Perspectives on Capital Markets & Building Investor Confidence

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Prepared for

The Governance Institute Leadership Conference
September 11, 2023

Agenda

- State of the Industry
- Credit Ratings and Covenants
- The Business Case for Governance

State of the Industry

Where are We in the Stages of the Pandemic?

Crisis

Largely a monetary event.

CHARACTERIZED BY:

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

Stabilization

Largely a credit event as we adjust 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
- Renewed focus, and concern, on financial performance

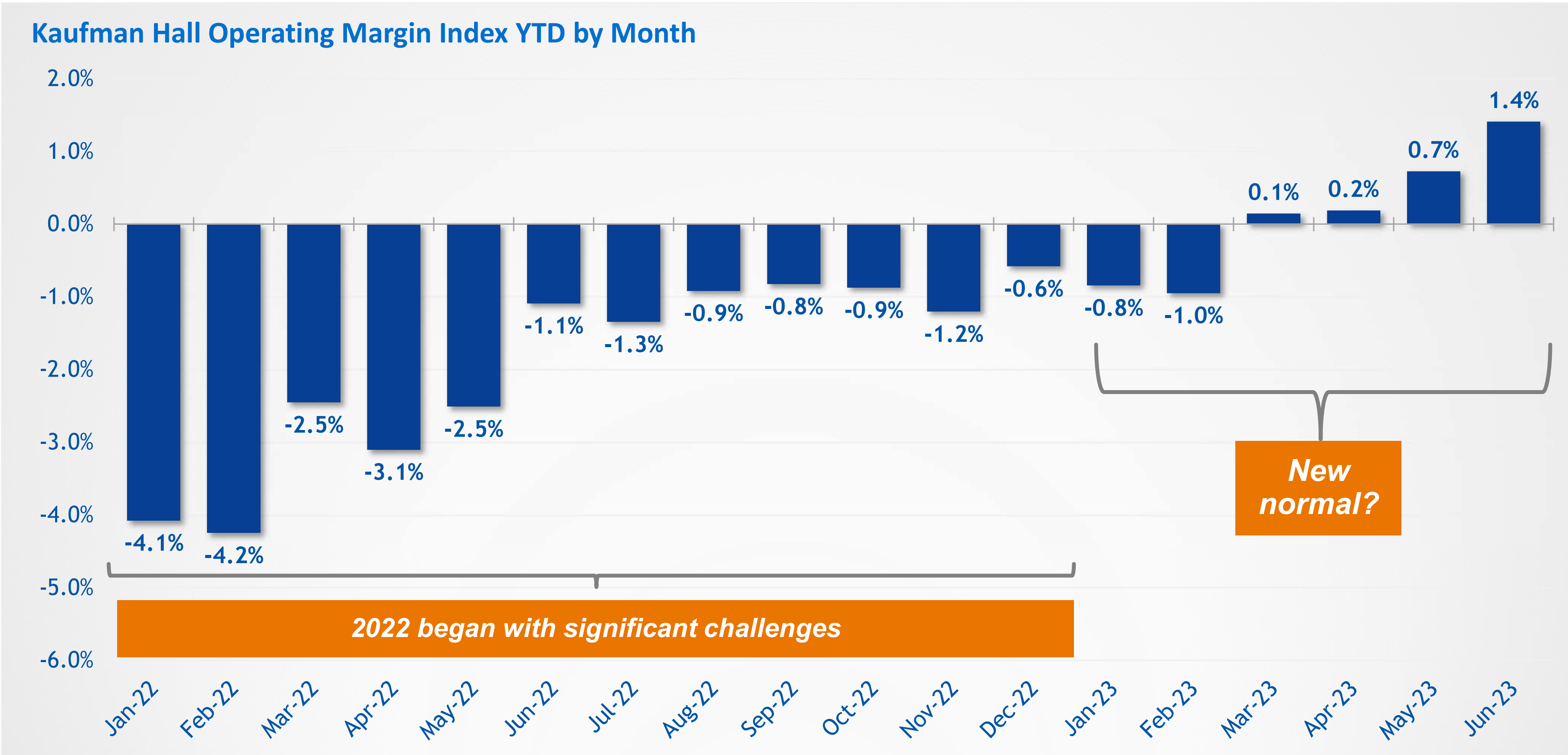
Normalization

What does financial performance look like in a normal future state?

TO BE CHARACTERIZED BY:

- Stable workforce environment
- Stable interest rate environment
- Return to steady financial performance and capital spending

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



Source: Kaufman Hall *National Hospital Flash Report*

While Improving, Volumes Remain Below 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*

Financial “Twindemic” Hit 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 they can no longer afford to hold their breath.

— Eric Jordahl, Moving Into and Through 2023

Sustained Headwinds in 2023 Challenge Every Component of the Business Model

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"?

Source: Kaufman Hall *Credit and Capital Markets Outlook for 2023*

Credit Ratings and Covenants

All Rating Agencies Maintain Negative Outlooks on the Sector

Moody's

Outlook: Negative

S&P Global

Outlook: Negative

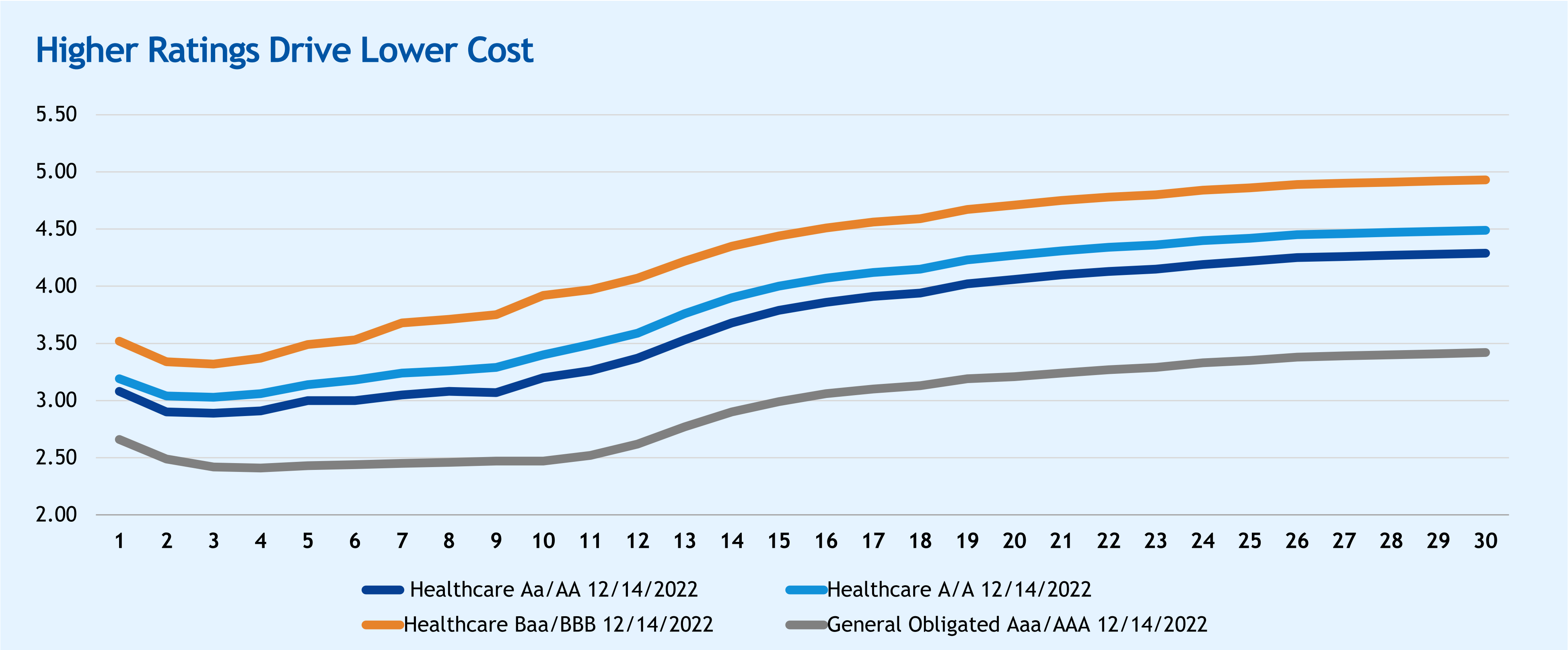
FitchRatings

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 and part
- 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**

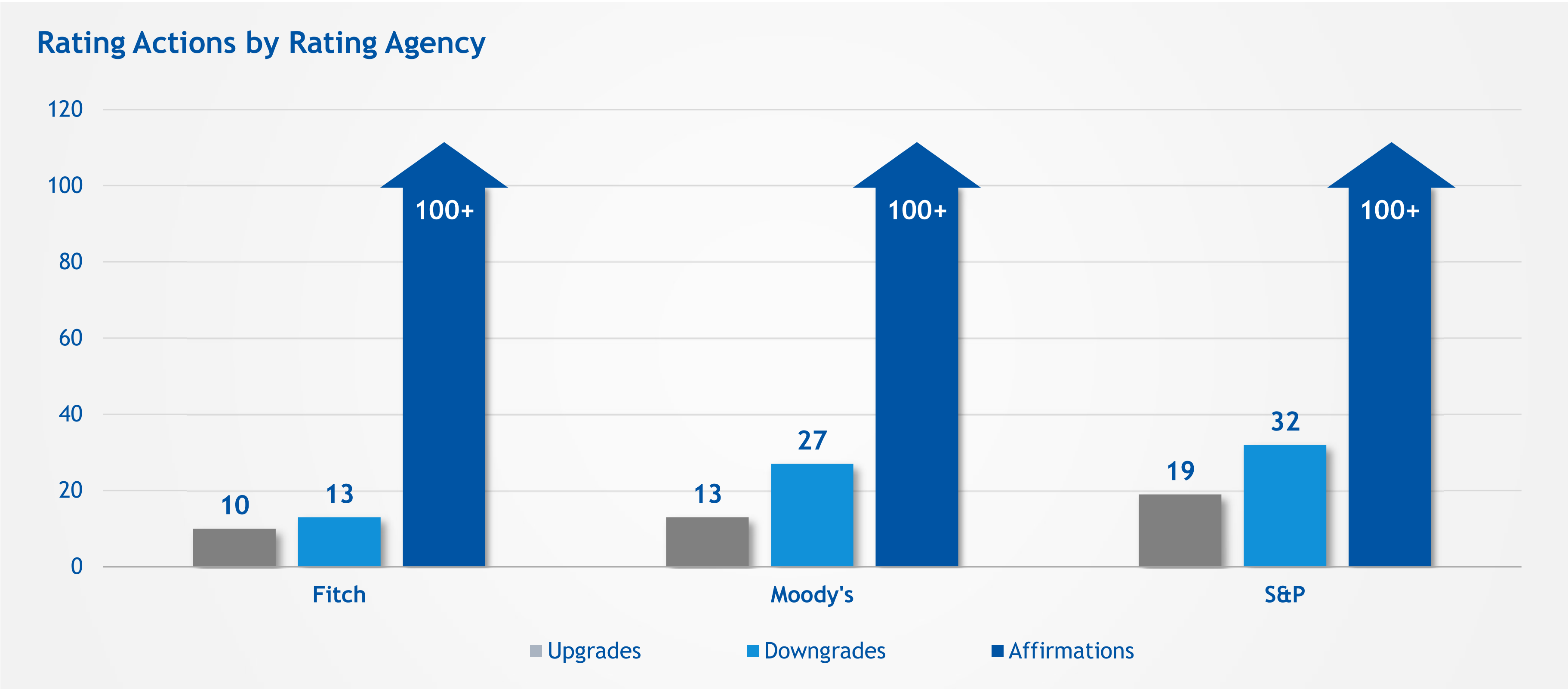
Source: Moody's, S&P, and Fitch sector outlook reports; KH Webinars.

Ratings are a Key Component in the Cost of Capital



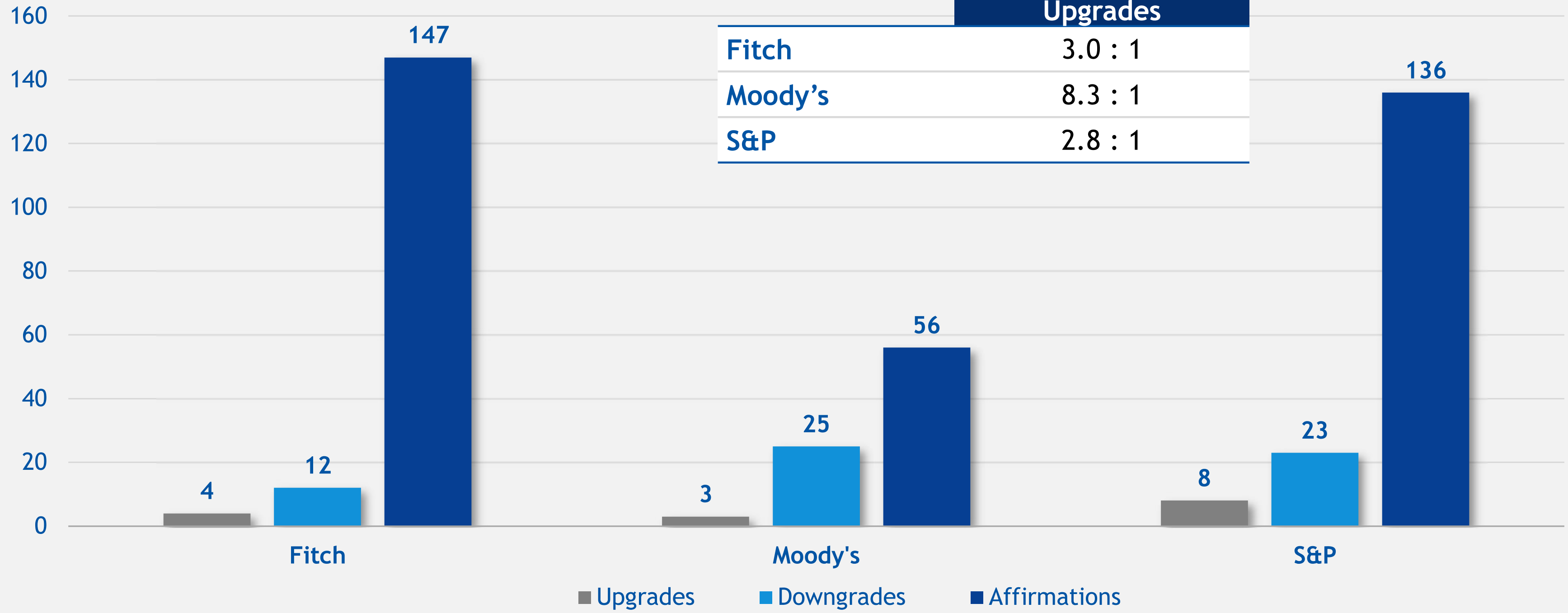
Source: Refinitiv TM3

Affirmations Remain the Majority of Rating Actions in 2022



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

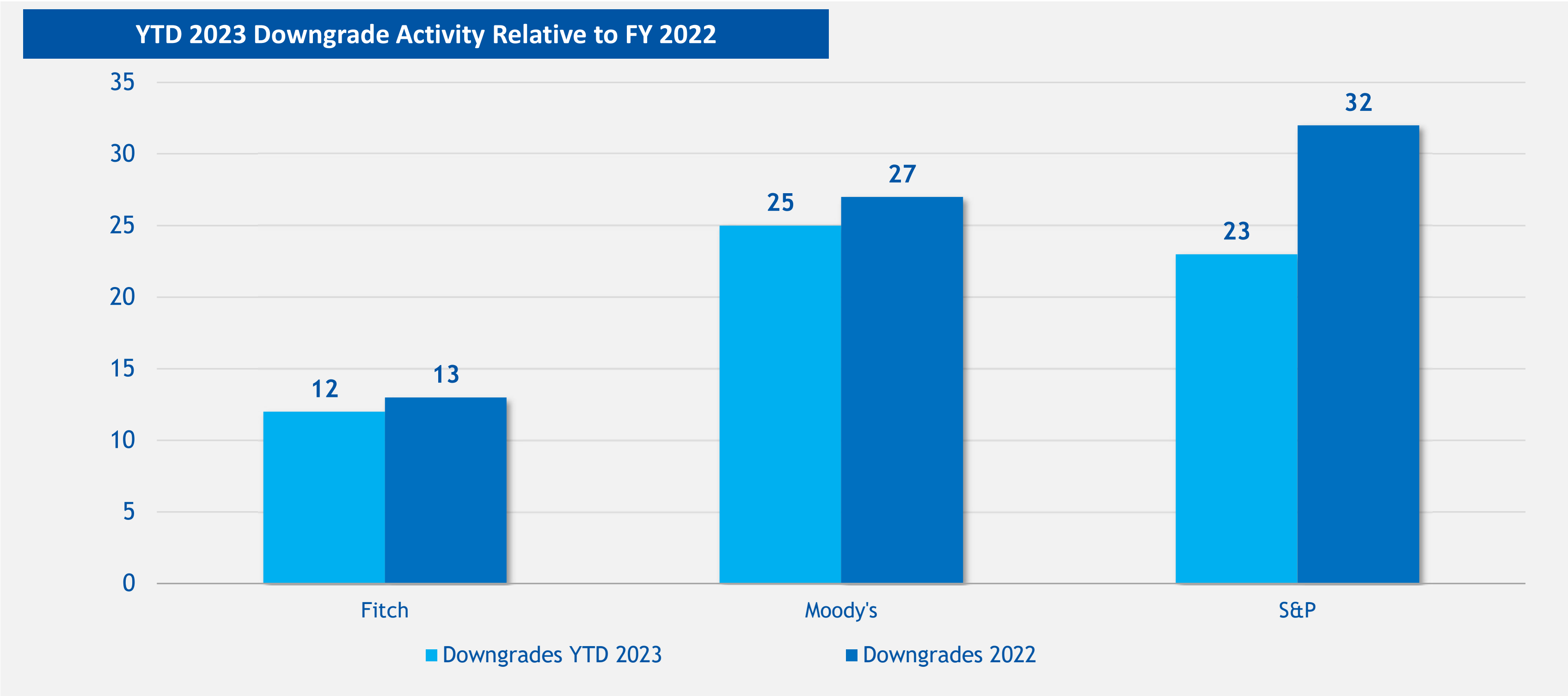
Affirmations Remain the Most Common Rating Action Through 1H 2023



	Downgrades to Upgrades
Fitch	3.0 : 1
Moody's	8.3 : 1
S&P	2.8 : 1

Source: Kaufman Hall Rating Agency Webinar July 12, 2023: Fitch actions exclude children's hospitals

YTD 2023 Downgrades Quickly Approaching Full Year 2022 Downgrades



Source: Kaufman Hall Rating Agency Webinar July 12, 2023

Rating Agencies Will Focus on Revenue and Expense Management

Margins/Liquidity

What makes the improvement durable?

- Return to stable, durable financial performance and capital spending practices
- Increase in absolute and relative cash measures including days cash on hand
- Ability to meet covenants with adequate headroom

Labor

How will you manage labor expense?

- Vacancy and turnover rates before, during and after the pandemic
- Trend of contract labor and the impact on performance
- Strategies to rebuilding the pipeline of healthcare workers

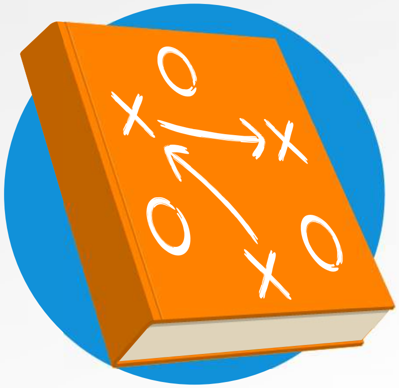
Regulatory

How will you adjust to Medicaid disenrollment?

- Expectations for decline in Medicaid enrollment, rise in self-pay and bad debt
- Additional FMAP funding of 6.2 percentage points will be phased out by the end of the year
- Impact from 340B ruling

Long-Term Sustainability is The Real Story

1. Understand key financial covenants in the MTI and credit agreements and whether the MTI and/or credit agreements need amendment or waivers
2. Develop detailed Performance Improvement plans that identify:
   - Key drivers causing the potential breach
   - Near- and long-term strategies and tactics to improve financial performance
   - The organization’s plan to execute, measure, and monitor its performance improvement plans
3. Integrate Performance Improvement plans with financial planning
4. Measure, monitor, and communicate results proactively
5. Communicate with rating agencies, investors, stakeholders



Managing Credit and Covenants

Communication with rating agencies, investors, and banks is important if a breach is likely

A downgrade is not necessarily automatic if there is a breach, but narrows the bandwidth of rating tolerance

Analysts will want to understand:

1. The drivers causing the breach;
2. How are you proactively managing the breach; and
3. Near-term and long-term strategies to improve financial performance and preclude future violations

Headroom to the covenant(s) is an important financial metric for rating agencies

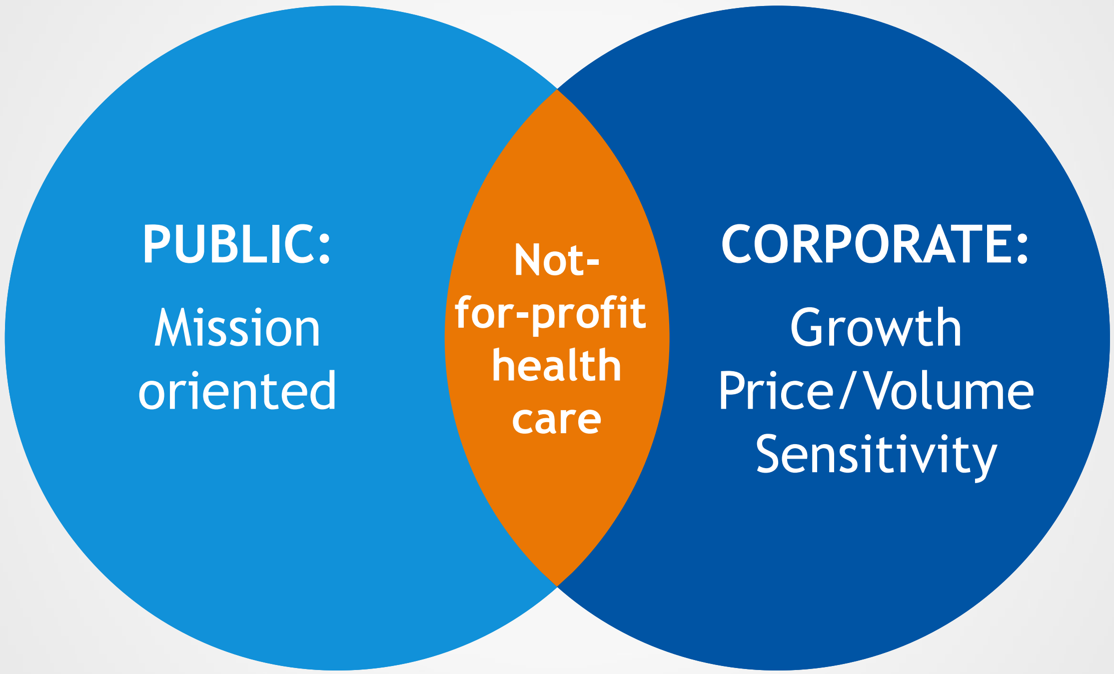
Scenario Planning Can Support the Sustainability Path

1. What is required to reach a sustainable operating path? What are key associated assumptions and factors driving uncertainty?
2. How do we stress-test our financial trajectory and strategy in light of changing market conditions?
3. How do we ensure the resiliency of our organization by pivoting our decision-making? What mitigation levers are available?

Approach			
Approach	Quantify the long-range financial trajectory	Stress-test the results and identify key drivers, risks, and opportunities	Monitor actual performance and market developments and communicate transparently

The Business Case for Governance

Not-for-Profit Hospitals Maintain Public and Corporate Characteristics



Five Attributes of Governance 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 effort to stay well informed on state, local, and federal healthcare policies

What Can Not-for-Profit Healthcare Learn from FTX? A Lot!

Five Key Lessons, Thus Far…

1. Transparency and disclosure build trust with investors
2. Understand the risks of new-fangled products
3. Adherence to the principles of corporate accounting
4. If it's too good to be true, it usually is
5. Critical thinking - not group think - is imperative

> "Never in my career have I seen such a complete failure of corporate controls and such a complete absence of trustworthy financial information as occurred here…this situation is unprecedented."
>
> *— John J. Ray III, CEO, FTX*

Can Your Trustees Answer the Following Five Questions?

1. What was the **biggest challenge** your organization faced?

2. What are the **biggest risks now facing your organization** and how will you address them?

3. How does the board **monitor financial performance**?

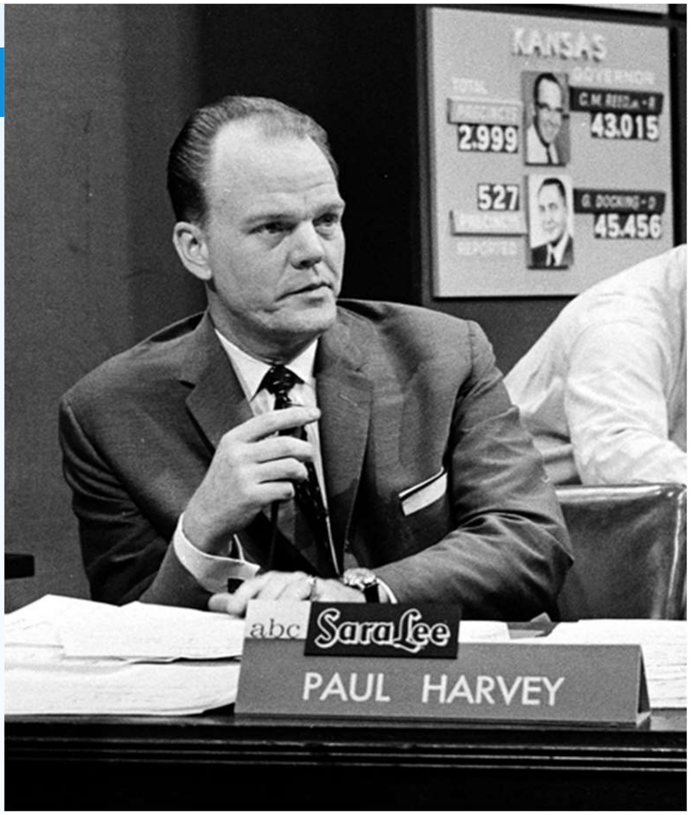
4. What **financial targets** has the board set for the organization?

5. How does the board **remain educated** on healthcare policy and reimbursement structures?

How You Tell The "Rest of the Story" Is Equally Important

Today's presentations follow a new roadmap:

1. Focus the discussion on **recent financial challenges**
2. Discuss **immediate levers** pulled to stabilize performance and **meet covenants**
3. Include **long-term financial plan** for durable improvement
4. Outline **demands on finite liquidity** (short-term, near term, strategic and routine)
5. Explain **governance** over the financial plan



The Important of Cash…Yesterday, Today and Tomorrow

- Cash buys an organization time when unforeseen events occur
- Strong liquidity allows a health system to access cash quickly when needed
- Serves as a key metric for credit ratings
- Serves as a financial cushion when debt increases
- Serves as a source of capital when debt capacity is limited

Hope Doesn’t Pay Debt Service…or Does It?

- Impact investing takes community benefit to the next level with loans (not grants) to organizations who address social needs.
- A small return ensures that the funds can be re-invested into new projects.
- Shorter-term gains include social benefits that the projects address (such as affordable housing); longer-term gains can improve healthcare access and appropriate use of hospital facilities.
- Investors and rating agencies will focus on size of allocation relative to unrestricted cash, pace and structure of investments and reporting guidelines.

UMASS Memorial Health Care’s Anchor Mission focuses impact investments on affordable housing and community health services.

Prior Thinking Will Defray Momentum From Building Sustainable Organizations

"WE DO IT BEST"

In fact, there are some things that health systems do very well, and some things that others do better.

"WE MUST DO IT ALL"

Health systems do not have infinite resources, and those resources have become more constrained. The focus must turn to what is essential and what is sustainable.

"WE CAN DO IT OURSELVES"

Recognition of the need to focus attention on what will best fuel transformation is only part of the solution. The other piece is where to partner with others.

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