Perspectives on Capital Markets and Credit (or What I Always Wanted to Tell You)

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1

A few things I always wanted to tell you

- Your story matters
- Ratings matters, but long-term viability matters more
- Governance is hard to measure, but makes a difference
- I learned a lot as an analyst, but I learned more as a patient

2

Your Story Matters

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3

Credit ratings play an important role in the capital markets

- Ratings provide an independent, objective opinion and assessment on the ability of an organization repay debt
- Ratings are one of many factors that determine bond pricing; other factors include legal security, covenants and current market conditions
- Beyond an assessment, ratings can provide benchmarks to borrowers of debt when determining spending and debt capacity
- Ratings are monitored throughout the life of a bond and can be upgraded, downgraded or affirmed

4

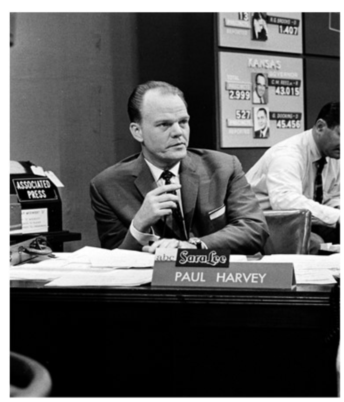
Hundreds of financial metrics form the basis of credit analysis

Area of credit analysis	Selected Metrics	What Does It Tell Us?
Financial Performance	• Operating margin (%) • Operating cash flow margin (%)	Ability to generate surpluses to fund capital, pay debt service and pensions, build cash
Debt Affordability	• Debt service coverage (x) • Debt-to-cash flow (x)	Ability to service debt requirements and meet covenants
Debt Burden	• Debt to revenue (%) • Debt to capitalization (%)	Amount of leverage relative to performance
Financial Reserves	• Cash for operating expenses (days) • Cash to debt (%)	Liquidity to fund daily operations, and liquidity relative to obligations such as long-term debt

5

Understanding "the rest of the story" is equally important

- The clear articulation of future strategies, key drivers and rationale as important as the financial metrics
- Successful recent strategies and their application to future strategies are integral to credit
- Sharing lessons learned from past challenges builds credibility
- Acknowledgement of future challenges and strategies to address them
- Transparency with rating agencies builds credibility



6

Successful articulation of strategy builds credibility, even when metrics may suggest otherwise

Case Study #1: Silver Cross Hospital, New Lenox, IL

- In 2015, SCH issued material amount of debt for campus expansion
- Performance and liquidity metric were in line with “A” medians, but debt burden and affordability were stretched
- Assigned Baa1 (Moody’s) and BBB+ (Fitch)
- Construction proceeded on time and budget
- Performance and liquidity mirrored forecasted levels but debt metrics were still outside “A” metrics
- The clear articulation of strategy and success with the project earned upgrades to A3 and A-

RATING ACTION COMMENTARY

Fitch Upgrades Silver Cross (IL) Revenue Bonds and IDR to 'A-'; Outlook Revised to Stable

Mon 28 Jun, 2021 - 9:47 AM ET

Fitch Ratings - New York - 28 Jun 2021: Fitch Ratings has upgraded Silver Cross Heath System Issuer Default Rating (IDR) to 'A-' from 'BBB+'. Fitch has also upgraded the long-term rating to 'A-' from 'BBB+' on series 2008A and series 2015C bonds issued by the Illinois Finance Authority on behalf of Silver Cross.

The Rating Outlook is revised to Stable from Positive.

Durable financial performance may also result in positive rating movement, despite external challenges

Case Study #2: Ballad Health, headquartered Johnston City, TN

- In 2018, Ballad Health was formed following the merger of Mountain States Health Alliance and Wellmont Health System
- Ongoing rate restrictions were enacted by state oversight agencies, limiting margin potential
- Ballad demonstrated how it could operate within the state requirements and de-leverage
- The clear articulation of strategy and execution of plan earned an upgrade to A3 by Moody’s in 2021

MOODY’S INVESTORS SERVICE

Rating Action: Moody’s upgrades Ballad Health (TN) and Mountain States Health Alliance (TN) to A3; outlook revised to stable

31 Mar 2021

New York, March 31, 2021 — Moody’s Investors Service has upgraded Ballad Health (TN) and Mountain States Health Alliance’s (TN) bond rating to A3 from Baaa1, affecting $525 million and $174 million, respectively. Our report refers to both issuers as “Ballad Health”. The outlook is revised to stable from positive at the higher rating level.

Ratings matter but long-term viability matters more

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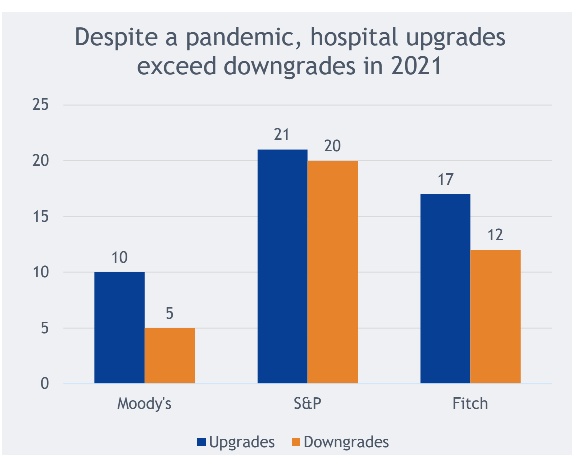
9

Some ratings may never change; others will be upgraded or downgraded during the life of the bonds



Source: Moody's Investors Service; S&P Global Ratings; Fitch Ratings

- **Downgrades** generally reflect a decline in financial performance, material increase in debt or change in market position that weakens debt coverage
- **Upgrades** anticipate future performance will lead to greater debt affordability and headroom to covenants

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10

The most common question asked of rating agencies is an extremely important one:

Will we be downgraded if margins decline because we are investing in our future?

Internal Challenges	• Workforce deficit • Price inelasticity • Limited sources of capital
External Challenges	• Fierce competition • Rapidly changing technology • Reimbursement pressure
Evolving Challenges	• Regulatory climate • Macroeconomic forecast • Expanding role in the communities served

Integrated capital planning will position the organization for long-term viability

- Over emphasizing an organization's credit rating could jeopardize its ability to fulfill its mission and serve its communities over time
- Thoughtful, deliberate planning that integrates financial, strategic and capital needs will provide a roadmap of affordability
- As the industry heads into post-COVID stabilization period:
  - Double down on operating improvement
  - Revisit all resources: investments, access to liquidity, real estate
  - De-risk the debt portfolio
  - Identify and quantify all risks
  - Build financial resiliency
  - Integrated resource allocation

A virus, a unicorn, and a disciplined growth strategy converge

- Founded in 2011, Zoom, Inc. reached rarified air in 2017 as a "unicorn" company with a $1 billion valuation
- The pursuit of customer happiness was critical to Zoom's long-term viability
- Prior investments in technology and staff allowed Zoom to scale with extraordinary speed in 2020
- Zoom's focus on long-term viability over near-term margins and customer satisfaction made it perfectly positioned for a pandemic and longer-term economic trends

> "We have a relentless focus on making the best product with the best user experience. Our philosophy is we really focus on making our existing customer happy."
>
> *— Eric Yaun, CEO, Zoom*

13

Governance is hard to measure, but makes a difference

14

Not-for-profit healthcare shows resiliency in the face of ongoing challenges

Conversion to prospective payment system in 1985

- Industry ill-equipped to change from cost based to DRG
- Highly leveraged hospitals defaulted, filed for bankruptcy or closed

Medicare reductions in the Balanced Budget Act of 1998

- Medicare rates frozen with teaching hospitals particularly hard hit
- Medicare typically represents about half of a hospital's revenues

Liquidity crisis and Great Recession in 2008

- Auction rate securities failures
- Bank liquidity became expensive, if attainable
- Great recession led to volume declines, rise in unemployment and bad debt

Weak Governance (Re)Tells a Cautionary Tale

Repeated themes:
- Failure to integrate following M&A
- Unfettered capital spending
- Unwillingness to change

Where was the board?

Lessons learned:
- Deliberate planning of growth
- Spending carefully monitored
- Willingness to change

Strong oversight of strategy

Not-for-profit hospitals that failed to course correct:
- Allegheny Health and Education Research Foundation, PA
- Saints Memorial Healthcare, MA
- East Texas Medical Center Regional Health System, TX
- Fort Worth Osteopathic Hospital, TX

Governance resiliency during a global pandemic

Remarkable agility

- Clinical lessons learned from the rapidly spreading cases in Seattle, New York, and New Jersey
- Trustees and management used all available resources to secure PPE, ventilators and liquidity
- Uniform advocacy for swift and substantial relief funds
- Rapid decisions made on staffing given the shutdown

Deft Covenant Management

- Many hospitals faced debt covenant violations given material revenue decline
- Many hospitals proactively sought amendments during COVID before the covenant violation occurred or received a multi-period waiver thereafter
- Rating agencies not only look at the causal factors but a team's steps to manage covenants

Five attributes of great leadership is critical in not-for-profit healthcare

1. A highly centralized governance model
2. Systematic board monitoring of capital spending
3. Careful, deliberate oversight of organizational growth strategies
4. Agility, manageable size, and high functioning committee structure
5. Continuous efforts to stay well informed on state, local, and federal healthcare policies and industry developments

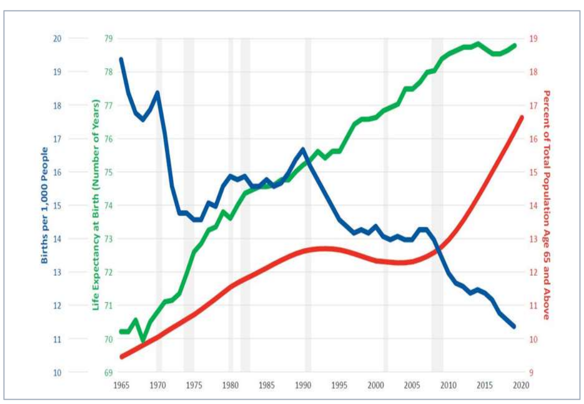
Can Your Trustees Answer these Five Questions?

1. What was the biggest challenge your hospital faced and how did it work through it?
2. What are the biggest risks now facing your organization and how will you address them?
3. How does the board monitor hospital strategy and make mid-course corrections?
4. What financial targets or ranges has the board set for the organization?
5. How does the board remain educated on healthcare policies, particularly reimbursement?

Ten things about healthcare that keep me up at night
Where does your organization stand?

1. Aging population
2. Rising interest rates and federal budget pressure
3. Workforce challenges
4. Rapid shift in sites of care
5. Access to affordable care
6. Rising inflation
7. The next health crisis
8. Cyber preparedness
9. Payer rate reduction
10. The role of not-for-profit healthcare

US population is living longer,
birth rate is down and the population is aging



Source: FRED Economic Bank, Federal Reserve Bank of St. Louis; World Bank Data

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21

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Lisa Goldstein is a nationally recognized analyst, speaker, writer, and expert on not-for-profit healthcare. At Kaufman Hall, she is a member of the Treasury and Capital Markets practice and Thought Leadership team.

Prior to joining Kaufman Hall, Lisa spent more than 30 years at Moody's Investors Service, including 10 years serving as Associate Managing Director. She managed the rating agency's U.S. not-for-profit healthcare ratings team and oversaw credit rating and monitoring for 350 not-for-profit hospitals.

Lisa has been quoted by national media including CNN, *The Wall Street Journal*, and *The New York Times*. She is a regular speaker at regional and national healthcare conferences, and serves as a guest lecturer at Harvard University, New York University, and Rutgers University. She has authored numerous industry reports and is an appointed faculty member for The Governance Institute.

Lisa holds an M.P.A. in Public and Nonprofit Finance, Management and Policy from the New York University Robert F. Wagner Graduate School of Public Service.

22