The Impact of COVID-19 on Bond Ratings

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Fitch Ratings

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Agenda and Introductions

- Introductions
- Medians – Run Up to Covid
- COVID Discussion
- Key Sector Trends – Are They Still Applicable?
- What does 2021 Hold?

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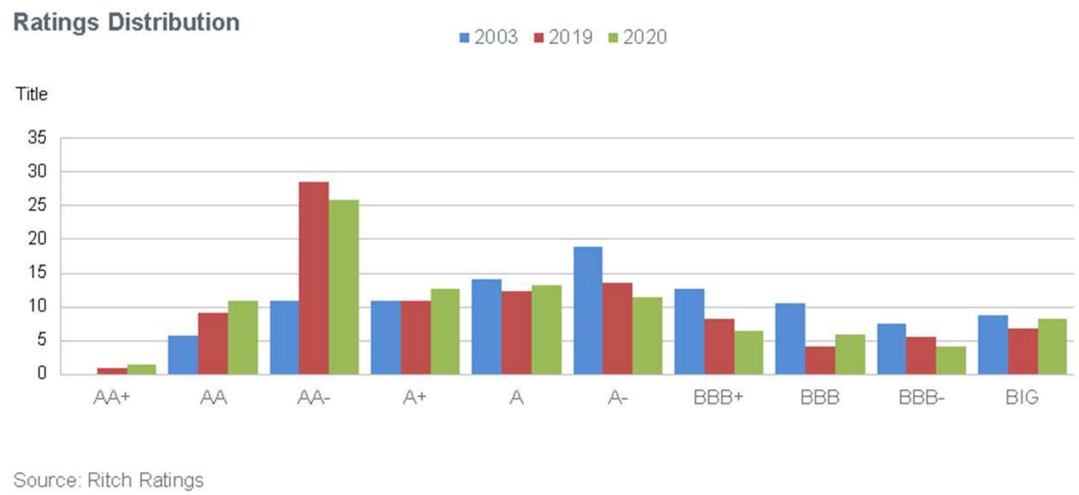
Rating Definitions

Investment Grade
AAA: Highest credit quality (Exceptionally strong capacity for payment)
AA: Very high credit quality (Very strong capacity for payment)
A: High credit quality (Strong capacity for payment; some vulnerability to adverse conditions)
BBB: Good credit quality (Adequate capacity for payment; likely vulnerable to adverse conditions)

Non-Investment Grade
BB: Speculative (Existing flexibility supports payment; more vulnerable to adverse conditions)
B: Highly Speculative (Limited margin of safety for payment; subject to adverse conditions)
CCC: Substantial credit risk (Default is real possibility)
CC: Very high levels of credit risk (Default appears probable)
C: Exceptionally high levels of credit risk (Default is inevitable or imminent)
D: Default (Bankruptcy, liquidation, ceased business)

US Not For Profit Healthcare Portfolio



Hospital & Hospital System Financial Performance

	2013	2014	2015	2016	2017	2018	2019
Sample Size	243	235	246	249	232	220	220
Days Cash on Hand	193.9	203.4	203.8	195.5	213.9	214.9	219.8
Days in Accounts Receivable	49.3	48.2	47.9	47.3	47.0	45.9	46.8
Cushion Ratio (x)	16.4	17.6	18.2	18.7	20.9	22.5	22.8
Days in Current Liabilities	64.8	66.4	65.7	63.8	61.7	62.8	64.3
Cash to Debt (%)	127.7	141.8	138.5	142.8	159.0	155.4	159.3
Cash to Adjusted Debt (%)					130.4	130.6	138.9
Operating Margin (%)	2.2	3.0	3.5	2.8	1.9	2.1	2.3
Op EBITDA Margin (%)	9.2	9.7	10.3	9.5	8.5	8.6	8.7
Excess Margin (%)	3.7	4.8	5.2	3.8	4.2	4.0	4.5
EBITDA Margin (%)	10.9	11.7	12.2	10.5	10.3	10.4	10.6
Net Adjusted Debt to Adjusted EBITDA (%)					(1.1)	-1.1	-1.3
Personnel Costs as % of Total Operating Revenue	55.0	54.4	53.6	54.8	54.9	54.0	53.3
EBITDA Debt Service Coverage (x)	3.5	4.0	4.3	3.6	3.8	4.0	4.1
OP EBITDA Debt Service Coverage (x)	3.0	3.5	3.7	3.2	3.2	3.4	3.3
Maximum Annual Debt Service as % of Revenues	3.1	2.9	2.8	2.6	2.6	2.5	2.4
Debt to EBITDA (x)	3.6	3.1	3.1	3.5	3.3	3.4	3.3
Debt to Capitalization (%)	37.8	36.6	38.4	37.0	34.3	33.7	33.1
Average Age of Plant (Years)	10.6	10.6	10.8	11.0	11.2	11.2	11.6
Capital Expenditures as % of Depreciation Expense	115.7	106.6	111.9	115.8	121.4	117.0	117.7

N.A. - Not Available. EBITDA – Earnings before interest, taxes, depreciation, and amortization. CFFOBI – Cash flow from operations before interest.

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The Novel Coronavirus (COVID-19) Had an Immediate Impact

Fitch Credit Outlooks: March 2020 Update

FitchRatings

Sector	Sub-sector	Sub-topic	Region	Sector Outlook: 2020 Update	Sector Outlook 2020 Original	What to Watch
Public Finance	Life Plan Communities	U.S. Not For Profit Life Plan Communities	NA	Negative	Stable	Not anticipating near-term sector-wide downgrades, but we do anticipate that negative rating actions (downgrades, outlook changes) will outpace upgrades in 2020, given potential pressure points of coronavirus. • Operating cost escalation is the most significant near-term pressure, as the LPC sector is already exposed to margin volatility due to labor shortages pre-dating the outbreak. Lower-rated credits and issuers with a high exposure to skilled nursing operations in particular could come under rating pressure if revenue declines and cost increases persist beyond the next few months. • Credits that are currently undergoing expansions, particularly those that are already lower rated and in areas heavily affected by the outbreak, may come under the most pressure, including challenges in filling units, especially if home sales remain slowed for a protracted period. • While equity market exposure is mixed across Fitch's rated LPC portfolio, equity market volatility could affect LPC credits in two ways – by reducing their liquidity cushions and affecting prospective residents' financial condition.
Public Finance	Education and Nonprofits	U.S. Public Colleges and Universities	NA	Negative	Negative	• Prolonged student, faculty or staff campus access restrictions into the fall 2020 semester could reduce demand and auxiliary revenue • Increased implementation costs and reliance on online platforms; non-traditional programmes (including online) likely to expand and affect margins • Additional international student enrollment pressure and overall changes in student draw could be negative • Exposure to market volatility and its impact on operating performance, as well as on endowment returns and fundraising • Continued uncertainty in federal and state support
Public Finance	Healthcare	U.S. Not For Profit Hospitals and Health Systems	NA	Negative	Stable	• There will be a definitive shift from inpatient elective surgeries to COVID-19 patients. Elective surgeries will decline, which will reduce revenue. We expect this volume to return to the sector and the duration of the outbreak will determine the severity to the sector • Shortages of key supplies, such as gloves, masks, proactive equipment, beds and, most acutely, ventilators. There is a growing concern that as both volumes and the very real likelihood that staff becomes infected and therefor quarantined, access to adequate levels of personnel will become a challenge • Given the almost inevitable decline in revenues and expected uptick in expenses, combined with recent market losses, hospital and health system unrestricted liquidity levels will be negatively affected without significant curtailment of capital spending, or some external sourcing of funds

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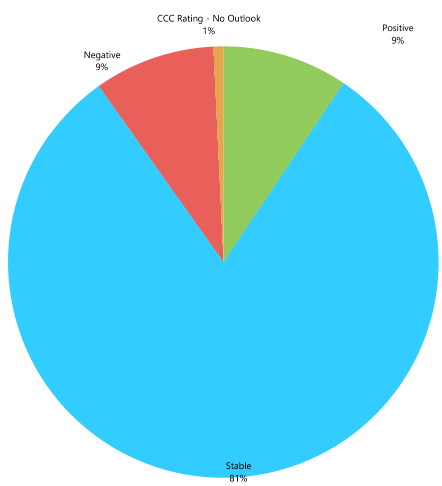
Hospitals and Health Systems : Medians

3-31 Interims		
Sample Size: 74	**12/31/19**	**3/31/20**
Operating Margin	2.5	(2.3)
Operating EBITDA Margin	9.1	4.7
EBITDA Margin	11.7	1.6
Days Cash on Hand	238.6	214.9
Cash to Debt	160.4	142.9
Cash to Adjusted Debt	154.6	142.9
Net Adjusted Debt to Adjusted EBITDA	(1.7)	0.4
MADS DSCR	4.4	0.3

Source: Fitch Ratings.

Rating Actions

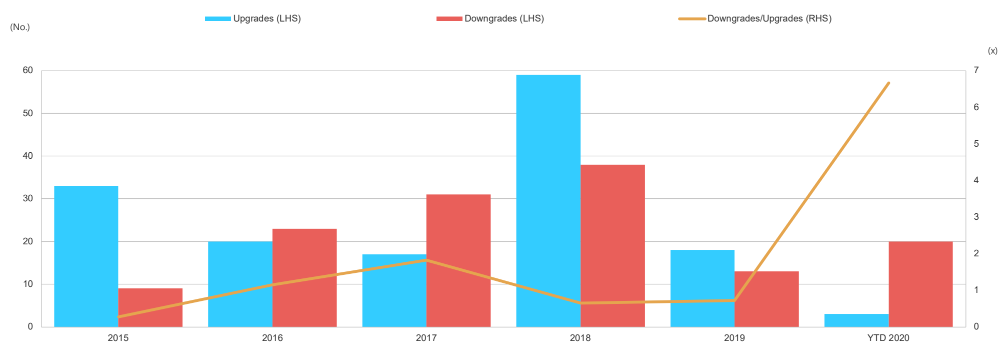
Hospitals - Ratings Outlook/Watch
(As of December 2020)



Source: Fitch Ratings

Rating Actions

Hospitals - Rating Changes

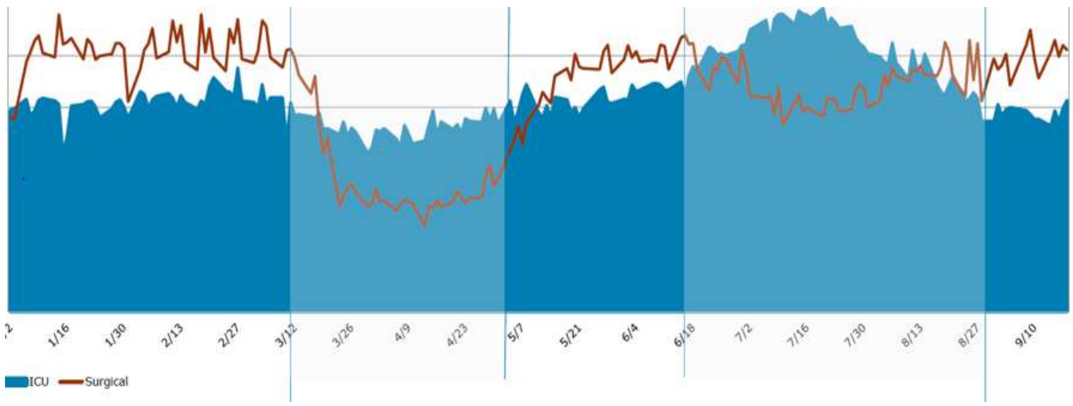


Source: Fitch Ratings.

Coronavirus: Every Few Weeks, Something Changed

- The former epicenter of the pandemic, New York, effectively flattened the curve, providing a real life, real time, blueprint for others – but has recently seen increased COVID levels;
- Other states that avoided a coronavirus surge for long stretches of time; allowed for the procurement of PPE, etc., and surge/capacity planning; but experienced a “summer surge”;
- Critical clinical knowledge continues to be shared worldwide; and treatments emerged (e.g., Remdesivir, Dexamethazone, Convalescent Plasma Infusions, Interferon Beta, Monoclonal Antibodies);
- Relaxation of “shelter in place” orders; along with holiday season have made containment difficult; some states have been forced to resume the stoppage of non-emergency volumes and/or phases of “re-opening” have been rolled back
- Continued expense mitigation efforts; return of electives (some reported as high as 90% or more) and successful stimulus funding, have resulted in the vast majority of rating actions remain affirmations and stable outlooks;
- Seasonal influenza has been remarkably low;
- Two vaccines have received Emergency Use Authorization (Pfizer and Moderna) and vaccinations of front-line and high risk individuals continues, signaling (hopefully) the beginning of the end;
- The next 1-3 months will be particularly difficult for hospitals until the majority of workers are vaccinated and the vaccine becomes available (and adopted) in the general public

Coronavirus: Every few weeks, something changes



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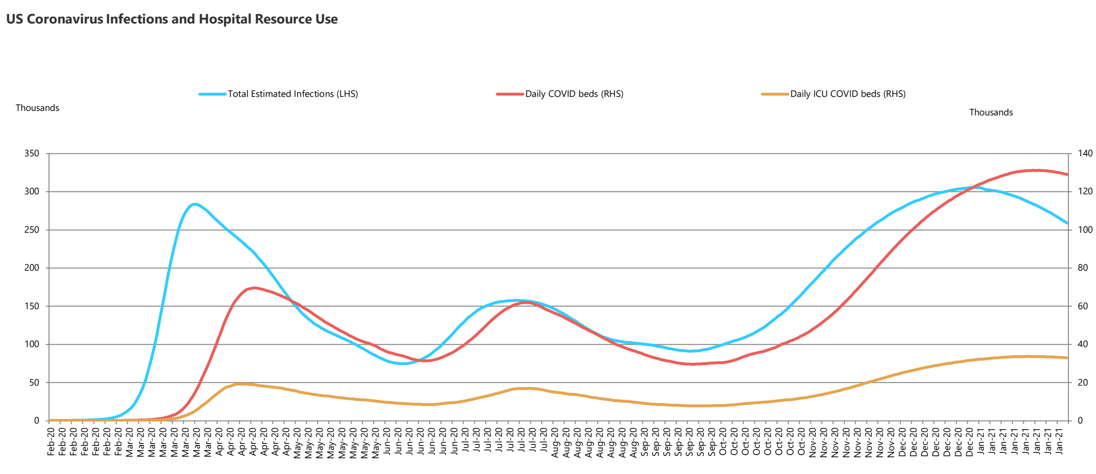
What's Next



Note: Projections begin November 2020
Source: Institute for Health Metrics and Evaluation

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What's Next

- Near Term (more worrisome):
  - We will see "second/third" waves of COVID continue in conjunction with schools adjourning and holiday get togethers; even with a vaccine;
  - The current trajectory in the US is particularly alarming;
  - Some parts of the US healthcare system have been overrun, resulting in "spot shutdowns" with a national impact zone;
  - Staffing is the number one concern, both on the short term and the longer-term;
  - Due to economic conditions, we can expect weaker payor mix; significant in some areas; with higher self-pay, Medicaid, and an expected reduction of some sort to Medicaid as States balance expected budget deficits.

- Longer Term (more optimistic):
  - Continued expense mitigation efforts; return of electives post-COVID will continue;
  - Additional vaccines are in development, although logistics around distribution remain complex;
  - Mergers and acquisitions will pick up post pandemic;
  - The end of fee-for-service; but it will still take time for payors and providers to find common ground

Sector Themes

- Changing Reimbursement Models
- Pressure on Margins, More Recent Improvement
- Changing Legislative Conversation
- Continued Consolidation and Changing Credit Profiles
- 'Non-Traditional' Entrants and Technology Entering into the Sector

Sector Theme: Changing Legislative Environment

Key Takeaways

- Policies to expand healthcare coverage, lower prescription drug prices, end surprise billing and fund Medicare and Medicaid could face legislative gridlock.
- If President-Elect Biden is able to work across party lines, the striking down of the ACA by SCOTUS could be resolved with new healthcare legislation.
- President-Elect Biden could get bipartisan support on some aspects of his less controversial policy proposals, including ending surprise billing and limiting increases on prescription drug prices.
- The addition of a public insurance option and lowering Medicare's age requirement may be less likely, given the pandemic's effect on the government's budget.

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Continued Consolidation and Changing Credit Profile

- Fitch believes M&A activity will surge once the coronavirus is under control:
  - Need for additional size and scale.
  - "Winners" will be able to absorb "Strugglers" at fire-sale prices.
  - Even strong stand-alone providers will likely come to some conclusion that the best way to serve their community is to join up with a larger system.
- Consolidation and affiliation strategies are generally viewed as credit positives but involve execution risk and may divert management attention from ongoing operations.
- Not all consolidation will be full asset mergers (e.g., JV, JOA structures)
- The coronavirus has potentially exposed the fatal flaw in fee-for-service: "No Service, No Fee"; expect to see more provider and payor mergers and affiliations.
- In general, organizations with broader operating footprints and financial resources outperformed smaller, independent ones, but not always and is resulting in something akin to a migration of credit quality

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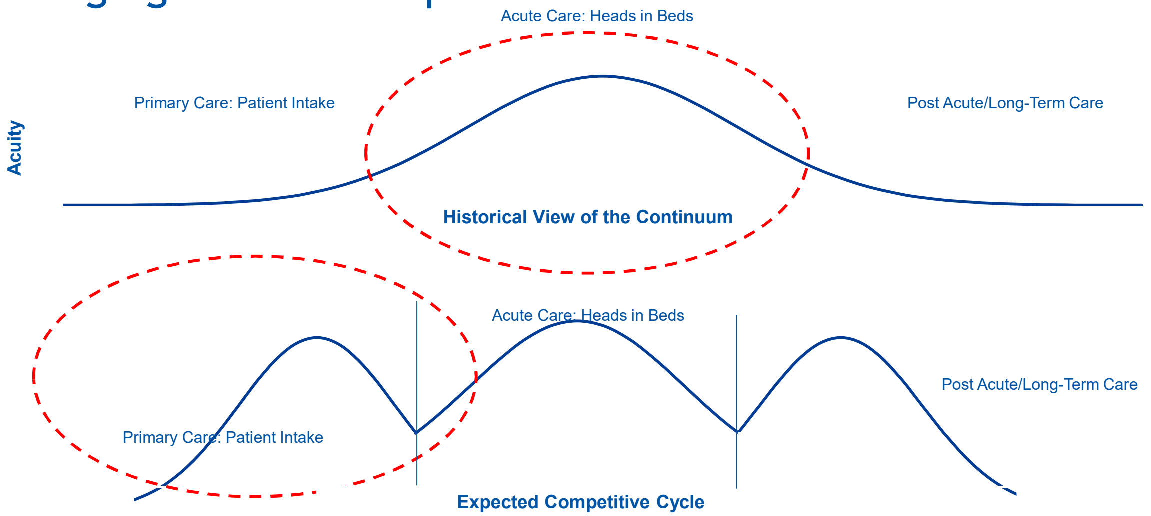
New Competition, Along with Technology, is Rapidly Changing the Landscape



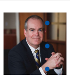
New Competition, Along with Technology, is Rapidly Changing the Landscape = Same Pre/Post COVID

- Will result in additional competition at every level of the care/competitive continuum as traditional and non-traditional competitors potentially get between you and your patient, particularly at the earliest stages of interaction and treatment.
- Keep in mind, tech companies in particular are cash flush, tech savvy, and customer focused
- Likely to be less "dominance" at the heart of the batting order
  - As front-end "access" to your patients becomes more limited, every inpatient will become more difficult to secure; case mix rises and related per-stay expenses rise as well
  - Additional flattening of the revenue line is possible; net-patient revenues in particular are likely to be squeezed as price/quality becomes more transparent
- Hospital/health systems need to change "leakage" to "steerage".
- Establishment of new service lines and products (e.g., significant movement to ambulatory, imaging, sports medicine, provider-sponsored/partnered health plans) – creating new revenues with one hand, while divesting with the other.
- Relentless cost cutting; clinical and operational; margin vs. mission decisions to be made.

Keys to Success = Same Pre/Post COVID

- Keys to success in operating in this dynamic reimbursement environment
  - Demonstrated ability to improve and sustain high level of quality results
  - Understanding the dynamics of a local patient and payor population and their respective healthcare needs
  - Aligning physician productivity models with successful outcomes of the hospital system
  - Successful continuous improvement process to increase efficiency and reduce total cost of care
  - Understanding that consumers will be increasingly savvy about healthcare choices and realization that this will lead to a new competitive dynamic in the industry (i.e., the “uberization” of healthcare)
  - Ability to operate in multiple reimbursement worlds simultaneously is critical to financial health
  - Understanding capital investments needs will evolve over time
  - Having a strong balance sheet always helps

Contact



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