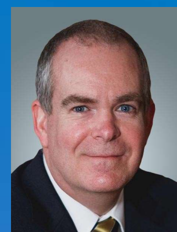
Healthcare Rating Agencies Update



Kevin Holloran

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Rating Agency Update

Kevin Holloran
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Fitch Ratings

Prepared for

The Governance Institute Leadership Conference
Date

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Covid -19 has, and will continue, to impact our sector outlook

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 fr… this volume to return to the secto… • Shortages of key supplies, such… volumes and the very real likeliho… challenge • Given the almost inevitable dec… unrestricted liquidity levels will be…

Stable to Negative: March 2020

Negative to Stable: December 2020

FitchRatings

Fitch Ratings 2021 Outlook: U.S. Not-For-Profit Hospitals and Health Sy…

Acute Care Sector

Fitch's Sector Outlook: Stable

Fitch Ratings has changed its sector outlook to stable from negative for 2021, reflecting our expectation that results in 2021 will be consistent with the overall weak margins in 2020. Fitch believes that the acute care sector will remain pressured by the challenging operating environment in 2021, but not to a greater extent than in 2020. Fitch views it as unlikely that the sector will see significant government-mandated "stay-at-home" orders, which should enable providers to continue serving non-COVID-19 patients (both elective and emergent) alongside a steady volume of COVID-19 patients. Traditional surgical and specialty care volume has not fully returned to 2019 levels, but some of the volume gaps may be filled by COVID-19 cases.

Although the clinical mix will be different than in prior years, Fitch expects that total revenue in 2021 will be higher than in 2020, when providers in most of the country saw a sharp decline in patient revenue in the spring. However, as the virus outbreak continues into 2021, Fitch views it as likely that high COVID-19 hospitalization rates may limit elective procedures at times, even without government shutdown orders, as hospitals seek to preserve capacity and personal protective equipment (PPE). Fitch also anticipates that expense pressure will remain high in 2021, particularly for staff and PPE, which will keep operating margins below 2019 levels for a second consecutive year.

Kevin Holloran, Senior Director

"The healthcare sector has responded extremely well to past crises, although the scale of the coronavirus pandemic and resultant "shutdown" of non-emergent procedures was unprecedented. Severe disruptions to operations and longer-term economic pressures will affect provider and consumer decisions in the years to come. The sector is currently experiencing yet another surge in coronavirus outbreaks across the majority of the country versus the comparatively more localized incidents that defined spring and summer 2020.

Providers are likely to effectively operate at their peak capacity due to a lack of appropriate beds, staffing, or both, limiting the amount of non-coronavirus procedures (particularly elective surgeries) that can be performed, and therefore suppressing operating margins. Until a viable vaccine is widely available and utilized, Fitch expects continued stress and strain on the sector — particularly in the first half of 2021 — with high demand for intensive care unit beds and staffing."

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The sector will need to engage in more than the traditional ways of improving margins

	Traditional Strategies
Growth	Pursue increases in market share and the size of operations; develop economies of scale; become too big to fail. Includes partnering with others; developing new services and entering new markets
Efficiency	Focus on reducing variable per-unit expenses; reduce the number of units
Capital	Focus on reducing fixed costs; although this has to be balanced by capacity needs/demographics
Quality	Focus on high quality and customer experience
Lagniappe	Accepting risk; focusing on the total cost of care/value equation

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Why governance matters

- **What has changed?**
  - Level of cooperation and collaboration among what would normally be considered competitors
  - Resistance to change (the status quo isn't sufficient)
  - Pace of change in general has increased and the industry absorbed that philosophy – it is now a new expectation
  - Staying nimble (anti-size and scale?)
  - Office space and work place - more employees will be remote, less expenses for office space
  - Perhaps a rethinking of too much outpatient – Inpatient beds are what was needed during COVID; aging of the population and the aged use rates may drive addition inpatient build over outpatient build
  - Virtual care acceleration; force multiplier, but also increases the CMI at the inpatient site requiring additional spending
  - Location of care out of the downtown setting?
  - Medical diversity and healthcare disparity – developing actionable items
- **What hasn't changed?**
  - Healthcare delivery remains challenged and very fluid – even absent the presence of a pandemic
  - Focus on clinical care, patient care – following the science
  - Protect your flanks – no margin, no mission – renewed focus on total cost of care and value based payments
  - Pursuit of size and scale / consolidation (anti-nimbleness?)
  - **Labor will remain a "top three" issue: employee morale and stress; early retirements are likely**
  - More focus on behavioral health in the community (tele/virtual care has been very beneficial)

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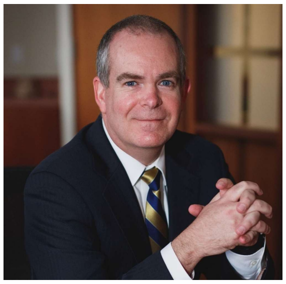
Contact Information



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Outlook remains negative as volume recovery remains uneven and labor challenges persist

» Financial performance constrained by uneven volume recovery in many markets; surges will impact markets differently, slowing volume gains made in highly impacted service areas

» Labor costs and resumption of certain compensation benefits will contribute to cash flow pressure

» Pre-pandemic shift to lower cost settings and increased competition for ambulatory volumes will continue

» Labor costs and resumption of certain compensation benefits will contribute to rising expenses

» Aging population will reduce commercial insurance revenue

» Large, diverse systems and those with cash will be better positioned

Industry outlooks reflect our view of fundamental business conditions for an industry over the next 12-18 months. Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

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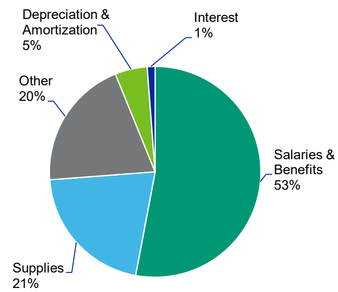
Labor pressure will continue over the near term

- Clinical and non-clinical shortages will dampen margin recovery in 2021
- Retention, recruitment, wage inflation and competition will contribute to salary and benefits pressure
- Additional benefits including expanded behavioral health to drive up expenses
- Rising minimum wage in various states will also contribute to wage inflation
- Possibility of greater union activity or tougher contract negotiations following the pandemic

Salaries & benefits represent over half of total expenses

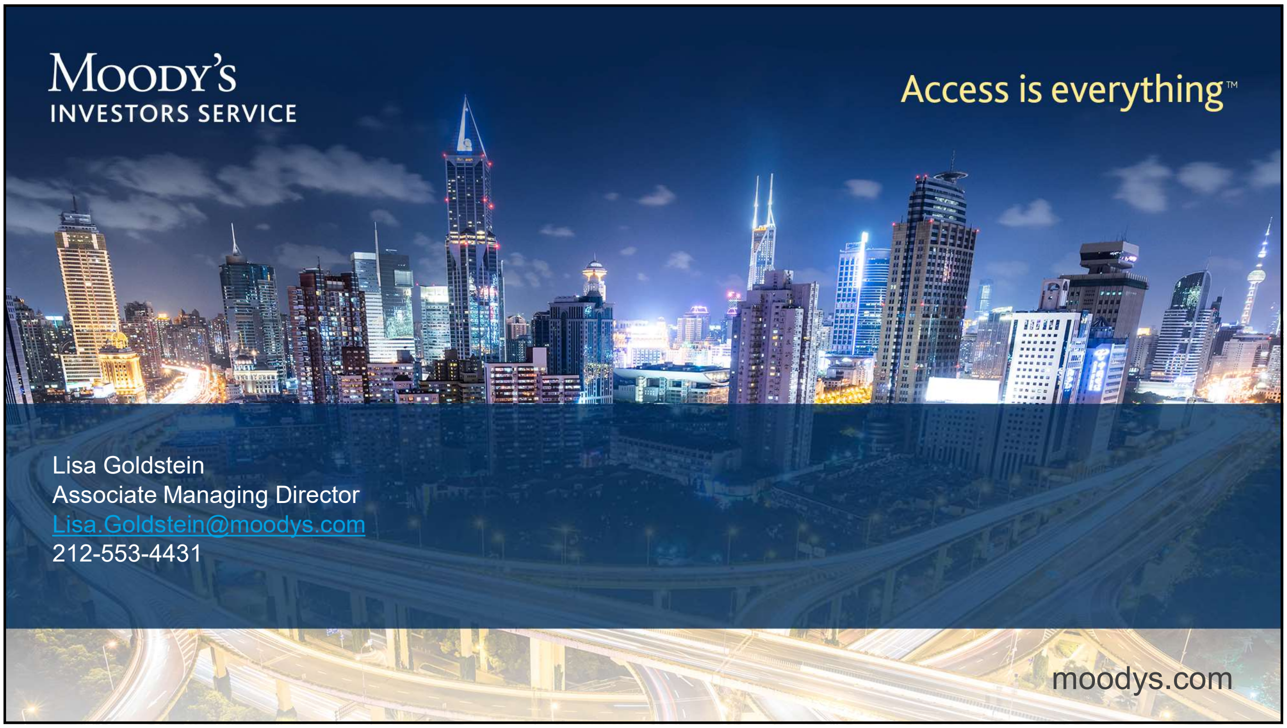


Median expense by expense category. Data based on fiscal 2020 aud
Other includes pension, leases, and research.
Source: Moody's Investors Service

Strong governance integral in complex healthcare sector

- Pandemic highlighted the most effective organizations and teams
- Parameters or guideposts that drive strategic decisions
- Robust discussion around projections and assumptions, even if imperfect
- Available levers to address shortfalls and challenges
- Demonstrated flexibility to respond to changes, execute strategies
- Good transparency practices followed

Quotes from Moody's credit opinions:
"ability to quickly execute complicated integration strategies"
"disciplined and decisive leadership approach"
"well-developed integration competencies"
"high degree of integration and centralization"
"data-driven planning abilities"
"well-defined & ingrained culture"
"lengthy leadership succession planning"



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This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

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Sector view: revised to stable from negative (June 2021)

Improving Revenues

- Improving volume trends, although still not back to pre pandemic levels for most providers
- Revenue yield continues to be sound
- Rebounding economy supported payor mix trends

Financial Flexibility

- Reserves remain sound for most
- Investment markets, limited capital spending, and stimulus funds have been supportive to credits' reserves
- Access to external liquidity sources provides additional flexibility

Level of Federal Support

- Federal support & CARES Act funds provided significant support and helped limit negative financial and downside risk from the pandemic
- Expanded ACA has remained supportive to credits

Enterprise Strengths

- Demand for services, proactive management teams and institutional characteristics continue to support credit quality

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What to watch as health systems manage COVID-19 and industry related financial challenges

Volume Recovery & Revenue Focus

- Pressured margins likely with current variant and payor mix and IP to OP trends
- Expanding access may help grow volumes over time
- Revenue diversity efforts may aid in top line growth
- For many larger providers, non-op helping cash flow

Federal & State Support Mixed

- Impact to hospitals when public health emergency ends & CARES Act funds are no longer available
- Increased scrutiny of M&A activity/other regulatory pressures
- ACA support remains ongoing, but some of that is temporary

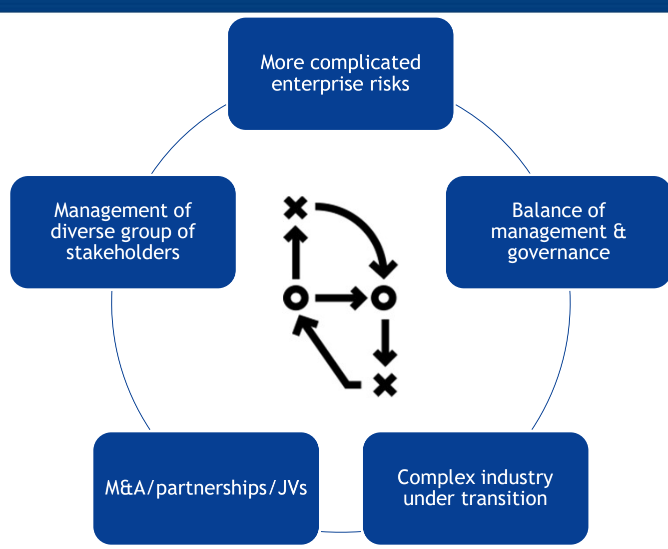
Other Impacts to Cash Flow

- Expense pressures, notably labor, remain a challenge
- Technology and data needs to be factored into cost structure
- Ongoing focus to identify ways to lower cost structure as revenue remains pressured

Balance Sheet Considerations

- Maintaining reserves will remain important for near-term credit stability
- Balancing capital spend on current and future state
- Capital markets and access to liquidity provide added flexibility for business decisions

How and Why Governance Matters



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