and 30-yr MMD are 58 bps and 31 bps higher, respectively, year-to-date
- The U.S. yield curve remains inverted as the Fed's entrenched battle with inflation has pushed up short-term rates further
- Short-term benchmark rates remain volatile, with SIFMA resetting 30 bps higher this week at 3.30%

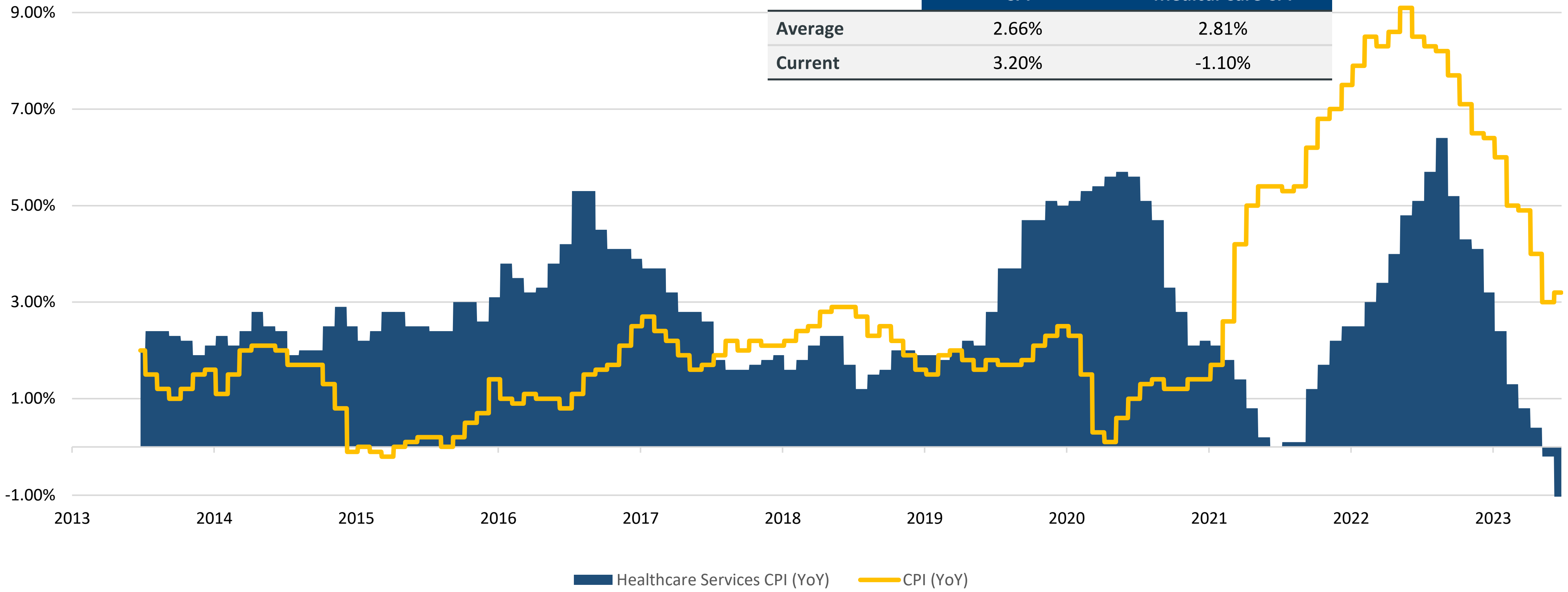
Muni Market Dynamics

- Total municipal issuance and total healthcare supply are 16% and 56% lower, respectively, in 2023 compared to the same point in 2022
- Recent healthcare issuances have been met with solid investor reception, as supply remains thin, and investors seek to deploy capital
- The market repriced credit risk in 2022, as uncertainty led to credit spreads widening, however, spreads have remained stable throughout most of 2023

Sources: Bloomberg, Thomson Reuters, the Bond Buyer, and KH Experience as of August 18, 2023

Healthcare Services CPI Increases vs. Total CPI

	CPI	Medical Care CPI
Average	2.66%	2.81%
Current	3.20%	-1.10%



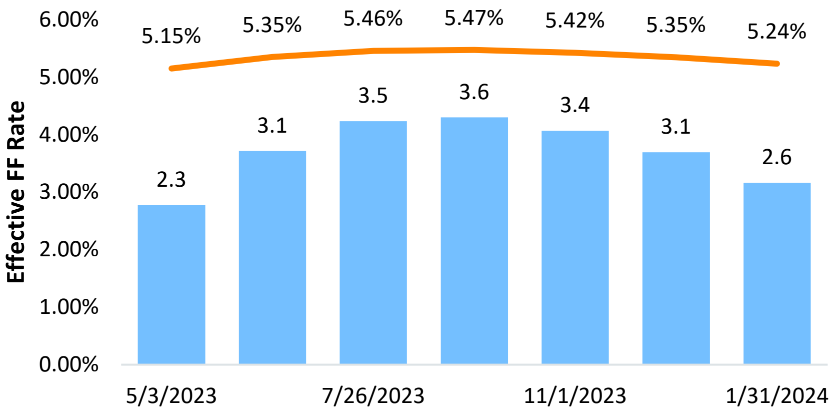
U.S. consumer prices are up 3.2% year over year in July as the cost of medical care has fallen significantly after a steep rise in late 2022 and is currently in negative territory

Source: Bloomberg as of August 18, 2023

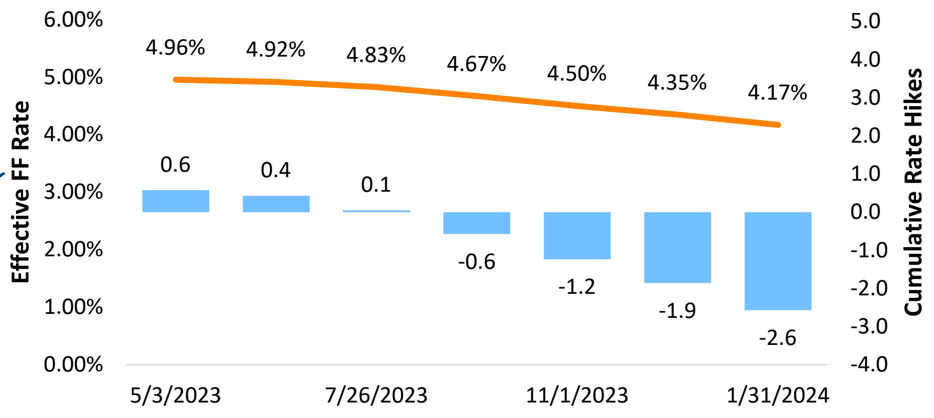
Short-Term Rates Expectations Changing Quickly in 2023

2023 year-end projections are currently almost 100bps higher than expected at the beginning of 2023

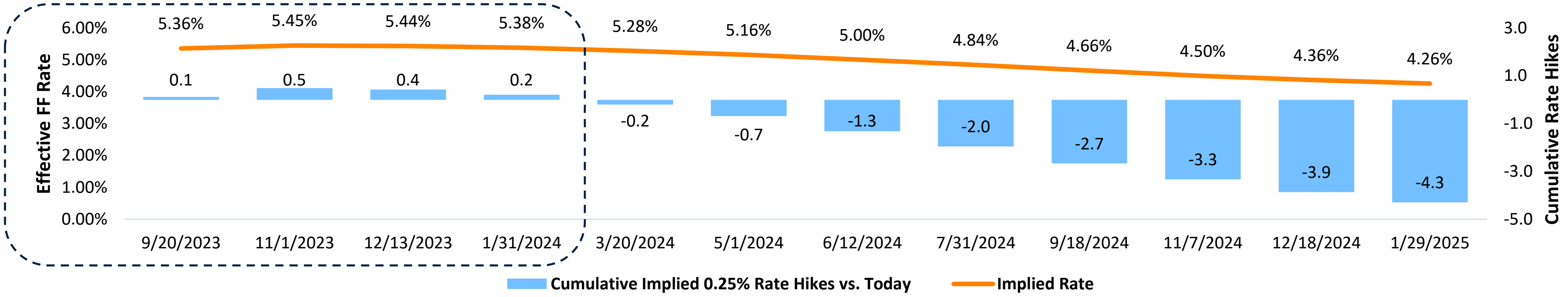
March 1, 2023 – Fed Funds Expectation



March 31, 2023 – Fed Funds Expectation



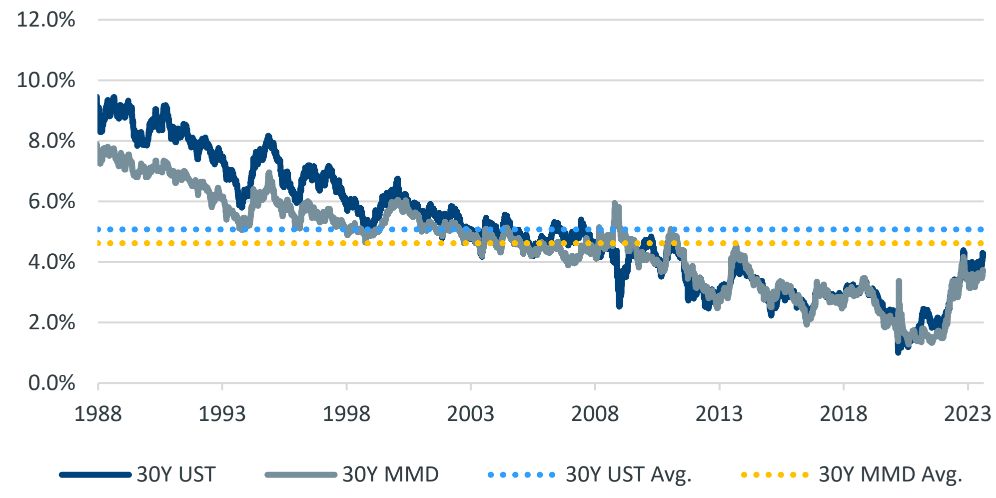
August 21, 2023 – Fed Funds Expectation



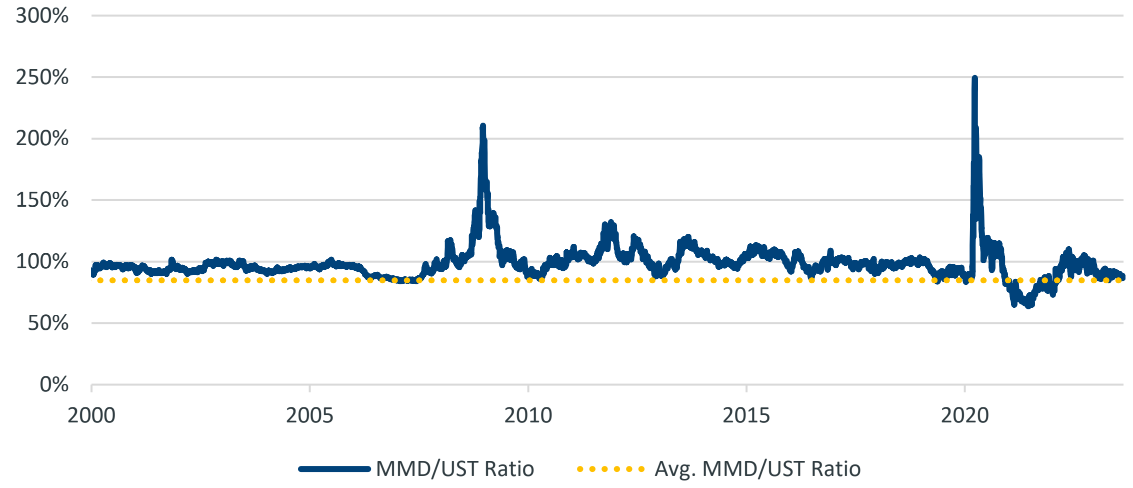
Source: Fed Funds expectations based on Bloomberg consensus forecasts

Current Rates in Historical Context

With recent increases, benchmark rates approach historic averages



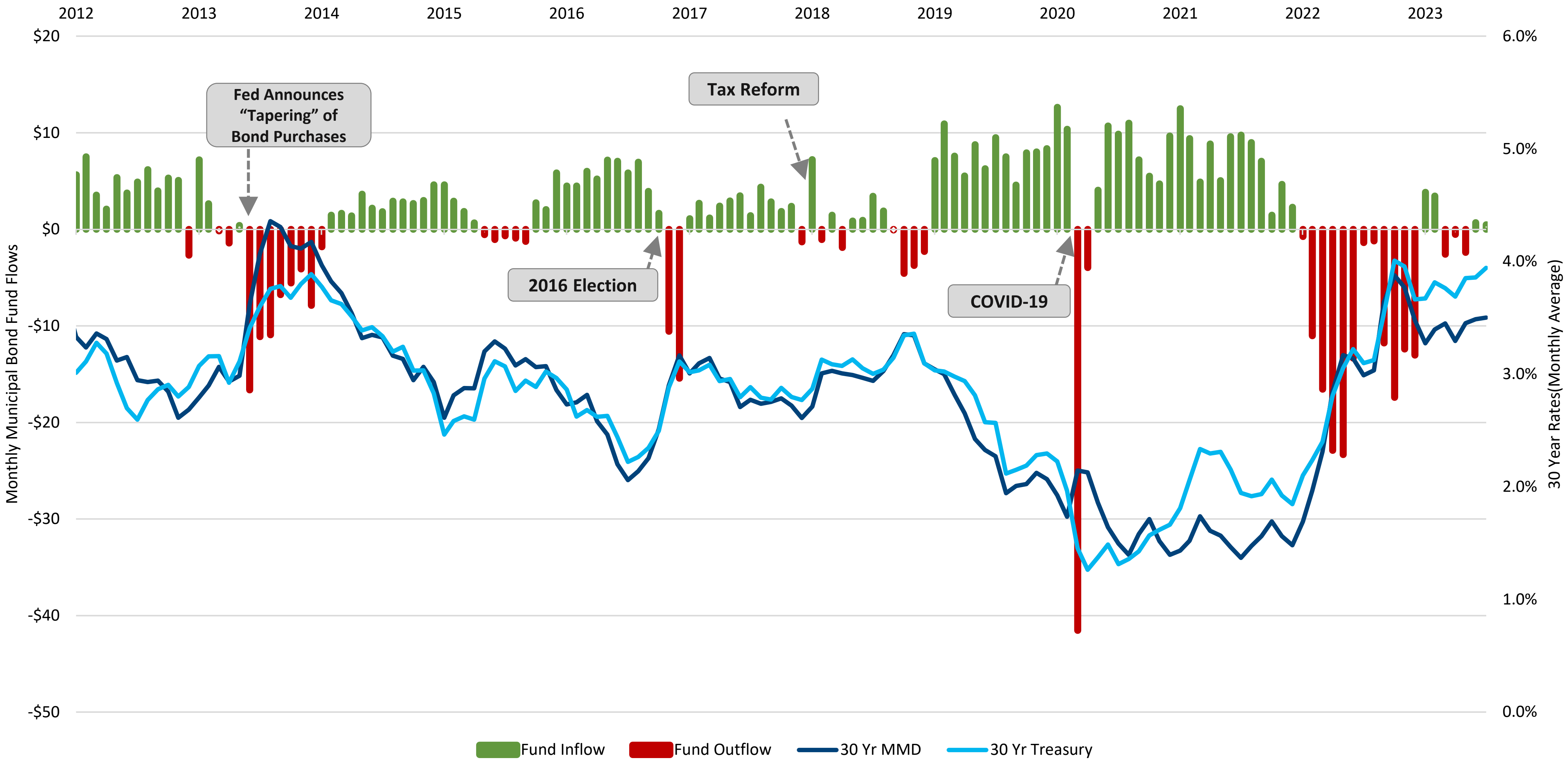
30-year Muni ratios are trading near historical averages



	UST			MMD			Ratios		Spreads	
	5Y	10Y	30Y	5Y	10Y	30Y	10Y	30Y	30Y – 5Y MMD	30Y – 5Y UST
Current	4.39%	4.25%	4.38%	2.84%	2.84%	3.82%	66.8%	87.3%	0.98%	-0.01%
YTD Change	0.38%	0.38%	0.41%	0.32%	0.21%	0.24%	-1.1 pts	-3.0 pts	-0.08%	0.03%
10-year Average	1.84%	2.25%	2.79%	1.36%	1.92%	2.71%	88.5%	97.5%	1.36%	0.95%
Average Since 1987	4.08%	4.58%	5.07%	3.13%	3.77%	4.63%	85.3%	93.6%	1.50%	0.99%
% Time Higher Since 1987	44.9%	50.7%	60.8%	53.9%	65.4%	68.9%	97.9%	65.6%	80.8%	94.2%

Sources: Bloomberg, Thomson Reuters as of August 18, 2023

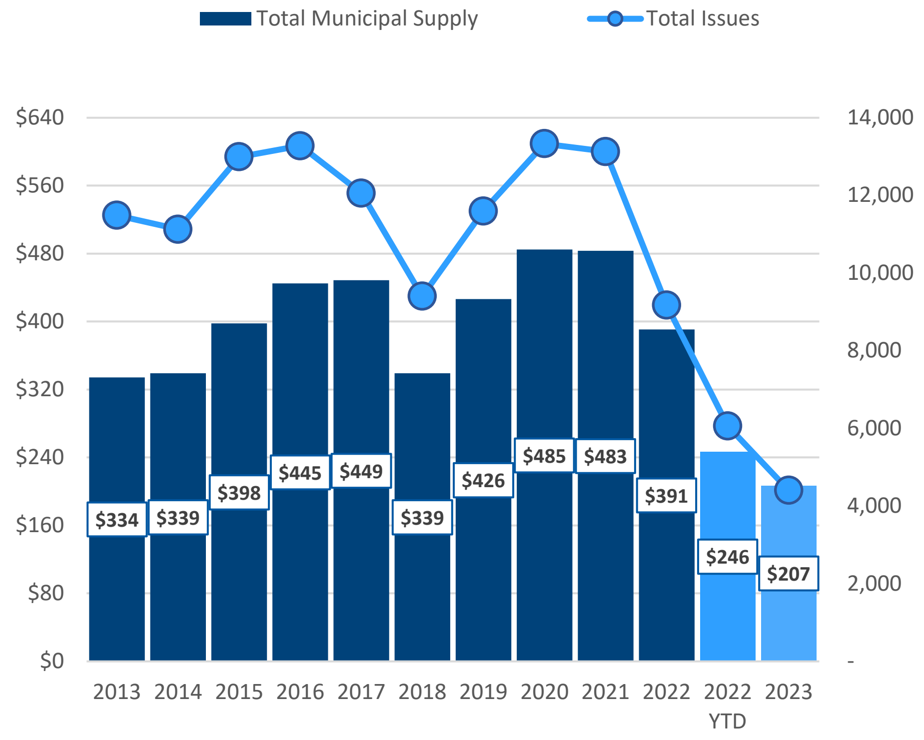
Tax-Exempt Fund Flows and Long-Term Rates Move Together



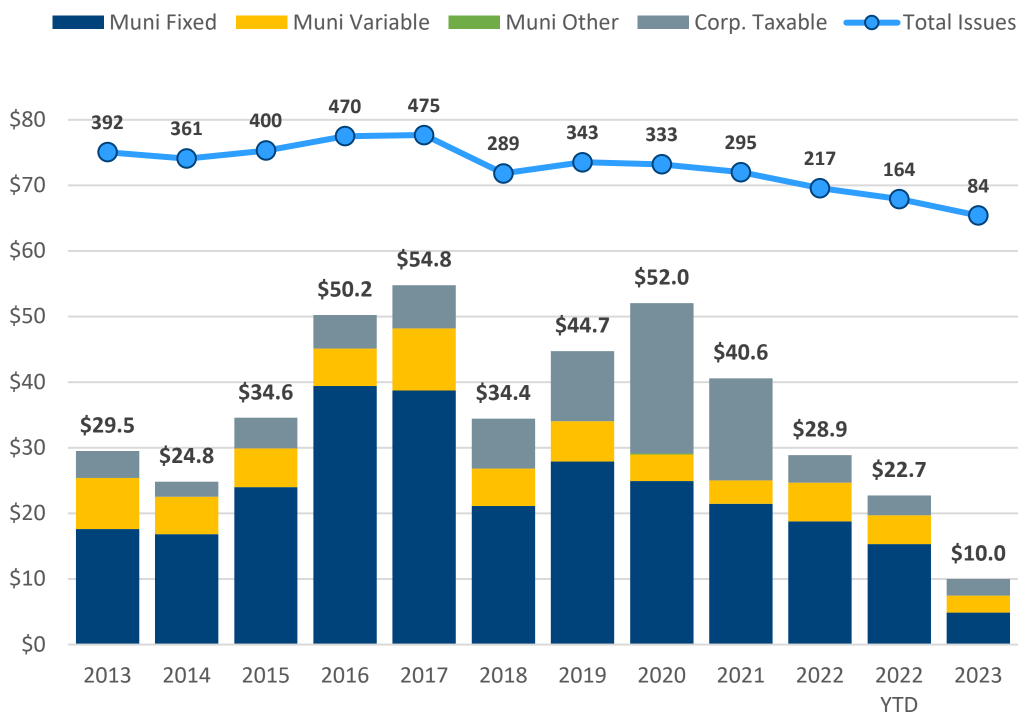
Source: ICI.org, Thomson Reuters, and Bloomberg as of August 18, 2023

2023 Municipal and Healthcare Issuance Lagging 2022

Total Municipal Market Activity ($B)



Total Healthcare Issuance ($B)

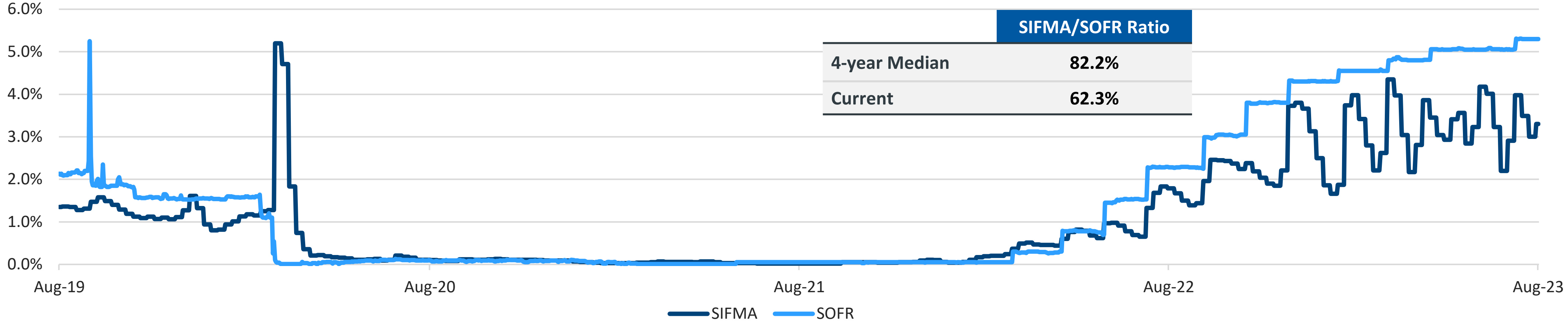


Total municipal issuance and total healthcare supply are 16% and 56% lower, respectively, in 2023 compared to the same point in 2022. Issuance is on pace to finish the year at 25% of 2020 volume.

Source: Thomson Reuters, MuniOS as of August 18, 2023; Bond Buyer as of July 31, 2023

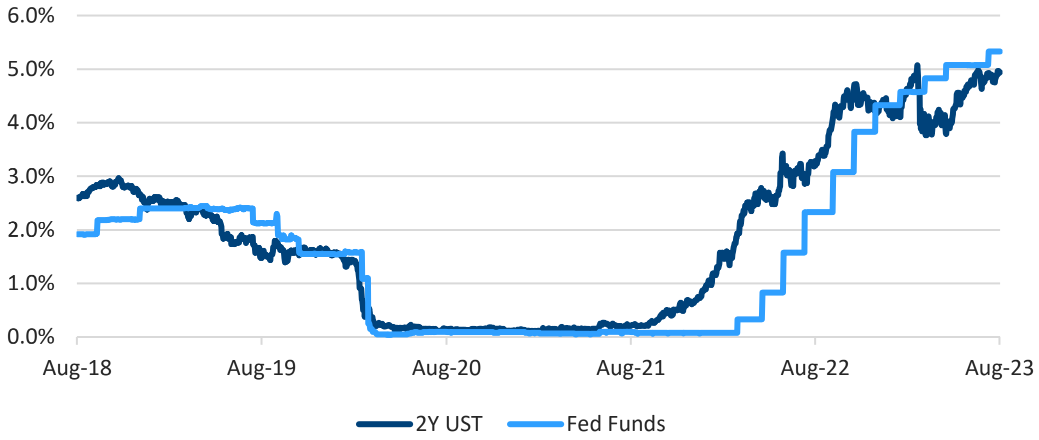
Short-Term Market Overview

Short-term benchmark rates have risen with Federal Reserve policy actions

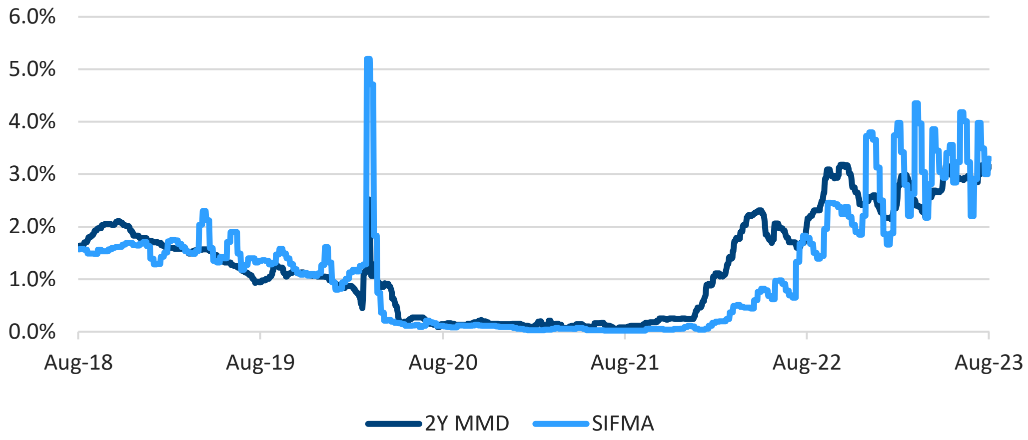


SIFMA/SOFR Ratio	
4-year Median	82.2%
Current	62.3%

Effective Fed Funds Rate vs. Short-term Treasuries



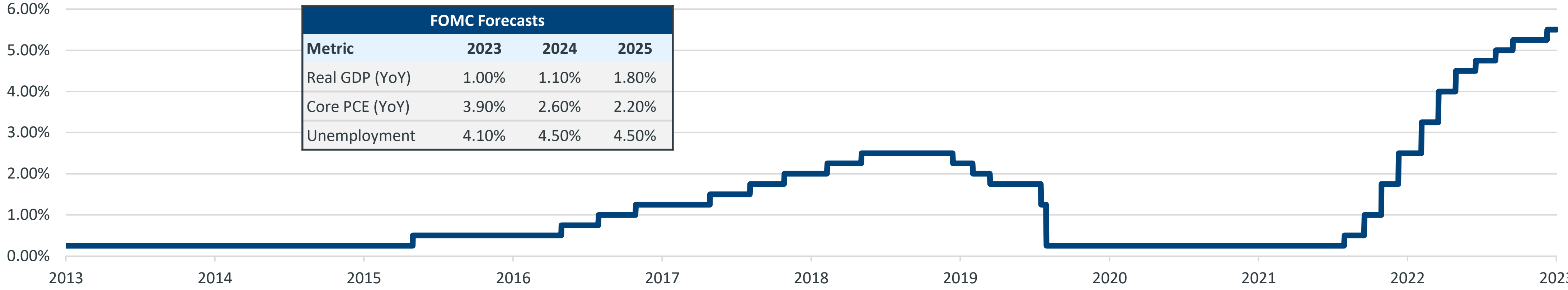
SIFMA vs. Short-term MMD



Source: Bloomberg, Thomson Reuters as August 18, 2023

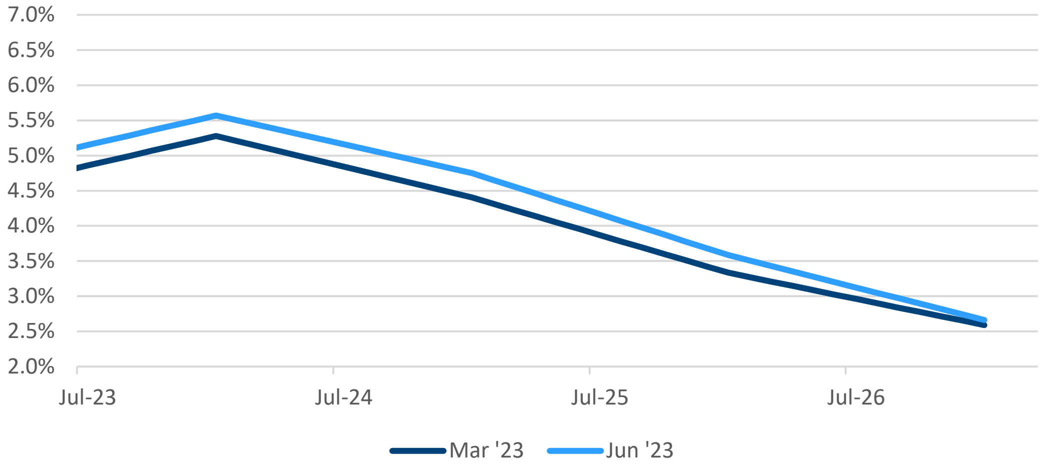
FOMC and Market Expectations for Fed Funds Rate

The Federal Reserve continues to increase their Federal Funds rate to help combat record-high inflation, as well as utilizing other measures

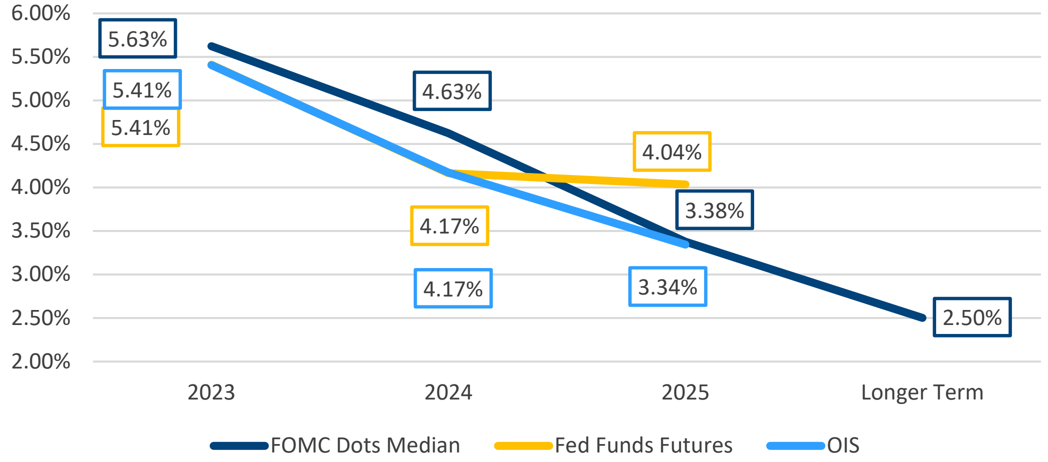


FOMC Forecasts			
Metric	**2023**	**2024**	**2025**
Real GDP (YoY)	1.00%	1.10%	1.80%
Core PCE (YoY)	3.90%	2.60%	2.20%
Unemployment	4.10%	4.50%	4.50%

FOMC Average Fed Fund Projection Curve



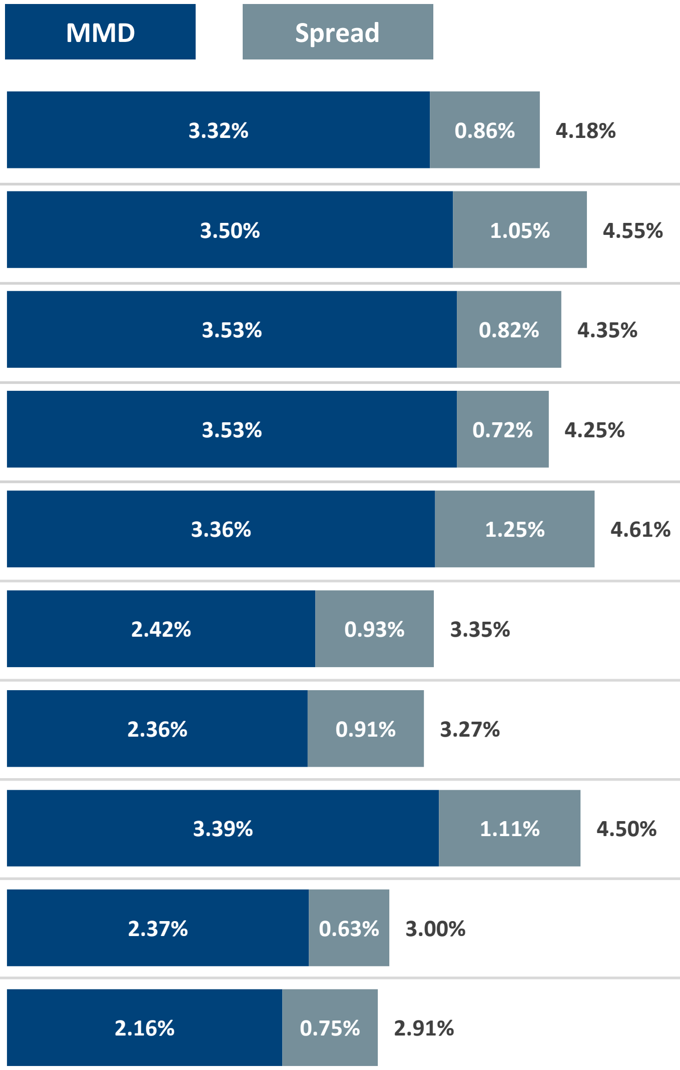
OIS and Fed Funds Futures



Source: Bloomberg as of August 18, 2023; Federal Open Market Committee as of June 14, 2023

Select Recent Tax-Exempt Healthcare Transactions

Borrower	Sale Date	Par Amount ($MM)	Rating	Coupon	Mty
Norton Healthcare	7/11/2023	$146.4	NR / A / A+	5.00%	2042
Frederick Health	6/13/2023	$70.0	Baa1 / NR / A-	5.25%	2053
Arkansas Children's Hospital	6/6/2023	$128.2	A1 / AA- / NR	5.25%	2053
IU Health	6/6/2023	$282.3	Aa2 / AA / AA	5.00%	2053
WVU Medicine	5/10/2023	$285.9	A2 / A / NR	4.38%	2053
Ballad Health	5/4/2023	$145.8	NR / A- / A	5.00%	2034
	5/4/2023	$39.6	NR / A- / A	5.00%	2033
Connecticut Children's	5/2/2023	$112.4	A3 / NR / A+	4.25%	2053
BJC HealthCare	4/20/2023	$139.0	Aa2 / AA / NR	5.00%	2033
UPMC Life Changing Medicine	4/10/2023	$245.2	A2 / A / NR	4.00%	2031



Source: Thomson Reuters, Bloomberg, and Internal Kaufman Hall sources

Recent Healthcare Corporate Taxable Transactions

Denotes non-index eligible

Borrower	Sale Date	State	Par Amount	Rating	Mty	UST	5-10Y Spread	20Y Spread	30Y+ Spread	
CENTRAL HEALTH	7/12/2023	TX	$8.4	Aa2 / NR / NR	2033	2.59%	0.59%			3.18%
	7/12/2023	TX	$90.9	Aa2 / NR / NR	2043	4.23%		1.24%		5.48%
Sutter Health	6/1/2023	CA	$375.0	A1 / A+ / A+	2033	3.61%	1.55%			5.16%
			$375.0	A1 / A+ / A+	2053	3.85%			1.70%	5.55%
MARIN GENERAL HOSPITAL	5/9/2023	CA	$100.0	NR / BBB / BBB	2045	3.84%		3.40%		7.24%
Providence	4/26/2023	WA	$585.0	A2 / A / A	2033	3.40%	2.00%			5.40%
SSMHealth	4/18/2023	MO	$300.0	NR / A+ / AA-	2028	3.69%	1.20%			4.89%
UPMC LIFE CHANGING MEDICINE	4/4/2023	PA	$300.0	A2 / A / NR	2043	3.74%		1.64%		5.38%
			$500.0	A2 / A / NR	2033	3.37%	1.67%			5.04%
Adventist Health	12/1/2022	CA	$353.0	NR / A- / A	2032	3.48%	1.95%			5.43%
CommonSpirit	10/18/2022	IL	$507.4	Baa1 / A- / A-	2027	4.22%	1.85%			6.07%
			$300.0	Baa1 / A- / A-	2052	4.06%			2.40%	6.46%

Source: Thomson Reuters, Bloomberg, and Internal Kaufman Hall sources

What Happens Next?

Industry Forces Are Reshaping the Basis of Competition

Transactions are a given: new forms of alignment with unexpected participants and with novel structures will become the norm

Healthcare service delivery will further disintegrate into more distinct and specialized segments of care – beyond just ‘inpatient’ and ‘outpatient’ care

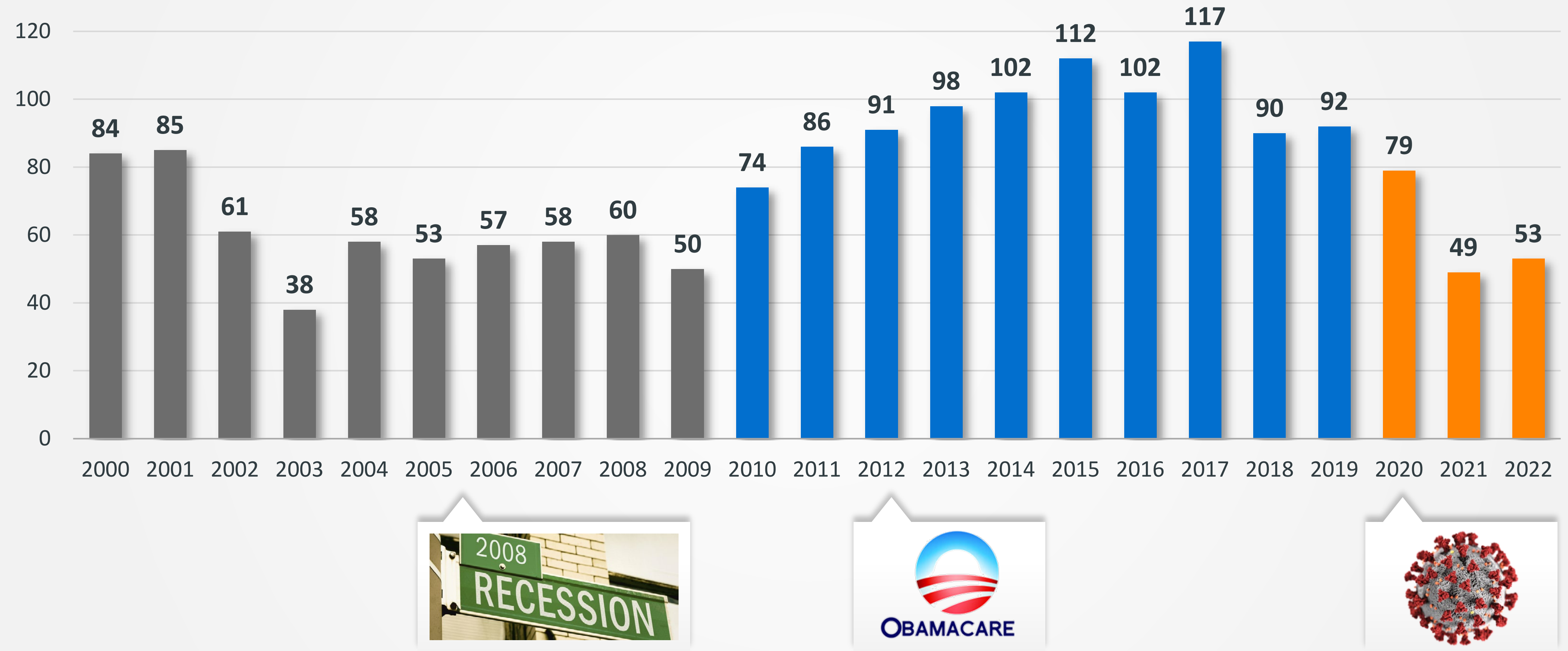
New entrants likely will focus on either higher margin services or more consumer-driven elements, ceding the rest to legacy providers

True population health management likely will be beyond the reach of most organizations that opt to ignore all forms of collaborations and partnerships

Industry transformation will present the biggest threat to management teams that ignore the fundamental market shift, and provide opportunities to those that embrace it.

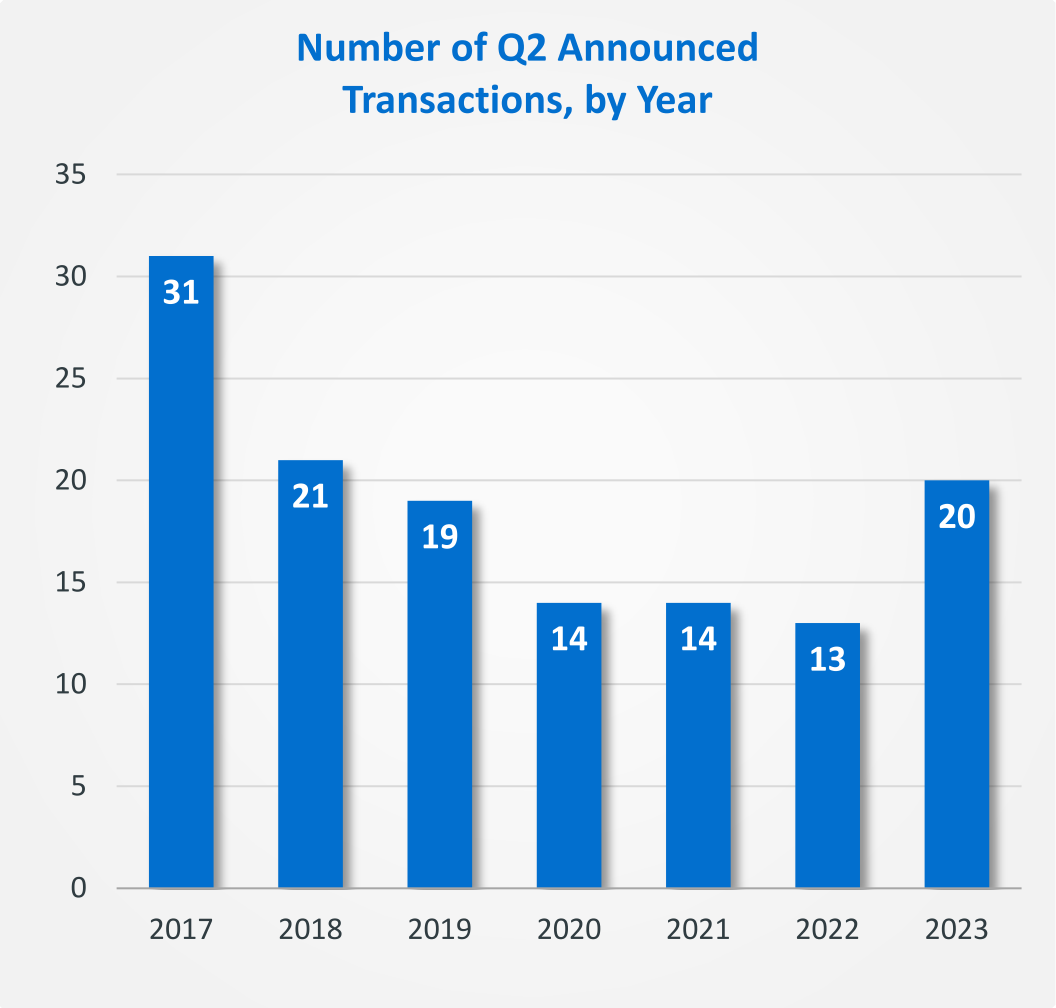
The Evolution of Market Transaction Activity

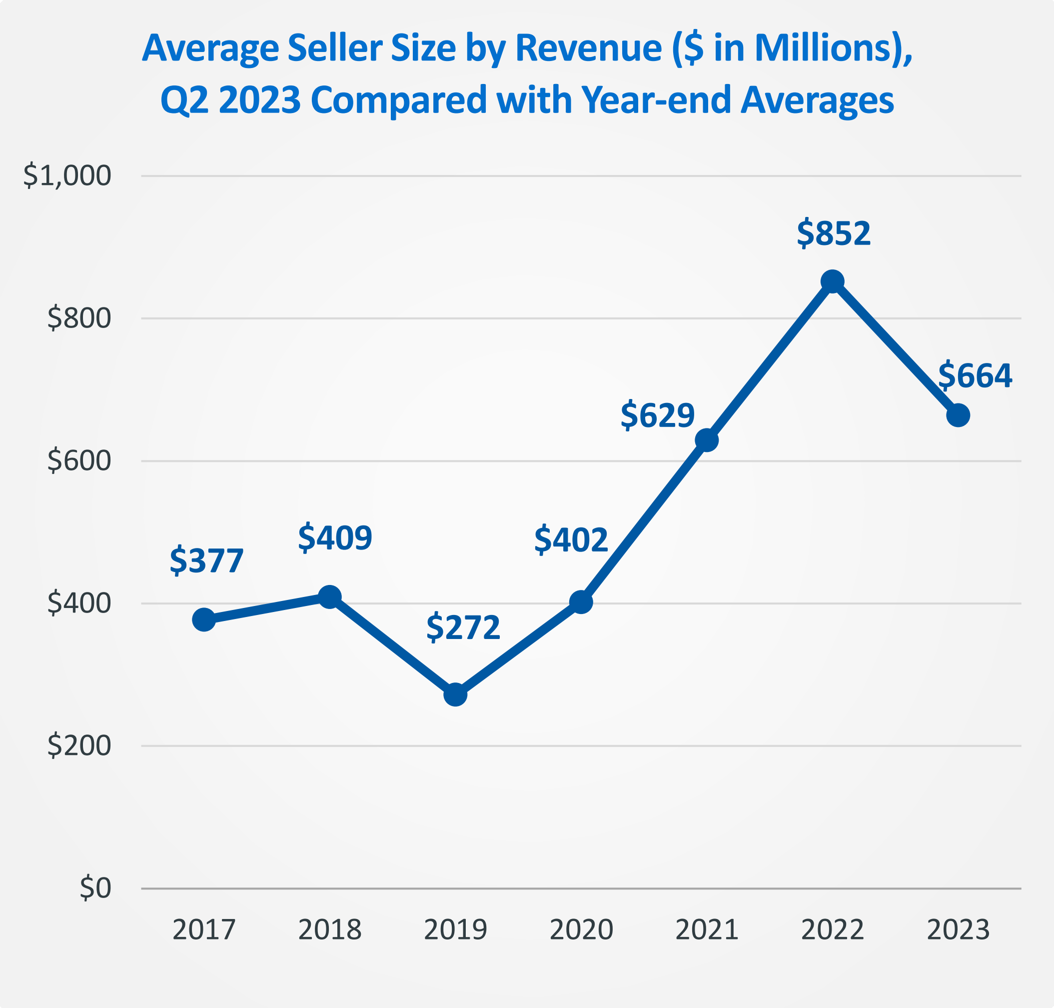
Hospital and Health System M&A Transactions, 2000-2022



Source: Public information, Kaufman Hall proprietary database

M&A Quarterly Activity Report: Q2 2023

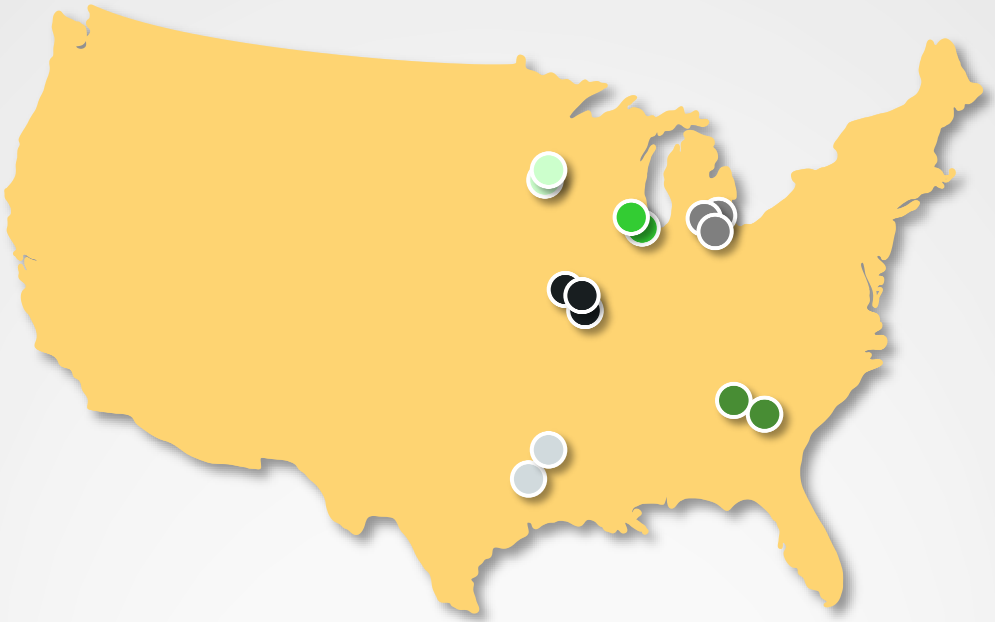




Source: Kaufman, Hall & Associates, LLC

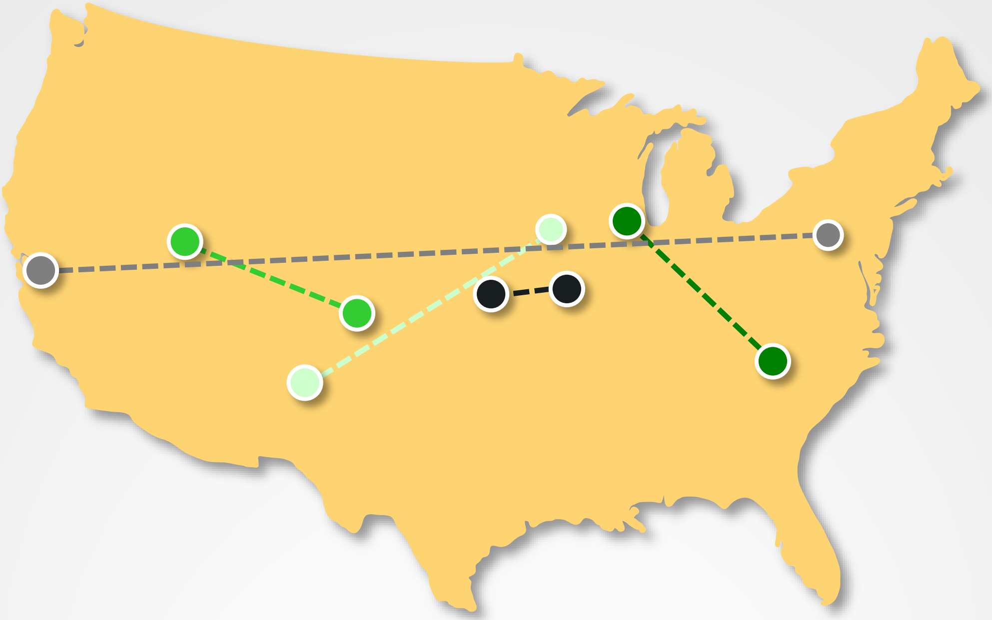
Drive for New Capabilities Creates Cross-Market Strategy

INITIAL WAVE (REGIONAL)



- Barnes + Jewish + Christian: *Same Market*
- Beaumont + Oakwood + Botsford: *Same Market*
- Baylor + Scott & White: *128 Miles*
- HealthPartners + Park Nicollet: *Same Market*
- Provena + Resurrection: *Same Market*
- Palmetto + Greenville: *103 Miles*

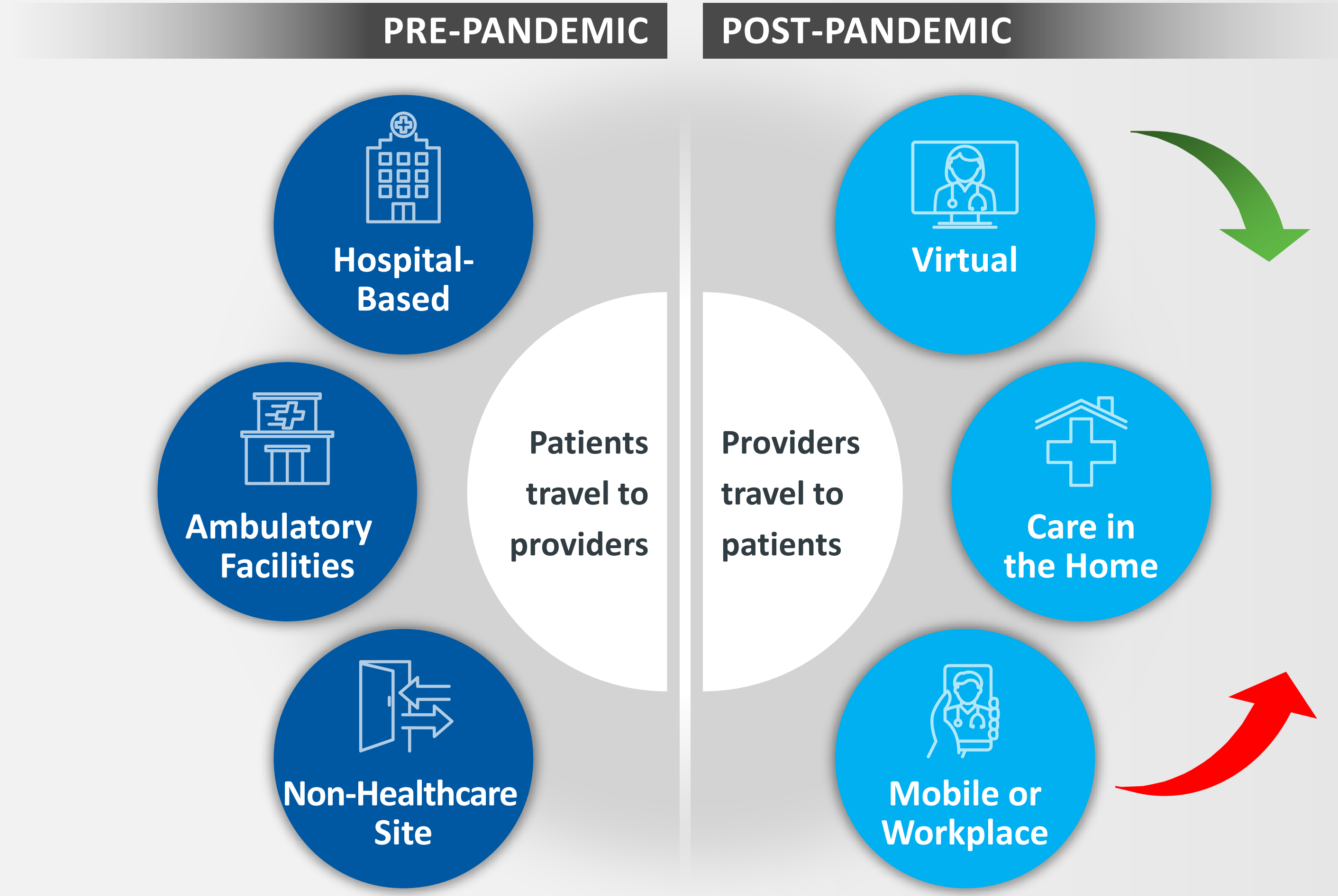
CURRENT WAVE (CROSS-MARKET)



- BJC + Saint Luke's: *318 Miles (pending)*
- Kaiser Permanente + Geisinger: *2,500 Miles (pending)*
- Presbyterian + UnityPoint: *983 Miles (pending)*
- SCL Health + Intermountain: *508 Miles*
- Advocate + Atrium: *754 Miles*

Note: Includes New System Formation Transactions among Regional/Super-Regional Systems with the Smaller Organization Revenue Base > $1B

Pandemic Accelerates Demand for Lower Cost Settings of Care



BENEFITS

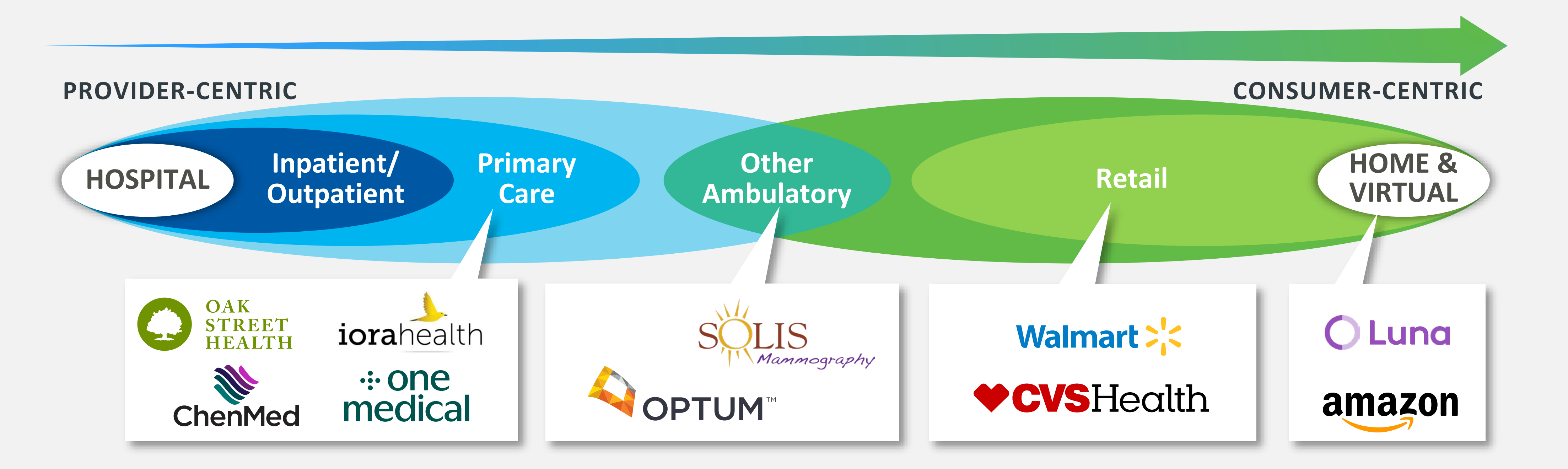
1. Deliver care in setting with **dramatically lower fixed costs** and overhead
2. Increase patient satisfaction
3. Provide alternative revenue streams

RISKS

1. **Unclear economic model**, particularly in terms of revenue
2. Unclear risk implications
3. Potential increase in staffing needs

As Have the Disruptors…"The Doctor Will Zoom You Now"

- Well-capitalized to pursue aggressive growth strategies
- Hyper-focused on select market segment(s) and have tailored their value proposition accordingly
- View strategic partnerships with existing players as worthwhile to increase visibility, market share, and financial resources, though not necessary to survive
- Leverage technology and non-traditional business models, though not entirely novel



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Characteristics of Health Systems “Bucking the Trend”

High-Growth Service Area

Population growth driving increasing volumes

Located in growth markets with diversified economies and affordable housing

Proactive Expense Strategies

Enacted early-on expense control strategies during the pandemic and doubled down on efforts during the 2021 margin rebound

Identified Levers & Tough Decisions

Implemented levers for improvement such as labor force reallocation/reduction, pension suspension

Executed exit strategies for certain non-core services or facilities

Manageable Debt Positions

Adequately managed debt capacity to fund future growth strategies or to replenish reserves for prior capital

Thank You

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