

## **IV. Financial Impact on Highmark**

**Blackstone**



#### IV. Financial Impact on Highmark

### Summary of Risks and Analyses: Financial Impact on Highmark

The Transaction's impact on Highmark's financial stability was assessed as follows:

#### Potential Concerns Noted:

##### **Transaction Impact on Highmark's Financial Profile:**

1. Highmark's stated total of \$1 billion of capital commitments related to its IDN strategy may understate the total financial exposure of plans to transfer capital from insurance entities
2. Highmark's direct investments into WPAHS and related IDN entities may result in the conversion of a significant amount of currently diversified, liquid assets into highly-concentrated, illiquid and, in the case of WPAHS, speculative investments

##### **Future WPAHS Financial Performance:**

1. The assumptions upon which Highmark has built projections for WPAHS and the amount of financial support it anticipates providing to the hospital system may prove optimistic, frustrating Highmark's efforts to (i) refinance certain of its exposures to WPAHS and (ii) to recoup investments it plans to make in the hospital system
2. Highmark's financial flexibility may be further negatively impacted if, in addition to continued financial difficulty at WPAHS, the insurance operations experience external competitive and/or financial shocks due to unforeseen circumstances in the rapidly evolving health insurance and health care industry

##### **No Transaction Scenario:**

1. Highmark assumes that, absent the proposed WPAHS Transaction, its insurance enrollment may decline significantly in Western Pennsylvania while Highmark continues to commit substantial resources to its IDN strategy, resulting in diminished financial strength

#### Analyses Performed:

- ▶ Overview of Highmark's current financial position
- ▶ Assessed Highmark's total financial commitments, both direct and indirect, related to the overall IDN Plan
- ▶ Assessed the amount of capital commitments implied by Highmark's IDN Plan that are contingent upon approval of the Form A vs. commitments that have already been funded or will be funded irrespective of the PID's decision with respect to the Form A
- ▶ Assessed the potential impact of the Transaction on Highmark's:
  - Net liquid assets
  - Investment portfolio
  - Credit profile
  - Risk Based Capital Ratio
- ▶ Assessed Highmark's RBC stress test
- ▶ Reviewed Highmark's "Base Case" financial projections for WPAHS and assessed, together with Compass Lexecon, potential vulnerabilities in Highmark's underlying assumptions
- ▶ Reviewed "Downside Case" financial projections, as requested by Blackstone and prepared by Highmark, for WPAHS and the related impact on Highmark
- ▶ Reviewed Highmark's "No Transaction" case and underlying assumptions

**A. Highmark Financial Condition and IDN Impact**



## A. Highmark Financial Condition and IDN Impact

### Highmark Combined Historical Balance Sheet and Income Statement

**As of December 31, 2011, Highmark's Combined GAAP balance sheet shows cash and investments of approximately \$6.2 billion and total reserves of approximately \$5.0 billion, which averaged 5.7% growth annually since 2007.**

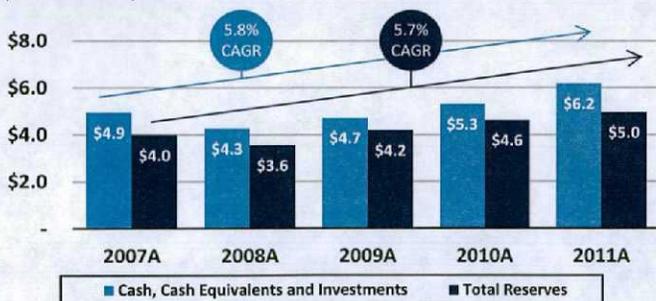
#### Highmark Combined Historical Balance Sheet – GAAP Basis (\$ in millions)

|  | As of December 31, |                 | CAGR<br>'07 - '11 |
|--|--------------------|-----------------|-------------------|
|  | 2007A              | 2011A           |                   |
| Cash, Cash Equivalents and Investments | 4,938              | 6,181           | 5.8%              |
| Other Assets <sup>(1)</sup>            | 3,988              | 4,438           | 2.7%              |
| <b>Total Assets</b>                    | <b>\$8,926</b>     | <b>\$10,619</b> | <b>4.4%</b>       |
| Debt                                   | 800                | 1,120           | 8.8%              |
| Other Liabilities <sup>(2)</sup>       | 4,149              | 4,538           | 2.3%              |
| <b>Total Liabilities</b>               | <b>\$4,949</b>     | <b>\$5,657</b>  | <b>3.4%</b>       |
| <b>Total Reserves</b>                  | <b>\$3,977</b>     | <b>\$4,961</b>  | <b>5.7%</b>       |
| <b>Total Liabilities and Reserves</b>  | <b>\$8,926</b>     | <b>\$10,619</b> | <b>4.4%</b>       |

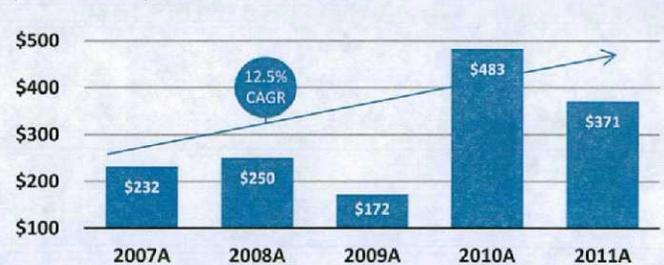
#### Highmark Combined Historical Income Statement – GAAP Basis (\$ in millions)

|                            | Year Ended December 31, |              | '07 - '11<br>CAGR |
|----------------------------|-------------------------|--------------|-------------------|
|                            | 2007A                   | 2011A        |                   |
| Total Operating Revenue    | \$12,026                | \$14,628     | 5.0%              |
| Total Operating Expenses   | 11,794                  | 14,258       | 4.9%              |
| <b>Operating Income</b>    | <b>\$232</b>            | <b>\$371</b> | <b>12.5%</b>      |
| Income before Income Taxes | 559                     | 476          | (3.9%)            |
| <b>Net Income</b>          | <b>\$375</b>            | <b>\$445</b> | <b>4.4%</b>       |
| Operating Income Margin    | 1.9%                    | 2.5%         |                   |
| Net Income Margin          | 3.1%                    | 3.0%         |                   |
| Medical Loss Ratio         | 88.2%                   | 87.0%        |                   |

#### Highmark Combined Cash and Reserve Position 2007 - 2011 (\$ in billions)



#### Highmark Combined Operating Income 2007 - 2011 (\$ in millions)



Source: Highmark.

- (1) "Other Assets" includes Accounts Receivable, Net Property and Equipment, Net Goodwill and Intangibles, and Other Assets.  
 (2) "Other Liabilities" includes Claims Outstanding, Unearned Subscription Revenue, and Other Liabilities.



A. Highmark Financial Condition and IDN Impact

**Highmark Projected Financials**

**Assuming the Transaction is consummated, Highmark projects approximately \$1.2 billion of cumulative net income from 2013 to 2017, but expects earnings of only \$106 million in 2013 due to the impact of IDN related expenditures and healthcare reform.**

(\$ in millions)

| Highmark Inc. Income Statement             | 2012E           | 2013E           | 2014E           | 2015E           | 2016E           | CAGR          |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|---------------|
| Subscription Revenue                       |                 |                 |                 |                 |                 |               |
| Net Patient Service Revenue                |                 |                 |                 |                 |                 |               |
| Management Services Revenue                |                 |                 |                 |                 |                 |               |
| Other Operating Revenue                    |                 |                 |                 |                 |                 |               |
| <b>Total Operating Revenue</b>             | <b>\$14,866</b> | <b>\$15,614</b> | <b>\$16,663</b> | <b>\$16,563</b> | <b>\$17,538</b> | <b>4.2%</b>   |
| Claims Expense                             |                 |                 |                 |                 |                 |               |
| Operating Expense                          |                 |                 |                 |                 |                 |               |
| <b>Total Operating Expense</b>             | <b>\$14,405</b> | <b>\$15,300</b> | <b>\$16,233</b> | <b>\$16,136</b> | <b>\$17,044</b> | <b>4.3%</b>   |
| Plus: Change in PDR                        |                 |                 |                 |                 |                 |               |
| <b>Operating Income</b>                    | <b>\$462</b>    | <b>\$314</b>    | <b>\$430</b>    | <b>\$427</b>    | <b>\$493</b>    | <b>1.7%</b>   |
| Investment Results                         |                 |                 |                 |                 |                 |               |
| Net Assets of BCBSD Acquired               |                 |                 |                 |                 |                 |               |
| Other Expense                              |                 |                 |                 |                 |                 |               |
| Equity Income of Subs/Affiliates           |                 |                 |                 |                 |                 |               |
| Income Before Income Tax                   | \$546           | \$234           | \$497           | \$513           | \$583           | 1.7%          |
| Income Tax Provision (Benefit)             | 134             | 128             | 163             | 177             | 193             |               |
| <b>Net Income</b>                          | <b>\$413</b>    | <b>\$106</b>    | <b>\$334</b>    | <b>\$336</b>    | <b>\$390</b>    | <b>(1.3%)</b> |
| <b>Operating Margin %</b>                  | <b>3.1%</b>     | <b>2.0%</b>     | <b>2.6%</b>     | <b>2.6%</b>     | <b>2.8%</b>     |               |
| <b>Net Income (Loss) as a % of Revenue</b> | <b>2.8%</b>     | <b>0.7%</b>     | <b>2.0%</b>     | <b>2.0%</b>     | <b>2.2%</b>     |               |

**Key Highmark Assumptions:**

- ▶ Assumes full implementation of IDN Plan
- ▶ Assumes WPAHS Affiliation
- ▶ Assumes UPMC is out-of-network beginning in January 2015

**2013E – 2017E  
Cumulative Net Income:  
\$1.17 billion**

| Key Balance Sheet Items     | 2012E   | 2013E   | 2014E   | 2015E   | 2016E   | 2012E - 2016E Δ |
|-----------------------------|---------|---------|---------|---------|---------|-----------------|
| Cash and Investments        | \$6,854 | \$7,226 | \$7,458 | \$7,252 | \$7,659 | \$805           |
| Property and Equipment, net | 626     | 557     | 626     | 573     | 553     | (72)            |
| Debt                        | 1,118   | 1,322   | 1,254   | 599     | 599     | (519)           |
| Reserves                    | 5,444   | 5,444   | 5,763   | 6,090   | 6,464   | 1,020           |
| RBC                         |         |         |         |         |         |                 |

Source: Highmark financial projections.



A. Highmark Financial Condition and IDN Impact  
**Summary of Credit Rating History**

**Following is an abbreviated summary of the credit rating agency's recent evaluations of Highmark's financial condition. The proposed Transaction has had a negative impact on Highmark's credit outlook.**

Past

Most Recent

**MOODY'S**  
 INVESTORS SERVICE

**3/30/2012** – Moody's changes outlook on Highmark's ratings to negative from stable, citing the additional uncertainty caused by the absence of Dr. Melani while the Company is in the midst of three major issues: (i) re-negotiation of UPMC contract, (ii) obtaining regulatory approval of proposed Transaction with WPAHS, and (iii) the investment and turnaround plans for WPAHS if regulatory approval is obtained

**6/25/2012** – Moody's affirms Highmark's Baa1 insurance financial strength rating, Baa2 senior unsecured debt rating and negative outlook for Highmark, citing the risk and uncertainty of its plan to establish a medical-provider network to compete with UPMC

**1/24/2013** – Moody's places Highmark's Baa1 insurance financial strength rating and Baa2 senior unsecured debt rating on review for downgrade following its announced plan to purchase the WPAHS 2007A series bonds for cash at 87.5% of par amount

**STANDARD**  
**& POOR'S**

**12/13/2010** – S&P revises Highmark Inc. outlook to stable from negative and affirms the Company's 'A' rating, citing stronger than expected earnings and credit profile

**5/3/2011** – S&P rates Highmark Inc.'s Senior Unsecured Debt Issue 'A', citing the Company's strong competitive position, strong operating performance, and very strong capitalization

**1/28/2013** – S&P affirms Highmark's 'A' rating, but revises its outlook from 'Stable' to 'Negative', citing the expectation that Highmark's operating earnings will weaken further in 2013 primarily because of concessionary pricing actions implemented during the company's contentious contract negotiations with UPMC, as well as expenses related to its integrated delivery IDN strategy and preparing for Healthcare Reform; S&P also stated that significant financial commitments to WPAHS specifically, or the broader IDN strategy in general, more than what the company currently expects, will put downward pressure on the ratings

**A.M. BEST**

**4/13/2011** – A.M. Best Co. revises outlook to stable from negative and affirms the financial strength rating (FSR) of "A" (Excellent) and issuer credit rating (ICR) of "A" of Highmark Inc., citing strong underwriting and net income results, strong market share and continued strengthening of capitalization

**11/2/2011** – A.M. Best places ratings under review with negative implications, citing concerns regarding Highmark's Transaction with WPAHS, including the integration and the financial viability of WPAHS, its large outstanding debt as well as WPAHS' troubled financial past

**2/7/2013** – A.M. Best affirms Highmark's financial strength rating (FSR) of "A" (Excellent) and issuer credit rating (ICR) of "A"; A.M. Best also maintains Highmark's under review status with negative implications, citing concerns with the integration and the financial viability of WPAHS, the large debt outstanding as well as WPAHS' troubled financial past

Source: Moody's, S&P, A.M. Best, and Factiva.



## A. Highmark Financial Condition and IDN Impact

### Summary of Highmark's IDN Plan Capital Commitments

**Although Highmark has stated that it plans to commit \$1 billion in total capital to the IDN strategy, including commitments to WPAHS, the total capital commitment implicated by Highmark's plans is in excess of \$1.8 billion, \$646 million of which is contingent upon execution of the proposed Transaction.**

#### Highmark's Stated \$1 billion IDN Capital Commitment (\$ in millions)

|  | Capital<br>Outlay<br>Prior to<br>12/31/2012 | Remaining<br>Without<br>PID<br>Approval | Total<br>Without<br>PID<br>Approval | Contingent<br>on PID<br>Approval | Total With<br>PID<br>Approval |
|--|---|---|-------------------------------------|----------------------------------|-------------------------------|
| WPAHS <sup>(1)</sup>                     | \$200 <sup>(2)</sup>                        | \$84                                    | \$284                               | \$191                            | \$475                         |
| Physician Network                        | 94  | 214                                     | 308                                 | -                                | 308                           |
| Medical Malls                            | 32  | 7 <sup>(3)</sup>                        | 39                                  | -                                | 39                            |
| Outpatient and/or<br>Community Hospitals | 23  | 346 <sup>(4)</sup>                      | 369                                 | (191) <sup>(5)</sup>             | 178                           |
| <b>Total</b>                             | <b>\$349</b>                                | <b>\$651</b>                            | <b>\$1,000</b>                      | <b>-</b>                         | <b>\$1,000</b>                |

**Note: Totals do not include WPAHS unfunded pension liabilities, contingent liabilities or other liabilities**

#### Memo: Transaction-Contingent Capital Commitments

|   |                |
|---|----------------|
| Transfer to WPAHS at Closing (formerly Med School Grant)                  | \$41.4         |
| 4th Funding - Loan (At Closing, on or before 4/30/2013) <sup>(6)</sup>    | 100.0          |
| Portion of 4th Funding Loan Converted from Non-Contingent Escrow Payment  | (50.0)         |
| 5th Funding - Loan (Latter of Closing or 4/1/2014)                        | 100.0          |
| Tender Offer for WPAHS 2007A Bonds <sup>(7)</sup>                         | 646.4          |
| <b>Transaction-Contingent WPAHS Capital Commitments</b>                   | <b>\$837.8</b> |
| Less: Undefined Community Hospital Development / Partnerships             | (191.4)        |
| <b>Transaction-Contingent Total IDN Capital Commitments<sup>(7)</sup></b> | <b>\$646.4</b> |

Source: Highmark.

- (1) Does not include WPAHS' unsecured liabilities of \$589.2 million (as of 1/31/2013), of which \$274.2 million is WPAHS' unfunded pension liability, and does not include other contingent WPAHS liabilities.
- (2) \$33 million difference between Highmark's stated and the all-inclusive view includes \$25 million cash advance paid to WPAHS for WPH and AGH on 4/18/2011 and \$8 million unrestricted payment to WPAHS for fees to Alvarez & Marsal paid on 4/18/2012.
- (3) \$100 million difference between Highmark's stated and the all-inclusive view includes financing for Medical Malls, excluded from Highmark's reported \$1 billion IDN capital commitment.
- (4) \$55 million difference between Highmark's stated and the all-inclusive view includes additional capital expenditures spending to JRMC up to \$100 million maximum, above Highmark's \$45 million estimate.
- (5) Absent the Transaction, Highmark will commit \$191 million of the funding earmarked for WPAHS to undefined community hospital development / partnerships.
- (6) Highmark has placed \$50 million into an escrow account to secure Highmark's performance with regard to the tender offer. If the closing occurs on or before April 30, 2013, or any agreed upon extension of that date, the \$50 million and another \$50 million from Highmark will be advanced to WPAHS at the closing in the form of a loan. If the closing does not occur by April 30, 2013, or any agreed upon extension of that date, the \$50 million escrow amount will be paid to WPAHS, absent default by WPAHS. Remaining capital commitment assumes the full \$100 million is loaned to WPAHS.
- (7) Assumes 76.74% of bondholders tender at 87.5% of par, which is assumed to be \$709.7 million at the time of the Tender Offer. Assumes Highmark pays accrued interest and purchases the non-tendered bonds at par. Note: If 100% of bondholders tender at 87.5% of par, Highmark's capital commitment for the WPAHS bonds, including accrued interest, would be \$625.8 million.

#### All-Inclusive View of Highmark's IDN Capital Commitment (\$ in millions)

|  | Capital<br>Outlay<br>Prior to<br>12/31/2012 | Remaining<br>Without<br>PID<br>Approval | Total<br>Without<br>PID<br>Approval | Contingent<br>on PID<br>Approval | Total With<br>PID<br>Approval |
|--|---|---|-------------------------------------|----------------------------------|-------------------------------|
| WPAHS <sup>(1)</sup>                     | \$233 <sup>(2)</sup>                        | \$84                                    | \$317                               | \$838                            | \$1,154                       |
| Physician Network                        | 94  | 214                                     | 308                                 | -                                | 308                           |
| Medical Malls                            | 32  | 107 <sup>(3)</sup>                      | 139                                 | -                                | 139                           |
| Outpatient and/or<br>Community Hospitals | 23  | 401 <sup>(4)</sup>                      | 424                                 | (191) <sup>(5)</sup>             | 233                           |
| <b>Total</b>                             | <b>\$382</b>                                | <b>\$806</b>                            | <b>\$1,188</b>                      | <b>\$646</b>                     | <b>\$1,834</b>                |

**Note: Totals do not include WPAHS unfunded pension liabilities, contingent liabilities or other liabilities**

- ▶ See page 36 for reconciliation of \$1 billion to \$1.8 billion of Total IDN Capital Committed



A. Highmark Financial Condition and IDN Impact

**All-Inclusive View of Highmark's IDN Plan Capital Commitments**

**A summary reconciliation of Highmark's stated \$1 billion of provider strategy spending to the all-inclusive capital commitment of \$1.8 billion is shown below.**

**Incremental Capital Commitments in Excess of \$1 billion**

(\$ in millions)

|   | Amount           |
|---|------------------|
| <b>Total Provider Capital Commitment, as Stated by Highmark</b>                             | <b>\$1,000.0</b> |
| Tender Offer for WPAHS 2007A Bonds, including Principal and Accrued interest <sup>(1)</sup> | 646.4            |
| Other Grants to WPAHS (Cash Advance and A&M Fees) <sup>(2)</sup>                            | 33.0             |
| <b>Community Hospitals:</b>   |                  |
| JRMC Capex Spending Above Highmark's \$45m Estimate   | 55.0             |
| <b>Medical Malls:</b>   |                  |
| External Financing on HMPG <sup>(3)</sup>   | 100.0            |
| <b>Total Grants and Highmark Loans<sup>(4)</sup></b>  | <b>\$1,834.4</b> |
| Less: Total Amount Spent Prior to 12/31/2012 <sup>(5)</sup>                                 | (\$382.0)        |
| <b>Net Financial Commitments Remaining<sup>(4)</sup></b>                                    | <b>\$1,452.4</b> |
| <b>Memo:</b>  |                  |
| <b>Total Grants and Highmark Loans</b>  | <b>\$1,834.4</b> |
| Plus: WPAHS Unfunded Pension Liability as of 1/31/2013                                      | 274.2            |
| Plus: WPAHS Other Liabilities as of 1/31/2013 <sup>(6)</sup>                                | 315.0            |
| <b>Total Grants, Highmark Loans, WPAHS Pension and Other Liabilities</b>                    | <b>\$2,423.6</b> |

Source: Highmark.

- (1) Assumes 76.74% of bondholders tender at 87.5% of par, which is assumed to be \$709.7 million at the time of the Tender Offer. Assumes Highmark pays accrued interest and purchases the non-tendered bonds at par.
- (2) Includes \$25 million cash advance paid to WPAHS for WPH and AGH on 4/18/2011 and \$8 million unrestricted payment to WPAHS for fees to Alvarez & Marsal paid on 4/18/2012.
- (3) Classified as a negative expenditure under "Medical Malls" within Highmark's "\$1bn Reported Provider Strategy Spending."
- (4) Does not include WPAHS' unsecured liabilities of \$589.2 million (as of 1/31/2013), of which \$274.2 million is WPAHS' unfunded pension liability, and does not include contingent liabilities.
- (5) See pages 35 and 131 for details.
- (6) Includes Deferred Revenue, Self-Insurance Liabilities and Other Liabilities; assumes Accrued Salaries and Vacation are assumed by a potential buyer and Floating Rate Restructuring Certificates are extinguished.



## A. Highmark Financial Condition and IDN Impact

### Transaction Impact on Highmark's Net Liquid Assets

**The Transaction, if approved, may reduce Highmark's net liquid assets by ~\$1.5bn, a decrease of nearly 49% based on Highmark's 12/31/2012 balance sheet.**

#### Considerations Related to the Table at Right: Modified Balance Sheet - 12/31/2012 vs. "Day 1" Pro Forma

- ▶ If Highmark were making all IDN and WPAHS-related expenditures upon closing of the Transaction, (in practice they will be made over a four year period), the estimated effect would be a reduction in net liquid assets of 49%, from \$2.97 billion to \$1.52 billion
- ▶ Although the analysis at right reflects a conservative measure of Highmark's financial strength and liquidity, the proposed Transaction and IDN Plan represent a substantial commitment of Highmark's financial resources and will result in a significant amount of net liquid assets being converted into relatively illiquid, highly concentrated, and, in the case of WPAHS Series 2007A Bonds, speculative grade investments. This conversion may significantly impact Highmark's future ability to react to unforeseen adverse economic conditions
- ▶ In practice, Highmark's net liquid assets will fluctuate with the Company's earnings; Highmark may increase / decrease the amount of planned IDN expenditures
- ▶ Although Highmark expects to increase its net liquid assets through 2017 via the accumulation of operating earnings (cumulative net income of \$1.2 billion is projected for FY2013 – FY2017), such results are uncertain and may not materialize as planned

| (\$ in millions)                                 | 12-Entity Modified Combined Highmark <sup>(1)</sup> | Non-Transaction Contingent Adjustments <sup>(2)</sup> | Non-Transaction-Contingent Pro Forma | Transaction-Contingent Adjustments <sup>(2)</sup> | Transaction-Contingent Pro Forma |
|--|---|---|--------------------------------------|---|----------------------------------|
| Cash <sup>(3)</sup>                              | \$986.9   | (\$806.0)   | \$180.9                              | -   | \$180.9                          |
| Unearned Revenue                                 | (275.2)   | -   | (275.2)                              | -   | (275.2)                          |
| Amounts Held For Others                          | (506.1)   | -   | (506.1)                              | -   | (506.1)                          |
| <b>Net Cash</b>                                  | <b>\$205.6</b>                                      | <b>(\$806.0)</b>                                      | <b>(\$600.4)</b>                     | <b>-</b>  | <b>(\$600.4)</b>                 |
| Available for Sale Securities                    | 4,615.0   | -   | 4,615.0                              | -   | 4,615.0                          |
| Net Securities Lending                           | -   | -   | -                                    | -   | -                                |
| Receivables                                      | 2,146.9   | -   | 2,146.9                              | -   | 2,146.9                          |
| <b>Gross Liquid Assets</b>                       | <b>\$6,967.5</b>                                    | <b>(\$806.0)</b>                                      | <b>\$6,161.5</b>                     | <b>-</b>  | <b>\$6,161.5</b>                 |
| Claims   | (2,191.3)   | -   | (2,191.3)                            | -   | (2,191.3)                        |
| Benefit Plan Liabilities                         | (248.9)   | -   | (248.9)                              | -   | (248.9)                          |
| Other Payables                                   | (653.7)   | -   | (653.7)                              | -   | (653.7)                          |
| <b>Net Working Capital</b>                       | <b>\$3,873.6</b>                                    | <b>(\$806.0)</b>                                      | <b>\$3,067.6</b>                     | <b>-</b>  | <b>\$3,067.6</b>                 |
| <b>Total Debt</b>                                | <b>(\$902.8)</b>                                    | <b>-</b>  | <b>(\$902.8)</b>                     | <b>(\$646.4)</b>                                  | <b>(\$1,549.2)</b>               |
| <b>Net Liquid Assets</b>                         | <b>\$2,970.8</b>                                    | <b>(\$806.0)</b>                                      | <b>\$2,164.8</b>                     | <b>(\$646.4)</b>                                  | <b>\$1,518.4</b>                 |
| Investments In Subs. and Affiliates              | 1,555.9   | -   | 1,555.9                              | -   | 1,555.9                          |
| Provider Investments                             | -   | 107.0   | 107.0                                | 846.4   | 953.4                            |
| Tax Receivable (Payable)                         | 38.4  | -   | 38.4                                 | -   | 38.4                             |
| Deferred Tax Asset (Liability)                   | 83.2  | -   | 83.2                                 | -   | 83.2                             |
| Premium Deficiency Reserve                       | (155.9)   | -   | (155.9)                              | -   | (155.9)                          |
| <b>Semi-Liquid Assets</b>                        | <b>\$1,521.6</b>                                    | <b>\$107.0</b>  | <b>\$1,628.6</b>                     | <b>\$846.4</b>                                    | <b>\$2,475.0</b>                 |
| Unrealized Gains (Losses)                        | 64.8  | -   | 64.8                                 | -   | 64.8                             |
| Net PP&E   | 384.6   | -   | 384.6                                | -   | 384.6                            |
| Goodwill and Intangibles                         | 145.8   | -   | 145.8                                | -   | 145.8                            |
| Other Assets <sup>(4)</sup>                      | 69.0  | -   | 69.0                                 | -   | 69.0                             |
| <b>Non-Liquid Assets</b>                         | <b>\$664.2</b>                                      | <b>-</b>  | <b>\$664.2</b>                       | <b>-</b>  | <b>\$664.2</b>                   |
| <b>Total Net Worth</b>                           | <b>\$5,156.6</b>                                    | <b>(\$699.0)</b>                                      | <b>\$4,457.6</b>                     | <b>\$200.0</b>                                    | <b>\$4,657.6</b>                 |
| <b>Net Liquid Assets as % of Total Net Worth</b> | <b>57.6%</b>  | <b>-</b>  | <b>48.6%</b>                         | <b>-</b>  | <b>32.6%</b>                     |

Source: Highmark.

- (1) As of 12/31/2012. Note that "Modified Combined Highmark" excludes HVHC, HWV, and HDE entities because Highmark's core group of insurance entities offering commercial health insurance in Pennsylvania do not guarantee HVHC, HWV, and HDE debts and there is no cross-collateralization of debt.
- (2) Adjustments exclude impact of WPAHS's unfunded pension liability of \$274m, other unsecured liabilities of \$315m, and contingent liabilities, as of 1/31/2013. Adjustments also exclude Highmark's Transaction-related expenditures prior to 12/31/2012, as shown on pages 35 and 131. See detail of Non-Transaction-Contingent and Transaction-Contingent Adjustments on page 130.
- (3) Includes Cash Surrender Value of \$75 million.
- (4) Excludes Cash Surrender Value of \$75 million.



## A. Highmark Financial Condition and IDN Impact

### Transaction Impact on Highmark's Fixed Income Portfolio

In order to fund its IDN strategy, Highmark expects to sell ~\$300 million of investment grade securities from its current fixed income portfolio, resulting in an increase in the duration of Highmark's total fixed income portfolio and a decrease in the average credit quality and coupon.

#### Fixed Income Portfolio Characteristics

|                  |  | Market Value (\$mm) | Effective Duration (yrs) | Modified Duration (yrs) | Maturity (yrs) | Quality | Coupon (%) |
|------------------|--|---------------------|--------------------------|-------------------------|----------------|---------|------------|
| <b>Current</b>   | Combined Highmark Fixed Income Portfolio as of 12/31/2012 <sup>(1)</sup>                             | \$3,863.2           | 4.62                     | 5.45                    | 6.68           | A1      | 4.13%      |
| <b>Pro Forma</b> | Pro Forma Combined Highmark Fixed Income Portfolio, inclusive of WPAHS debt at 80% <sup>(1)(2)</sup> | \$3,932.1           | 5.17                     | 5.72                    | 8.13           | A2      | 3.69%      |
| <b>Benchmark</b> | Barclay's Aggregate Index  | NA                  | 4.92                     | 5.06                    | 6.92           | Aa2     | 3.57%      |
| <b>WPAHS</b>     | WPAHS Debt <sup>(3)</sup>  | 621.3               | 11.78                    | 11.54                   | 22.75          | Ca      | 5.88%      |

#### Reconciliation of Current to Pro Forma

(\$ in millions)

|   | Market Value     |
|---|------------------|
| Combined Highmark Fixed Income Portfolio at 12/31/2012                              | \$3,863.2        |
| Less: Investment Grade Fixed Income Securities Sold <sup>(4)</sup>                  | (305.4)          |
| Less: High Yield Fixed Income Securities Sold                                       | (121.7)          |
| Plus: Addition of WPAHS Bonds <sup>(5)</sup>  | 496.0            |
| <b>Estimated Combined Highmark Fixed Income Portfolio - Inclusive of WPAHS Debt</b> | <b>\$3,932.1</b> |

Source: Highmark.

(1) Excludes Highmark BCBSD Inc. and HWV portfolios.

(2) Includes adjustments for assumed rebalancing of assets and liquidations for payment of Highmark-assumed remaining \$675 million of IDN commitments.

(3) Highmark assumes a par amount of \$709.7 million, valued at 87.5% of par with 80% tendered.

(4) Investment Grade Fixed Income securities sold to rebalance Highmark's Fixed Income portfolio, per Highmark. Proceeds from sale of these securities are not intended to fund the Tender Offer.

(5) \$496m purchase price assumes 80% of bondholders tender at 87.5% of par, which is assumed to be \$709.7 million at the time of the Tender Offer.

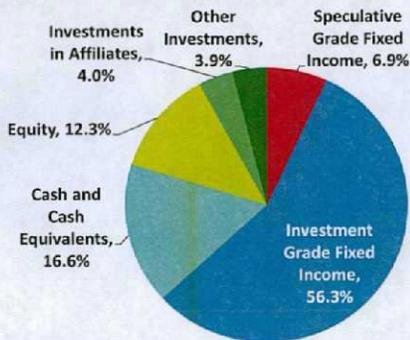


A. Highmark Financial Condition and IDN Impact

**Transaction Impact on Highmark's Overall Investment Portfolio**

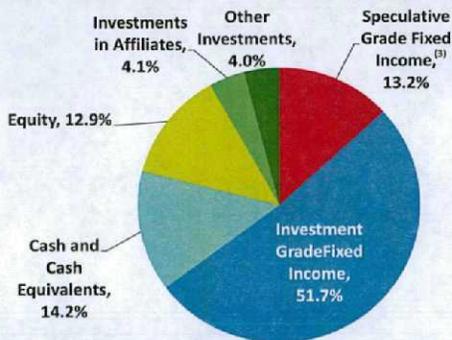
**Following the projected acquisition of WPAHS' Series 2007A bonds, 20% of Highmark's fixed income investment portfolio will be comprised of speculative grade securities, compared to 11% prior to the Transaction.**

2012 Investment Portfolio Allocation<sup>(1)</sup>



Total Fixed Income: 63.2%

Proposed Transaction Investment Portfolio Allocation<sup>(2)</sup>



Total Fixed Income: 64.9%

Highmark Combined Speculative Grade (High Yield and Bank Loans) as of 12/31/2012 and Pro Forma<sup>(4)</sup>  
(\$ in millions)

|  | Market Value   | Avg. Quality Rating |
|--|----------------|---------------------|
| <b>Current:</b>  |                |                     |
| High Yield   | \$377.6        | B1                  |
| Bank Loans   | 45.8           | Ba2                 |
| <b>Total Speculative Grade as of 12/31/2012</b>  | <b>\$423.4</b> |                     |
| Total Fixed Income Portfolio as of 12/31/2012  | 3,863.2        |                     |
| <b>Speculative Grade as % of Total Fixed Income Portfolio</b>  | <b>11.0%</b>   |                     |
| <b>Pro Forma:</b>  |                |                     |
| <b>Total Speculative Grade as of 12/31/2012</b>  | <b>\$423.4</b> |                     |
| Less: High Yield Fixed Income Securities Sold  | (121.7)        | NA                  |
| Plus: Addition of WPAHS Bonds <sup>(2)</sup>   | 496.0          | Ca                  |
| <b>Total Pro Forma Speculative Grade</b>   | <b>\$797.8</b> |                     |
| Estimated Total Fixed Income Portfolio - Inclusive of WPAHS Debt <sup>(2)</sup>                      | 3,932.1        |                     |
| <b>Pro Forma Speculative Grade as % of Total Pro Forma Fixed Income Portfolio<sup>(2)</sup></b>      | <b>20.3%</b>   |                     |
| <b>Memo: WPAHS 2007A Bonds percent of Total Pro Forma Speculative Grade Securities<sup>(2)</sup></b> | <b>62.2%</b>   |                     |
| <b>Memo: Pro Forma Increase in Speculative Grade Fixed Income Securities<sup>(2)</sup></b>           | <b>88.4%</b>   |                     |

Source: Highmark.

(1) Based on \$6.1 billion investment portfolio as of December 31, 2012.

(2) Includes addition of 80% of the WPAHS 2007A bond debt and payment of \$675 million of remaining IDN commitments. Does not include non-tendered bonds or accrued interest.

(3) Investment of WPAHS debt will be treated as a fixed income holding.

(4) Does not include Highmark BCBSD, Inc. or Highmark West Virginia.



A. Highmark Financial Condition and IDN Impact

Overview of Highmark's Credit Ratings

Highmark's credit ratings from each of Moody's, S&P and A.M. Best are either on negative outlook or under review for a possible downgrade. A downgrade by Moody's would move Highmark's senior unsecured debt rating to within one notch of speculative grade.

|           | Rated Entity                     | Current Rating / Outlook   | Current Rating Definition <sup>(1)</sup>  | Downward Notches to Next Category  | Rating Definition of Next Lower Category <sup>(1)</sup>   |
|-----------|----------------------------------|--|---|--|---|
| Moody's   | Insurer: Financial Strength      | <ul style="list-style-type: none"> <li>▶ Baa1</li> <li>▶ (On Review for Downgrade)</li> </ul>              | <ul style="list-style-type: none"> <li>▶ <b>Baa</b> = "Obligations rated Baa are judged to be <u>medium-grade and subject to moderate credit risk</u> and as such may possess certain speculative characteristics"</li> </ul> | <ul style="list-style-type: none"> <li>▶ 3 Notches:                             <ul style="list-style-type: none"> <li>• Baa2</li> <li>• Baa3*</li> <li>• Ba1</li> </ul> </li> <li>▶ 2 Notches:                             <ul style="list-style-type: none"> <li>• Baa3*</li> <li>• Ba1</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>Ba</b> = "Obligations rated Ba are judged to be <u>speculative and are subject to substantial credit risk</u>."</li> </ul>                      |
|           | Senior Unsecured Debt of Insurer | <ul style="list-style-type: none"> <li>▶ Baa2</li> <li>▶ (On Review for Downgrade)</li> </ul>              |   |  |   |
| S&P       | Insurer                          | <ul style="list-style-type: none"> <li>▶ A</li> <li>▶ (Negative Outlook)</li> </ul>                        | <ul style="list-style-type: none"> <li>▶ <b>A</b> = "<u>Strong</u> capacity to meet financial commitments, but <u>somewhat susceptible to adverse economic conditions</u> and changes in circumstances"</li> </ul>            | <ul style="list-style-type: none"> <li>▶ 1 Notch:                             <ul style="list-style-type: none"> <li>• BBB*</li> </ul> </li> </ul>   | <ul style="list-style-type: none"> <li>▶ <b>BBB</b> = "<u>Adequate</u> capacity to meet financial commitments, but <u>more subject to adverse economic conditions</u>"</li> </ul>           |
| A.M. Best | Insurer: Financial Strength      | <ul style="list-style-type: none"> <li>▶ A</li> <li>▶ (Under Review with Negative Implications)</li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>A</b> = Excellent; "Assigned to companies that have, in our opinion, an <u>excellent ability</u> to meet their ongoing insurance obligations"</li> </ul>                          | <ul style="list-style-type: none"> <li>▶ 2 Notches:                             <ul style="list-style-type: none"> <li>• A-</li> <li>• B++</li> </ul> </li> </ul>  | <ul style="list-style-type: none"> <li>▶ <b>B++</b> = Good; "Assigned to companies that have, in our opinion, a <u>good ability</u> to meet their ongoing insurance obligations"</li> </ul> |
|           | Insurer: Issuer Credit Rating    | <ul style="list-style-type: none"> <li>▶ a</li> <li>▶ (Under Review with Negative Implications)</li> </ul> |   |  |   |

Note: "\*" denotes relevant Moody's and S&P category referenced in PNC Commitment Letter.

(1) Source: Moody's January 2013 Report, "Rating Symbols and Definitions;" S&P's 2011 Report, "Understanding Ratings: Guide to Credit Rating Essentials;" and A.M. Best's 2013 Reports, "Guide to Best's Issuer Credit Ratings" and "Guide to Best's Financial Strength Ratings."



## A. Highmark Financial Condition and IDN Impact

### Historical RBC Relative to PID Guidelines

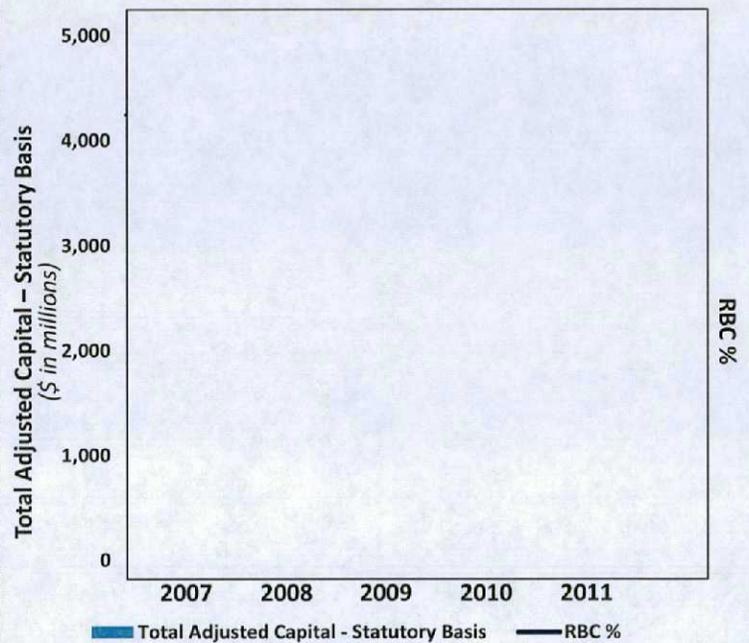
The Risk-Based Capital ratio ("RBC") is a statutory measure of liquidity and financial flexibility. This metric is monitored by the PID and measured against PID-established benchmarks. Highmark's RBC has been deemed "Sufficient" for the last five years. Highmark's RBC ratio was   % as of 12/31/2011.

#### PID Standards

- ▶ In 2005, the PID implemented a model of analysis to review reserve and surplus levels of state "Blue" plans, classifying the RBC level as either efficient, sufficient or inefficient
- ▶ Several risk factors are considered, including: health care regulation, inflation of health care costs, class action law suits, terrorism, public health outbreaks, and underwriting risk
- ▶ Benefits of insurer surplus include reducing policyholder risk, minimizing the threat of insolvency resulting from the measured level of risk, as well as investing in improving technology or other operational efficiencies

| "Efficient"  | "Sufficient"  | "Inefficient"  |
|--|---|--|
| <ul style="list-style-type: none"> <li>• Below 550 percent of the lower of the NAIC Health RBC ratio or the consolidated risk factor ratio</li> <li>• Plan does not face solvency issues from routine fluctuations</li> <li>• A lower bound for what is efficient is not identified and may differ for each Blue Plan</li> </ul> | <ul style="list-style-type: none"> <li>• 550 to 750 percent of the lower of the NAIC Health RBC ratio or the consolidated risk factor ratio</li> <li>• Plan in this range is not allowed to include any risk or contingency factors in any filed premium rates</li> </ul> | <ul style="list-style-type: none"> <li>• Above 750 percent of the lower of the NAIC Health RBC ratio or the consolidated risk factor ratio</li> <li>• Upper level of surplus, which means it is presumptively inefficient and potentially excessive</li> </ul> |

#### Highmark Historic RBC<sup>(1)</sup>



(1) Source: SNL Financial.



A. Highmark Financial Condition and IDN Impact

**Day 1 Transaction Impact on Highmark's RBC**

Although Highmark intends to implement and fund the IDN strategy over the next 4 years, if the investments were made at the time of the Transaction's projected closing, Highmark's RBC would decrease by approximately   basis points.

**Day 1 – RBC Impact**

(\$ in millions)

|  |   |  |   |   |   |   |                           |
|--|---|--|---|---|---|---|---------------------------|
|  |   |  |   |   |   |   |                           |
|  |   | <ul style="list-style-type: none"> <li>▶ <b>\$75m:</b> Grant to WPAHS</li> <li>▶ <b>\$100m:</b> 4th Funding Commitment - Loan</li> <li>▶ <b>\$100m:</b> 5th Funding Commitment - Loan</li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>\$496m:</b> Highmark Purchase of WPAHS Bonds<sup>(2)</sup></li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>\$94m:</b> Additional Unrestricted Grant to UPE for Non-WPAHS Purposes</li> <li>▶ <b>\$120m:</b> Highmark Payments to PLZ in Exchange for Participation in Network</li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>\$75m:</b> Highmark Unrestricted Grant to JRMC</li> <li>▶ <b>\$45m:</b> Highmark Capex Grant to JRMC</li> </ul> | <ul style="list-style-type: none"> <li>▶ <b>\$10m:</b> Highmark Grant to Sisters of St. Joseph of Northwestern PA for SVHS</li> <li>▶ <b>\$5m:</b> Highmark Capex Grant to SVHS</li> <li>▶ <b>\$20m:</b> Highmark Unrestricted Payment to SVHS</li> </ul> |                           |
|  | <b>2012 Adjusted Estimate<sup>(1)</sup></b> | <b>WPAHS Impact</b>  | <b>Bond Financing</b>   | <b>Physician Impact</b>   | <b>JRMC Impact</b>  | <b>SVHS Impact</b>  | <b>Day 1 - RBC Impact</b> |

Source: Highmark.

(1)

(2) \$496m purchase price assumes 80% of bondholders tender at 87.5% of par, which is assumed to be \$709.7 million at the time of the Tender Offer. Does not include non-tendered bonds or accrued interest.

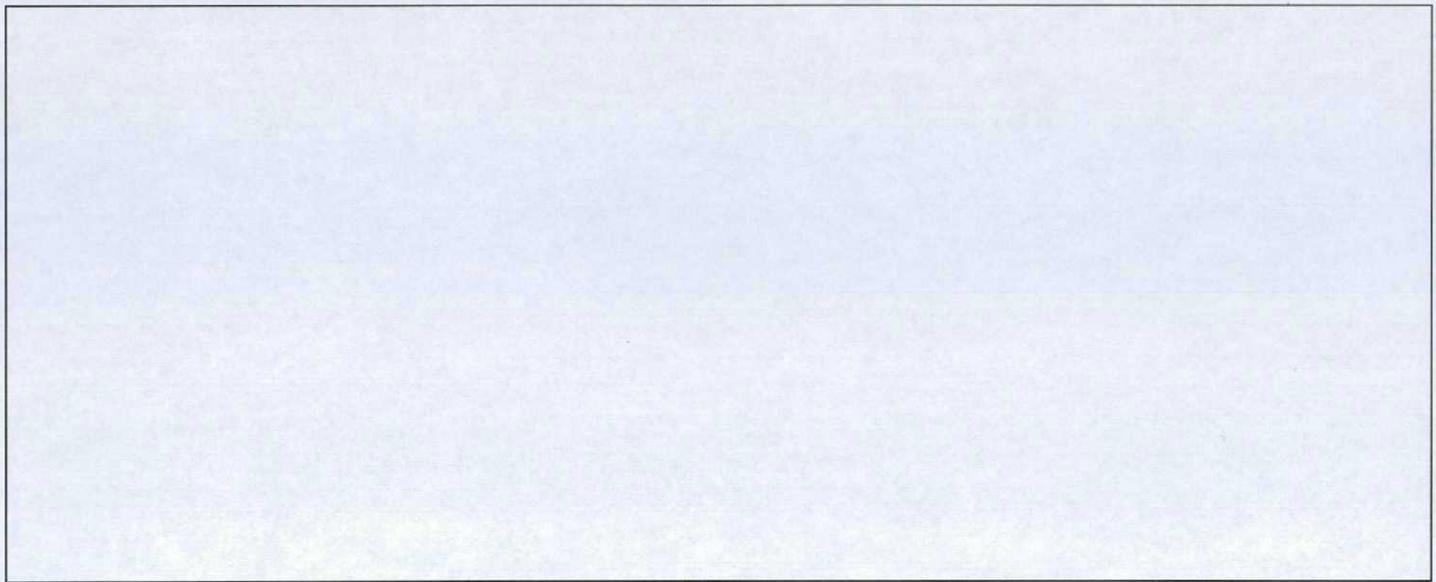


A. Highmark Financial Condition and IDN Impact

Highmark RBC Relative to Multi-State Blue Plans

Highmark's historical RBC, relative to other multi-state non-investor owned Blue plans, is shown below.

RBC Ratios of Multi-State Non-Investor Owned Blues (2007 – 2011)



2007                      2008                      2009                      2010                      2011  
 ◆ CareFirst Inc.      ■ Highmark Inc.      ▲ HCSC      ✕ Premera      ✱ Regence      ● Wellmark Inc.

Select Statutory Balance Sheet Items – as of 12/31/2011

(\$ in millions)

|                     | CareFirst Inc. | Highmark Inc. | HCSC       | Premera   | Regence   | Wellmark Inc. |
|---------------------|----------------|---------------|------------|-----------|-----------|---------------|
| Total Assets        | \$3,989.2      | \$7,168.9     | \$14,655.1 | \$1,661.2 | \$3,283.6 | \$1,899.6     |
| Capital and Surplus | 1,476.1        | 4,101.5       | 8,909.9    | 972.7     | 1,886.2   | 1,074.4       |

Source: SNL Financial.



## A. Highmark Financial Condition and IDN Impact

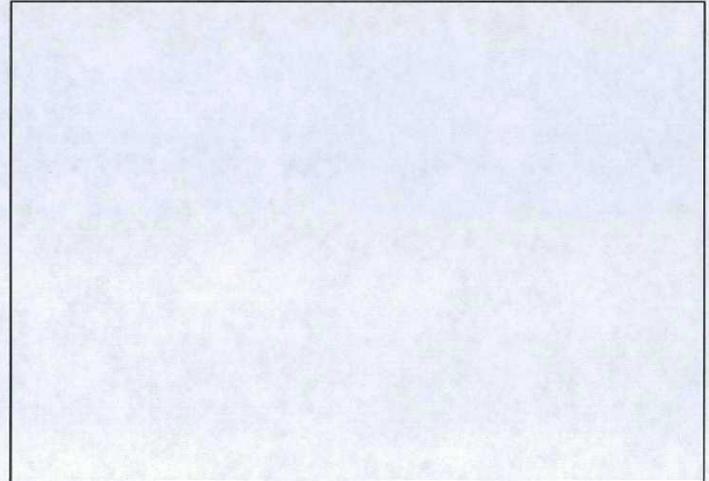
### Highmark's Base Case RBC "Stress Test"

Highmark submitted an RBC "stress test" in its revised Form A filing. Highmark's stress testing projected that Highmark's 2016 RBC would remain above  %.

#### Highmark's Base Case 2016 RBC "Stress Test" Assumptions

- ▶ Stress test applied to 2016 RBC of  %
- ▶ Highmark's stress test assumptions:
  - Highmark retains the health business lost as a result of the market turmoil in Western Pennsylvania associated with the termination of the UPMC contract in December 2014
  - The value of WPAHS is insufficient to support the carrying value of the WPAHS bonds that Highmark holds and the loans in place with WPAHS, and Highmark writes off half of the value of those investments / loans (a \$398 million write off) in December 2014, prior to the projected bond refinancing
  - Highmark invests another \$250 million in the provider strategy, over and above the IDN capital commitments<sup>(1)</sup>
  - Another major downturn in the financial markets (similar to 2008) results in a significant loss in the value of Highmark's equity portfolio as well, as the value of its benefit plan assets

#### Highmark's RBC "Stress Test" Results



| 2016<br>Projected<br>Transaction<br>Case RBC | Highmark<br>Maintains<br>Enrollment | Highmark<br>Writes Off<br>WPAHS<br>Loans | Increase<br>Provider<br>Funding by<br>\$250m | Market<br>Downturn | "Stress<br>Test"<br>Projected<br>Transaction<br>Case 2016<br>RBC |
|--|-------------------------------------|--|--|--------------------|--|
|--|-------------------------------------|--|--|--------------------|--|

Source: Highmark.

(1) See page 35 for detail of IDN capital commitments.



A. Highmark Financial Condition and IDN Impact

Revised RBC "Stress Test" as Requested by Blackstone and Prepared by Highmark

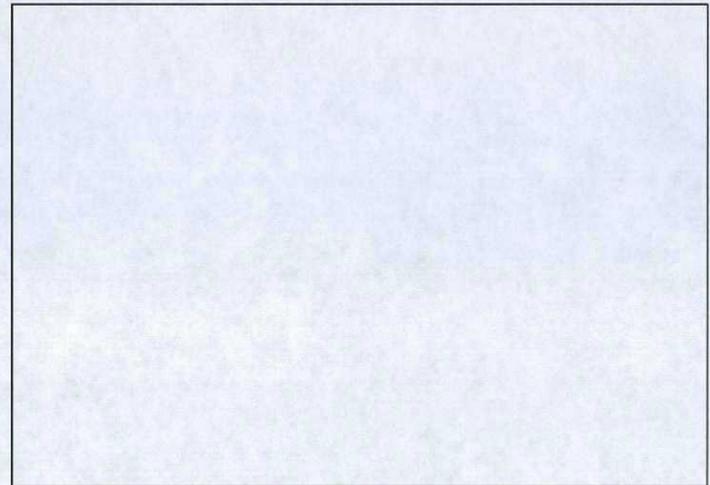
At Blackstone's request, Highmark prepared a revised RBC "stress test," which implies a 2015 RBC of [ ]%.

Revised 2015 RBC "Stress Test" Assumptions

- ▶ Revised stress test assumptions, at Blackstone's request:
- ▶ Stress test applied to 2015 RBC of [ ]%
  - Highmark's operating earnings remain flat from 2013-2015
  - The value of WPAHS is insufficient to support the carrying value of the WPAHS bonds that Highmark holds and the loans in place with WPAHS, and Highmark writes off a total of \$476 million;<sup>(1)</sup> Highmark is unable to refinance the bonds, as projected in the initial stress test, in 2014
  - Highmark invests another \$500 million in the provider strategy, over and above the IDN capital commitments<sup>(2)</sup>
  - Another major downturn in the financial markets (similar to 2008) results in a significant loss in the value of Highmark's equity portfolio as well, as the value of its benefit plan assets

Note: Since the revised stress test projections reflect a "UPMC-In" scenario, in which policyholder enrollment is maintained vs. the "UPMC-Out" assumption used in the initial stress test, no additional sensitivity was included for higher enrollment

Revised RBC "Stress Test" Results



| 2015 Projected Transaction Case RBC | Operating Earnings Flat | Write Down WPAHS Investments | Increase Provider Funding by \$500m | Market Downturn | Revised Stress Test 2015 RBC |
|-------------------------------------|-------------------------|------------------------------|-------------------------------------|-----------------|------------------------------|
|-------------------------------------|-------------------------|------------------------------|-------------------------------------|-----------------|------------------------------|

Source: Highmark.

(1) Write-off of \$476 million is based off of a recovery analysis that assumes 76.74% of WPAHS Series 2007A bondholders tender at 87.5% of par of \$714.7 million at the time of the Tender Offer. Also assumes Highmark pays accrued interest and purchases the non-tendered bonds at par. See page 82 for comparable recovery analysis that assumes WPAHS Series 2007A par of \$709.7 million at the time of the Tender Offer, and results in a "Low Value" write-off of \$471 million in 2015.

(2) See page 35 for detail of IDN capital commitments.

## **B. “No Transaction” Scenario**



## B. "No Transaction" Scenario

### Review of Select Highmark Assumptions

In order to assess the incremental impact of the Transaction on Highmark's insurance operations, Highmark developed the "No Transaction" scenario to use as a benchmark for comparison. Key Highmark assumptions are noted below.

#### Transaction Case

- 1** The status and future of WPAHS
  - Assumes WPAHS will form the foundation of Highmark's integrated delivery network
- 2** Highmark contract with UPMC
  - Reflects Highmark's current contracted rates with UPMC, per the May 2012 mediated agreement, through December 31, 2014
  - Assumes UPMC is out-of-network beginning in January 2015
- 3** Enrollment
  - Assumes Highmark maintains a larger balance of subscriber enrollees based on an enhanced IDN platform with the inclusion of a strong WPAHS
- 4** Provider Investments
  - Total IDN capital commitments, as presented on page 35, have been incorporated into the Transaction Case projections

#### "No Transaction" Case

- 1** The status and future of WPAHS
  - Assumes that WPAHS will continue to deteriorate and will ultimately be taken over by a for-profit entity
  - Assumes WPAHS will subsequently negotiate a % reimbursement increase from Highmark
  - Assumes that without WPAHS at the center of Highmark's provider strategy, potential vertical integration savings will be limited and consumer healthcare costs will increase significantly
- 2** Highmark contract with UPMC
  - Assumes UPMC commercial hospital rates will increase by % on July 1, 2012, July 1, 2013 and July 1, 2014
  - Assumes UPMC remains in-network with a new contract in 2015, at a % rate increase
- 3** Enrollment
  - Assumes Highmark loses more enrollment due to loss of marketplace differentiation; by 2016, enrollment is  lower than in the "Transaction" Case
- 4** Provider Investments
  - Total non-transaction contingent IDN capital commitments, as presented on page 35, have been incorporated into the "No Transaction" Case projections

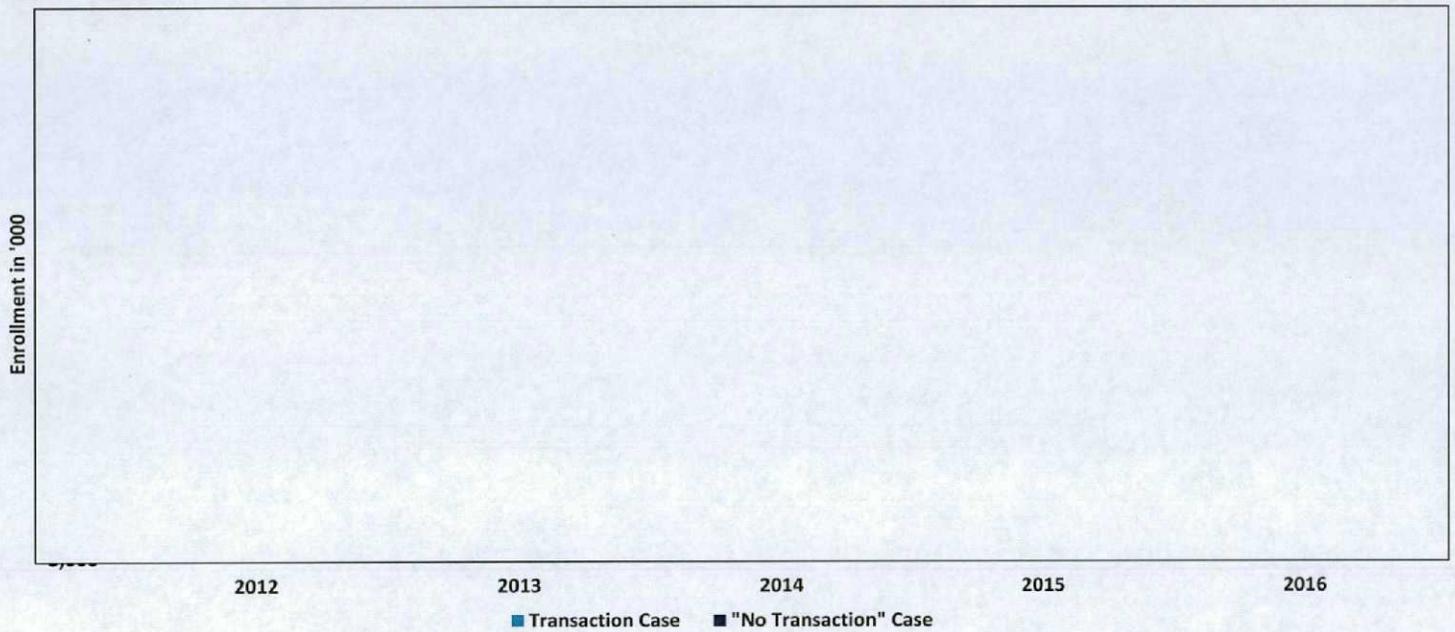


B. "No Transaction" Scenario

Review of Select Highmark Assumptions (cont'd.)

The chart below depicts the difference in Highmark enrollment between the Transaction Case and the "No Transaction" Case in 2016.

Highmark Enrollment Assumptions in Transaction Case Versus "No Transaction" Case



Source: Highmark projections.



B. "No Transaction" Scenario

Transaction vs. "No Transaction" – Scenario Comparison

A side-by-side comparison of Highmark's Transaction scenario projections and "No Transaction" scenario projections is shown below.

**Transaction Case**

(Assumes UPMC is Out-of-Network in January 2015)

(\$ in millions)

| Highmark Inc. Income Statement             | 2012E           | 2013E           | 2014E           | 2015E           | 2016E           | CAGR          |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|---------------|
| Subscription Revenue                       |                 |                 |                 |                 |                 |               |
| Net Patient Service Revenue                |                 |                 |                 |                 |                 |               |
| Management Services Revenue                |                 |                 |                 |                 |                 |               |
| Other Operating Revenue                    |                 |                 |                 |                 |                 |               |
| <b>Total Operating Revenue</b>             | <b>\$14,866</b> | <b>\$15,614</b> | <b>\$16,663</b> | <b>\$16,563</b> | <b>\$17,538</b> | <b>4.2%</b>   |
| Claims Expense                             |                 |                 |                 |                 |                 |               |
| Operating Expense                          |                 |                 |                 |                 |                 |               |
| <b>Total Operating Expense</b>             | <b>\$14,405</b> | <b>\$15,300</b> | <b>\$16,233</b> | <b>\$16,136</b> | <b>\$17,044</b> | <b>4.3%</b>   |
| Plus: Change in PDR                        | 1               | -               | -               | -               | -               |               |
| <b>Operating Income</b>                    | <b>\$462</b>    | <b>\$314</b>    | <b>\$430</b>    | <b>\$427</b>    | <b>\$493</b>    | <b>1.7%</b>   |
| Investment Results                         |                 |                 |                 |                 |                 |               |
| Net Assets of BCBSA Acquired               |                 |                 |                 |                 |                 |               |
| Other Expense                              |                 |                 |                 |                 |                 |               |
| Equity Income of Subs/Affiliates           |                 |                 |                 |                 |                 |               |
| Income Before Income Tax                   | \$546           | \$234           | \$497           | \$513           | \$583           | 1.7%          |
| Income Tax Provision (Benefit)             | 134             | 128             | 163             | 177             | 193             |               |
| <b>Net Income</b>                          | <b>\$413</b>    | <b>\$106</b>    | <b>\$334</b>    | <b>\$336</b>    | <b>\$390</b>    | <b>(1.3%)</b> |
| <b>Operating Margin %</b>                  | <b>3.1%</b>     | <b>2.0%</b>     | <b>2.6%</b>     | <b>2.6%</b>     | <b>2.8%</b>     |               |
| <b>Net Income (Loss) as a % of Revenue</b> | <b>2.8%</b>     | <b>0.7%</b>     | <b>2.0%</b>     | <b>2.0%</b>     | <b>2.2%</b>     |               |

| Key Balance Sheet Items     | 2012E   | 2013E   | 2014E   | 2015E   | 2016E   | 2012E - 2016E Δ |
|-----------------------------|---------|---------|---------|---------|---------|-----------------|
| Cash and Investments        | \$6,854 | \$7,226 | \$7,458 | \$7,252 | \$7,659 | \$805           |
| Property and Equipment, net | 626     | 557     | 626     | 573     | 553     | (72)            |
| Debt                        | 1,118   | 1,322   | 1,254   | 599     | 599     | (519)           |
| Reserves                    | 5,444   | 5,444   | 5,763   | 6,090   | 6,464   | 1,020           |
| RBC                         |         |         |         |         |         |                 |

**"No Transaction" Case**

(Assumes UPMC is In-Network in January 2015)

(\$ in millions)

| Highmark Inc. Income Statement             | 2012E           | 2013E           | 2014E           | 2015E           | 2016E           | CAGR           |
|--|-----------------|-----------------|-----------------|-----------------|-----------------|----------------|
| Subscription Revenue                       |                 |                 |                 |                 |                 |                |
| Net Patient Service Revenue                |                 |                 |                 |                 |                 |                |
| Management Services Revenue                |                 |                 |                 |                 |                 |                |
| Other Operating Revenue                    |                 |                 |                 |                 |                 |                |
| <b>Total Operating Revenue</b>             | <b>\$14,866</b> | <b>\$15,503</b> | <b>\$16,316</b> | <b>\$15,889</b> | <b>\$15,830</b> | <b>1.6%</b>    |
| Claims Expense                             |                 |                 |                 |                 |                 |                |
| Operating Expense                          |                 |                 |                 |                 |                 |                |
| <b>Total Operating Expense</b>             | <b>\$14,405</b> | <b>\$15,185</b> | <b>\$15,915</b> | <b>\$15,514</b> | <b>\$15,476</b> | <b>1.8%</b>    |
| Plus: Change in PDR                        | 1               | -               | -               | -               | -               |                |
| <b>Operating Income</b>                    | <b>\$462</b>    | <b>\$318</b>    | <b>\$401</b>    | <b>\$375</b>    | <b>\$354</b>    | <b>(6.4%)</b>  |
| Investment Results                         |                 |                 |                 |                 |                 |                |
| Net Assets of BCBSA Acquired               |                 |                 |                 |                 |                 |                |
| Other Expense                              |                 |                 |                 |                 |                 |                |
| Equity Income of Subs/Affiliates           |                 |                 |                 |                 |                 |                |
| Income Before Income Tax                   | \$546           | \$38            | \$431           | \$427           | \$419           | (6.4%)         |
| Income Tax Provision (Benefit)             | 134             | 134             | 196             | 213             | 209             |                |
| <b>Net Income</b>                          | <b>\$413</b>    | <b>(\$96)</b>   | <b>\$235</b>    | <b>\$214</b>    | <b>\$210</b>    | <b>(15.5%)</b> |
| <b>Operating Margin %</b>                  | <b>3.1%</b>     | <b>2.1%</b>     | <b>2.5%</b>     | <b>2.4%</b>     | <b>2.7%</b>     |                |
| <b>Net Income (Loss) as a % of Revenue</b> | <b>2.8%</b>     | <b>(0.6%)</b>   | <b>1.4%</b>     | <b>1.3%</b>     | <b>1.3%</b>     |                |

| Key Balance Sheet Items     | 2012E   | 2013E   | 2014E   | 2015E   | 2016E   | 2012E - 2016E Δ |
|-----------------------------|---------|---------|---------|---------|---------|-----------------|
| Cash and Investments        | \$6,854 | \$6,415 | \$6,620 | \$6,851 | \$6,956 | \$102           |
| Property and Equipment, net | 626     | 557     | 529     | 483     | 470     | (156)           |
| Debt                        | 1,118   | 722     | 654     | 599     | 599     | (518)           |
| Reserves                    | 5,444   | 5,242   | 5,462   | 5,667   | 5,861   | 418             |
| RBC                         |         |         |         |         |         |                 |

Source: Highmark projections.

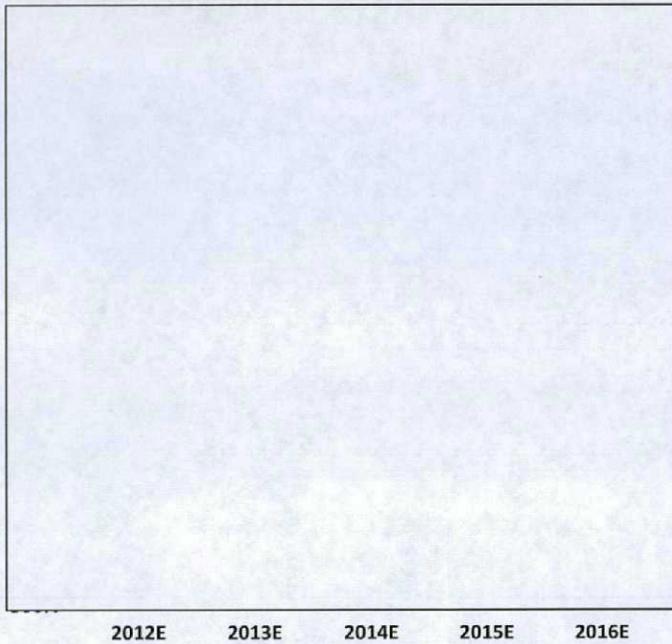


B. "No Transaction" Scenario

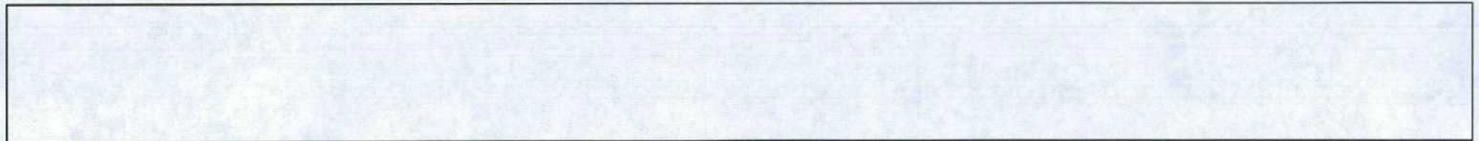
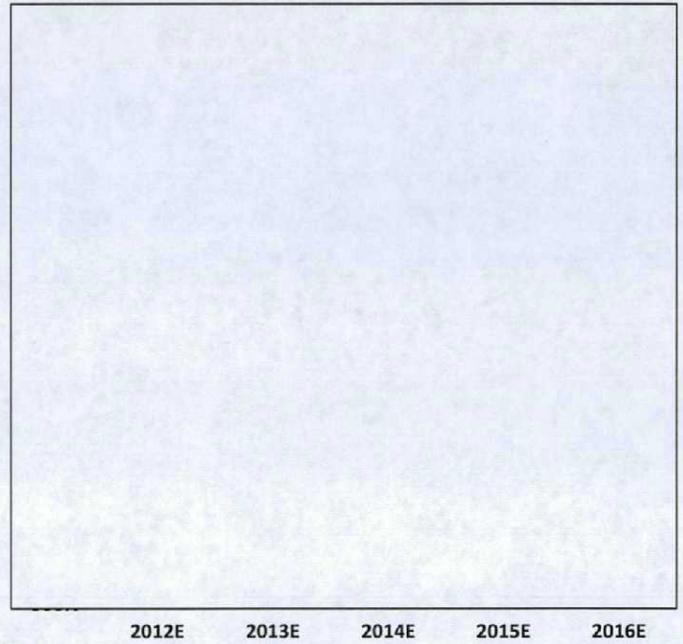
**Transaction Impact on Highmark's RBC**

Highmark has projected that its RBC would be in the [ ]% - [ ]% range if the Transaction is not consummated, versus in the [ ]% - [ ]% range if the Transaction is consummated.

**Highmark's RBC in Transaction Case**



**Highmark's RBC in "No Transaction" Case**



Source: Highmark financial projections.



## B. "No Transaction" Scenario

### Transaction Impact on Highmark's Credit Profile

Highmark's estimated impact of a "No Transaction" scenario on Highmark's credit profile is shown below.

#### Highmark's Credit Profile in Transaction Case

(\$ in millions)

| Key Credit Metrics   | Moody's Guidelines <sup>(1)</sup> |           |           | Transaction Case |       |       |       |       |
|--|-----------------------------------|-----------|-----------|------------------|-------|-------|-------|-------|
|  | A                                 | Baa       | Ba        | 2012E            | 2013E | 2014E | 2015E | 2016E |
| Goodwill and Intangible Assets as a % of Equity <sup>(2)</sup> | 25%-35%                           | 35%-50%   | 50%-80%   | 16.6%            | 15.4% | 14.5% | 13.6% | 12.8% |
| EBITDA Margin (3 year weighted average) <sup>(3)(4)</sup>      | 8%-5%                             | 5%-3%     | 3%-1%     | 3.7%             | 3.3%  | 3.3%  | 3.1%  | 3.4%  |
| Adjusted Debt to Capital <sup>(5)</sup>                        | 30%-40%                           | 40%-50%   | 50%-65%   | 17.0%            | 19.5% | 17.9% | 9.0%  | 8.5%  |
| Adjusted Debt to EBITDA <sup>(6)</sup>                         | 1.0x-1.5x                         | 1.5x-2.5x | 2.5x-3.5x | 2.0x             | 3.1x  | 2.3x  | 1.1x  | 1.0x  |

#### Highmark's Credit Profile in "No Transaction" Case

(\$ in millions)

| Key Credit Metrics   | Moody's Guidelines <sup>(1)</sup> |           |           | "No Transaction" Case |       |       |       |       |
|--|-----------------------------------|-----------|-----------|-----------------------|-------|-------|-------|-------|
|  | A                                 | Baa       | Ba        | 2012E                 | 2013E | 2014E | 2015E | 2016E |
| Goodwill and Intangible Assets as a % of Equity <sup>(2)</sup> | 25%-35%                           | 35%-50%   | 50%-80%   | 16.6%                 | 16.0% | 15.3% | 14.6% | 14.1% |
| EBITDA Margin (3 year weighted average) <sup>(3)(4)</sup>      | 8%-5%                             | 5%-3%     | 3%-1%     | 3.7%                  | 3.3%  | 3.3%  | 3.0%  | 3.1%  |
| Adjusted Debt to Capital <sup>(5)</sup>                        | 30%-40%                           | 40%-50%   | 50%-65%   | 17.0%                 | 12.1% | 10.7% | 9.6%  | 9.3%  |
| Adjusted Debt to EBITDA <sup>(6)</sup>                         | 1.0x-1.5x                         | 1.5x-2.5x | 2.5x-3.5x | 2.0x                  | 1.7x  | 1.3x  | 1.2x  | 1.3x  |

Source: Highmark projections and Moody's Rating Methodology for U.S. Health Insurance Companies, May 2011.

(1) Per Moody's Rating Methodology for U.S. Health Insurance Companies, May 2011.

(2) For Highmark, calculated as (Goodwill and Other Intangibles, Net) / (GAAP Total Reserves).

(3) For Highmark, calculated as 3-year average EBITDA margin per 2009 – 2011 GAAP Audit Reports.

(4) Assumes Depreciation & Amortization to be 0.72% of Total Operating Revenue in 2012E – 2016E, consistent with the average ratio for 2010A – 2011A per GAAP Audit Reports.

(5) For Highmark, calculated as Debt / (Debt plus GAAP Total Reserves).

(6) For Highmark, calculated as Debt / EBITDA, assuming Depreciation & Amortization to be 0.72% of Total Operating Revenue in 2012E – 2016E, consistent with the average ratio for 2010A – 2011A per GAAP Audit Reports.

**C. Projected Financial Impact on WPAHS**



C. Projected Financial Impact on WPAHS  
**Historical Balance Sheet and Income Statement**

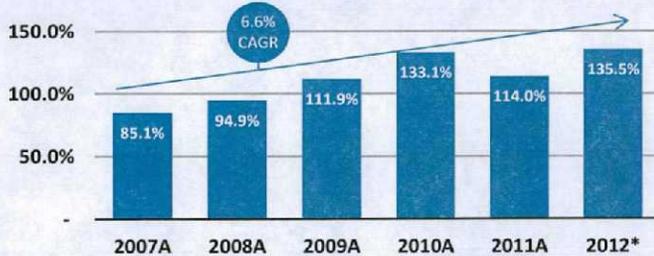
**WPAHS' historical financial statements indicate significant and consistent financial difficulties since 2007.**

**WPAHS' Historical Balance Sheet**  
 (\$ in millions)

|   | Year Ended June 30, |                |
|---|---------------------|----------------|
|   | 2007A               | 2012*          |
| Cash, Cash Equivalents and Short-term Investments | \$84                | 199            |
| Property and Equipment, Net                       | 579                 | 394            |
| Other Assets <sup>(1)</sup>                       | 717                 | 675            |
| <b>Total Assets</b>                               | <b>\$1,380</b>      | <b>\$1,268</b> |
| Long-Term Debt                                    | 833                 | 895            |
| Accrued Pension Obligation                        | 129                 | 279            |
| Other Liabilities <sup>(2)</sup>                  | 272                 | 329            |
| <b>Total Liabilities</b>                          | <b>\$1,234</b>      | <b>\$1,503</b> |
| <b>Total Net Assets / (Deficit)</b>               | <b>\$146</b>        | <b>(\$235)</b> |
| <b>Total Liabilities and Reserves</b>             | <b>\$1,380</b>      | <b>\$1,768</b> |

Note: Pension "Obligation in Excess of Assets" was \$279 million as of 6/30/2012.\*

**WPAHS Debt / Total Capitalization<sup>(4)</sup> 2007 – 2012**



Source: WPAHS.

\*Per WPAHS 2012 Unaudited Financial Statements, which can be found at: [http://www.wpahs.org/sites/default/files/file/FY2012\\_annual.pdf](http://www.wpahs.org/sites/default/files/file/FY2012_annual.pdf).

(1) "Other Assets" includes Net Patient Accounts Receivable, Other Receivables, Inventory, Assets Limited or Restricted as to Use, Other Current Assets and Other Non-Current Assets.

(2) "Other Liabilities" includes Accounts Payable, Other Current Liabilities and Other Non-Current Liabilities.

(3) Net of "Provision for Bad Debts."

(4) Total Capitalization is calculated as the sum of Long-Term Debt and Total Net Assets / (Deficit).

**WPAHS' Historical Income Statement**  
 (\$ in millions)

|   | Year Ended June 30, |                |
|---|---------------------|----------------|
|   | 2007A               | 2012*          |
| <b>Total Unrestricted Revenues, Gains and Other Support<sup>(3)</sup></b> | <b>1,444</b>        | <b>1,478</b>   |
| Salaries, Wages and Fringe Benefits                                       | 827                 | 866            |
| Other Operating Expenses  | 634                 | 724            |
| <b>Total Expenses</b>   | <b>1,461</b>        | <b>1,591</b>   |
| <b>Operating Income</b>   | <b>(\$17)</b>       | <b>(\$113)</b> |
| <b>(Deficiency)/Excess of Revenues over Expenses</b>                      | <b>(\$79)</b>       | <b>(\$38)</b>  |
| Operating Margin  | (1.2%)              | (7.6%)         |
| Excess Margin   | (5.5%)              | (2.6%)         |
| Bad Debt as a Percentage of Net Patient Revenue                           | (3.1%)              | (5.5%)         |

Includes Highmark Unrestricted Payments of \$58 million in FY2012

**WPAHS Revenue<sup>(3)</sup> and Operating Income 2007 – 2012**





C. Projected Financial Impact on WPAHS  
**Overview of WPAHS Debt**

**As of June 30, 2012, WPAHS had \$894.7 million of total debt.**

**Descriptions of WPAHS Debt Tranches**

- 1 Allegheny County Hospital Development Authority (ACHDA) Series 2007 A Bonds**
  - ▶ Maturity: Through November 15, 2040
  - ▶ Interest Rate: Ranges from 5.000% to 5.375%, including a net unamortized premium of \$4,605 at June 30, 2012
- 2 Floating Rate Restructuring Certificates (FRRC)**
  - ▶ Payable based on attainment of defined income and cash levels
  - ▶ Maturity: June 30, 2030
  - ▶ Interest Rate: 3-month LIBOR plus 0.25%
- 3 Series 2006 B Health Facilities Revenue Notes**
  - ▶ Payable in monthly interest and principal payments
  - ▶ Maturity: October 1, 2015
  - ▶ Interest Rate: Ranges from 4.55% to 4.61%
- 4 Series 2006 A Health Facilities Revenue Notes**
  - ▶ Payable in monthly interest and principal payments
  - ▶ Maturity: December 1, 2016
  - ▶ Interest Rate: 5.25%
- 5 Highmark Notes Payable**
  - ▶ Payable in two \$50,000 payments with interest payable semi-annually
  - ▶ Maturity: Due in 2023 and 2024
  - ▶ Interest Rate: Prime rate plus 2.00% (5.25% at June 30, 2012)
- 6 Equipment Notes**
  - ▶ Payable in monthly interest and principal payments
  - ▶ Maturity: June 1, 2016
  - ▶ Interest Rate: Ranges from 7.00% to 7.55%
- 7 Mortgage Loan**
  - ▶ Maturity: Through 2026
  - ▶ Interest Rate: Ranges from 5.12% to 7.55%

**Overview of WPAHS Debt (as of 6/30/2012)<sup>(1)</sup>**

| (\$ in thousands)   |                  |
|---|------------------|
| Tranche   | Principal        |
| 1 Allegheny County Hospital Development Authority (ACHDA) Series 2007 A Bonds | \$725,775        |
| 2 Floating Rate Restructuring Certificates (FRRC)                             | 37,084           |
| 3 Series 2006 B Health Facilities Revenue Notes                               | 18,450           |
| 4 Series 2006 A Health Facilities Revenue Notes                               | 1,811            |
| 5 Highmark Notes Payable  | 100,000          |
| 6 Equipment Notes   | 8,516            |
| 7 Mortgage Loan   | 3,066            |
| <b>Total WPAHS Debt</b>   | <b>\$894,702</b> |

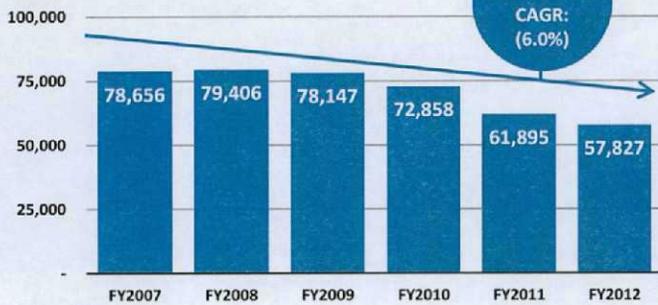
Source: WPAHS 2012 Unaudited Financial Statements, which can be found at: [http://www.wpahs.org/sites/default/files/file/FY2012\\_annual.pdf](http://www.wpahs.org/sites/default/files/file/FY2012_annual.pdf).  
 (1) Per WPAHS Notes to Consolidated Financial Statements in WPAHS 2012 Unaudited Financial Statements.



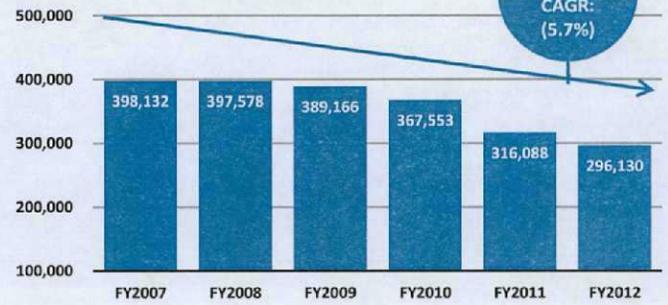
C. Projected Financial Impact on WPAHS  
**Key Historical WPAHS Operating Trends**

**WPAHS historical operating metrics shown below convey deteriorating performance since 2007.**

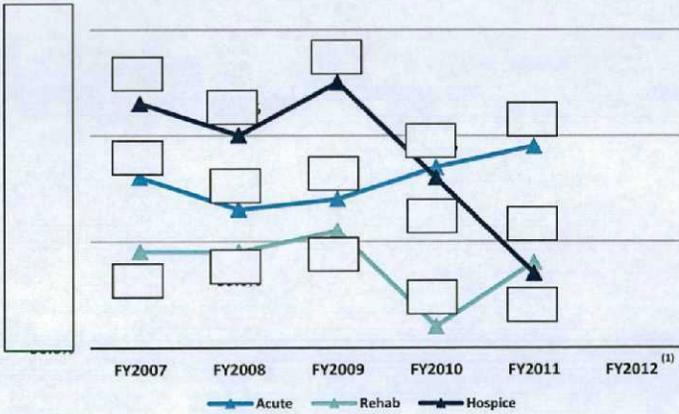
**Inpatient Discharges**



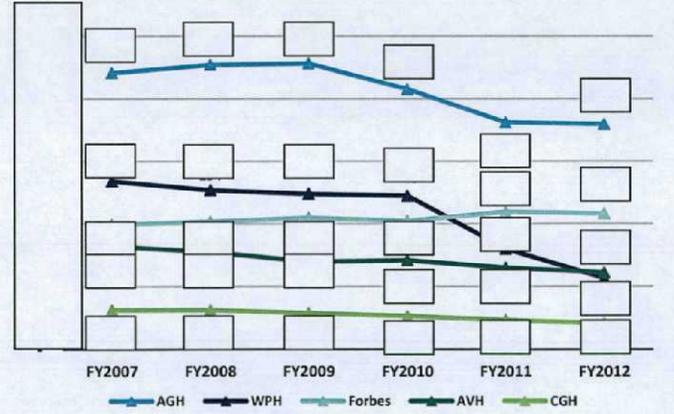
**Acute Care Patient Days**



**Historical Occupancy Rates**



**Average Daily Census**



Source: [redacted] WPAHS.  
 (1) 2012 Not Available.



C. Projected Financial Impact on WPAHS  
**Summary of WPAHS Credit Ratings**

**WPAHS is presently rated by Moody's Investor Service (or "Moody's"), Standard & Poor's (or "S&P"), and Fitch Ratings (or "Fitch"). Following is an abbreviated summary of these credit rating agency's recent evaluations of WPAHS.**

**MOODY'S**  
 INVESTORS SERVICE

**STANDARD**  
 &**POOR'S**

**Fitch**  
 Ratings

| Past   |   | Most Recent  |   |
|--|---|--|---|
| <p><b>2/3/2011</b> – Moody's downgrades bond rating on WPAHS' outstanding bonds to B2 from B1 and affirms its negative outlook, citing accelerating volume declines, weaker than expected operating performance, and risks and costs associated with the operational restructuring</p>   | <p><b>11/22/2011</b> – Moody's downgrades WPAHS' bond rating to Caa1 from B2 and affirms its negative outlook, citing the severity of WPAHS' financial status and the notion that without the financial support of Highmark (Baa2/stable), WPAHS would have been forced to restructure earlier in the year, which may have resulted in a bond payment default</p> | <p><b>9/28/2012</b> – Moody's places WPAHS' Caa1 bond rating under review for possible downgrade following announcement of termination of agreement with Highmark</p>  | <p><b>11/13/2012</b> – Moody's downgrades WPAHS' bond rating from Caa1 to Ca; Outlook remains negative, reflecting the severity of WPAHS' financial status and likelihood of a restructuring or bankruptcy filing</p>   |
| <p><b>11/15/2011</b> – S&amp;P affirms 'B+' bond rating of WPAHS' pending approval of Highmark Inc. Transaction; a positive outlook is likely once the parties receive all approvals and the Affiliation Agreement is consummated with evidence that Highmark's strategies have resulted in improved finances and stabilized volume at WPAHS</p> | <p><b>5/21/2012</b> – S&amp;P downgrades WPAHS' bond rating to 'B-' from 'B+', citing deterioration in WPAHS's overall finances</p>   | <p><b>9/28/2012</b> – S&amp;P places WPAHS' 'B-' rating on CreditWatch Negative</p>  | <p><b>12/4/2012</b> – S&amp;P lowers WPAHS' credit rating from 'B-' to 'CC', citing weak financial condition, likelihood of bankruptcy / restructuring and deterioration of affiliation with Highmark</p>   |
| <p><b>6/29/2011</b> – Fitch places WPAHS 'BB-' bonds on Rating Watch Evolving, indicating that the rating may be raised, lowered or affirmed, citing the announcement of a potential acquisition by Highmark Inc.</p>  | <p><b>12/23/2011</b> – Fitch downgrades WPAHS bonds to 'B+' from 'BB-' with an evolving outlook, citing the significant deterioration in operating performance in fiscal 2011 and first quarter of 2012, primarily driven by a drop in volume and physician losses</p>  | <p><b>10/25/2012</b> – Fitch downgrades WPAHS to 'CCC' from 'B+', reflecting the likelihood of debt restructuring, coupled with heightened uncertainty about the progress of WPAHS's affiliation with Highmark</p> | <p><b>1/11/2013</b> – Fitch downgrades WPAHS from 'CCC' to 'C', citing that a negotiated debt restructuring appears to be inevitable to forestall insolvency, given WPAHS's financial deterioration and the failure of WPAHS and Highmark to complete the proposed merger</p> |

Source: Moody's, S&P, Fitch Ratings, and Factiva.



### C. Projected Financial Impact on WPAHS

#### Context of WPAHS Financial Projections

**The current financial projections for WPAHS were developed by Highmark with the assistance of an external accounting and consulting firm and in consultation with WPAHS.**

#### Context Regarding WPAHS's Financial Projections

- ▶ Highmark engaged A&M in February of 2010 to conduct a high-level assessment of WPAHS (or "the System")
- ▶ In conjunction with this engagement, A&M developed a prototype turnaround plan for WPAHS, which included financial projections
  - These projections were developed without sanctioned input from WPAHS as the projections were developed prior to the signing of the Affiliation Agreement
- ▶ A&M professionals were instituted as interim senior management in WPAHS November 2011
- ▶ Highmark later engaged an additional external accounting and consulting firm in May of 2012 to assist in developing WPAHS financial projections that were reflective of evolving market conditions and to replace the previously developed A&M projections
  - Highmark had limited access to WPAHS interim senior management team for development of the projections filed with the PID in July 2012
- ▶ Highmark issued updated financial projections in January 2013 (Highmark's "Base Case" projections)
- ▶ WPAHS has declined requests from Blackstone to comment on the reasonableness of Highmark's Base Case projections. Accordingly, WPAHS has expressed no opinion regarding the projections prepared by Highmark

**2/10/2011:** A&M engaged by Highmark to conduct WPAHS assessment

**11/4/2011:** A&M publishes WPAHS turnaround plan

**5/4/2012:** External firm engaged by Highmark to assist in preparation of WPAHS financial projections

**7/1/2012:** Highmark completed updated WPAHS financial projections

**1/16/2013:** Highmark completed revised updated WPAHS financial projections

2011

2012

2013



### C. Projected Financial Impact on WPAHS

#### WPAHS Bond Tender Transaction

**Highmark has committed to provide \$300 million of secured loans to WPAHS, and also plans to initiate a tender offer for WPAHS' 2007A bonds.**

- ▶ The \$300 million in secured loans to WPAHS represent 50% of the second funding commitments and 100% of the third, fourth and fifth funding commitments
- ▶ \$709.7 million of the principal value of the 2007A bonds remain an obligation of WPAHS
  - At issuance, WPAHS received \$752.4 million in proceeds
  - The bonds bear an average coupon of 5.25% and require an average annual debt service of ~\$48 million
- ▶ Highmark will purchase the bonds at a discounted price of \$0.875 per \$1.00 for all bonds tendered
  - Highmark estimates that ~80% of the outstanding bonds will be tendered and the bonds will be carried on Highmark's balance sheet at a value of \$496 million
- ▶ Highmark will borrow the funds necessary to purchase the bonds
  - Highmark will pledge, as collateral for this loan, its own cash, cash equivalents and marketable securities
- ▶ Highmark has agreed to defer interest and principal payments from WPAHS on the tendered bonds through July 2015
  - WPAHS will be provided with covenant relief on the tendered securities
- ▶ Highmark projects that WPAHS will complete a tax-exempt bond offering in July 2015 in order to buy back the bonds from Highmark

#### Total Affiliation-Related WPAHS Debt (*\$ in millions*)

| Type of Debt  | Amount         |
|---|----------------|
| 50% of 2nd Funding - Loan (10/31/2011)                | \$50.0         |
| 3rd Funding - Loan (4/27/2012)                        | 50.0           |
| 4th Funding - Loan (At Close, on or before 4/30/2013) | 100.0          |
| 5th Funding - Loan (Later of Close or 4/1/2014)       | 100.0          |
| <b>Total WPAHS Loans</b>                              | <b>\$300.0</b> |
| <u>Tender Offer Assumptions</u>                       |                |
| Principal Outstanding                                 | \$709.7        |
| Percentage of Bondholders that Tender                 | 76.7%          |
| Discount to Par on Tendered Bonds                     | 12.5%          |
| Amount Paid to Tendering Bondholders                  | \$476.5        |
| Percentage of Bondholders that do not Tender          | 23.3%          |
| Discount to Par on Non-Tendered Bonds                 | -              |
| Amount Paid to Non-Tendering Bondholders              | \$165.1        |
| Accrued Interest Paid to Bondholders                  | \$4.8          |
| <b>Total Amount Paid to Bondholders</b>               | <b>\$646.4</b> |
| <b>Total Affiliation-Related WPAHS Debt</b>           | <b>\$946.4</b> |

Source: Highmark and H2C.



C. Projected Financial Impact on WPAHS

**Highmark Base Case Projected WPAHS Income Statement**

Highmark developed financial projections for WPAHS for the period 2013 – 2017 as presented below (i.e. the “Base Case” projections for WPAHS).

**WPAHS Projection Approach**

- ▶ The projections at right were based on historical WPAHS operational and financial results, management’s ongoing and planned initiatives, initiatives being undertaken by Highmark to improve financial performance and reflect the proposed tender offer for the 2007A bonds
- ▶ Revenue was forecasted based on inpatient, outpatient and professional fee net revenue
  - Inpatient net revenue was calculated as a product of forecasted inpatient discharges and net revenue per case on a facility-by-facility
  - Outpatient net revenue was calculated as a product of forecasted outpatient registrations and net revenue per case on a facility-by-facility basis
- ▶ Operating expenses were forecasted using an assumed amount of fixed cost and variable cost comprising each operating expense category
  - Fixed costs were projected to increase based on estimated inflation factors
  - Variable costs were projected based on a derivative of patient volume and increased by an estimated inflation factor

| (\$ in millions)                           | Projected Income Statement |                  |                  |                  |                  |
|--|----------------------------|------------------|------------------|------------------|------------------|
|  | FY2013E                    | FY2014E          | FY2015E          | FY2016E          | FY2017E          |
| Inpatient Net Revenue                      |                            |                  |                  |                  |                  |
| Outpatient Net Revenue                     |                            |                  |                  |                  |                  |
| Professional Fee Net Revenue               |                            |                  |                  |                  |                  |
| <b>Total Net Patient Revenue</b>           | <b>\$1,559</b>             | <b>\$1,757</b>   | <b>\$2,050</b>   | <b>\$2,273</b>   | <b>\$2,356</b>   |
| Provision for Bad Debts                    |                            |                  |                  |                  |                  |
| Other Operating Revenue                    |                            |                  |                  |                  |                  |
| Net Assets Released from Restrictions      |                            |                  |                  |                  |                  |
| <b>Total Revenue and Gains</b>             | <b>\$1,548</b>             | <b>\$1,736</b>   | <b>\$2,015</b>   | <b>\$2,227</b>   | <b>\$2,309</b>   |
| Salaries, Wages, and Fringe Benefits       |                            |                  |                  |                  |                  |
| Professional Fees & Purchased Services     |                            |                  |                  |                  |                  |
| System Wide Services                       |                            |                  |                  |                  |                  |
| Supplies & Drugs                           |                            |                  |                  |                  |                  |
| General and Administrative                 |                            |                  |                  |                  |                  |
| Depreciation & Amortization                |                            |                  |                  |                  |                  |
| Interest Expense                           |                            |                  |                  |                  |                  |
| Restructuring                              |                            |                  |                  |                  |                  |
| <b>Total Operating Expense</b>             | <b>(\$1,657)</b>           | <b>(\$1,774)</b> | <b>(\$1,957)</b> | <b>(\$2,123)</b> | <b>(\$2,216)</b> |
| Impairment Loss                            |                            |                  |                  |                  |                  |
| Operating Income / (Loss)                  |                            |                  |                  |                  |                  |
| (+) Depreciation & Amortization            |                            |                  |                  |                  |                  |
| (+) Interest Expense                       |                            |                  |                  |                  |                  |
| <b>EBIDA</b>                               | <b>\$3</b>                 | <b>\$83</b>      | <b>\$192</b>     | <b>\$265</b>     | <b>\$271</b>     |
| Investment Income                          |                            |                  |                  |                  |                  |
| Gifts & Donations                          |                            |                  |                  |                  |                  |
| Highmark Unrestricted Payments             |                            |                  |                  |                  |                  |
| Other Gain / (Loss)                        |                            |                  |                  |                  |                  |
| <b>Net Income</b>                          | <b>(\$97)</b>              | <b>(\$26)</b>    | <b>\$72</b>      | <b>\$181</b>     | <b>\$111</b>     |
| <b>Selected Operational Metrics</b>        |                            |                  |                  |                  |                  |
| EBIDA Margin                               | 0.2%                       | 4.8%             | 9.5%             | 11.9%            | 11.8%            |
| Operating Margin                           | (7.0%)                     | (2.2%)           | 2.9%             | 4.7%             | 4.0%             |
| Net Income Margin                          | (6.3%)                     | (1.5%)           | 3.6%             | 8.1%             | 4.8%             |
| Bad Debt as % of Net Patient Revenue       | 5.5%                       | 5.5%             | 5.5%             | 5.4%             | 5.4%             |
| Salaries/Benefits as % of Net Patient Rev. | 60.0%                      | 56.6%            | 52.1%            | 49.7%            | 49.1%            |

Source: Highmark financial projections for WPAHS as of 1/16/2013.



C. Projected Financial Impact on WPAHS  
**Highmark Base Case Projected WPAHS Balance Sheet**

Highmark's Base Case projected WPAHS balance sheet is shown below.

| (\$ in millions)   | Projected Balance Sheet |         |         |         |         |
|--|-------------------------|---------|---------|---------|---------|
|  | FY2013E                 | FY2014E | FY2015E | FY2016E | FY2017E |
| <b>Assets</b>  |                         |         |         |         |         |
| Cash, Cash Equivalents and Short Term Investments <sup>(1)</sup> |                         |         |         |         |         |
| Due (to) from Restricted Funds                                   |                         |         |         |         |         |
| Current Debt Service Funds                                       |                         |         |         |         |         |
| Receivables  |                         |         |         |         |         |
| Inventories  |                         |         |         |         |         |
| Prepaid Expenses & Other Current Assets                          |                         |         |         |         |         |
| <b>Total Current Assets</b>                                      |                         |         |         |         |         |
| Board Designated Funds   |                         |         |         |         |         |
| Other Assets Restricted As to Use                                |                         |         |         |         |         |
| <b>Assets Restricted As to Use</b>                               |                         |         |         |         |         |
| PPE, Net   |                         |         |         |         |         |
| Other Assets, Net  |                         |         |         |         |         |
| <b>Long Term Assets</b>  |                         |         |         |         |         |
| <b>Total Assets</b>  | \$1,298                 | \$1,376 | \$1,502 | \$1,613 | \$1,719 |
| <b>Liabilities &amp; Net Assets</b>                              |                         |         |         |         |         |
| Accounts Payable   |                         |         |         |         |         |
| Accrued Expenses   |                         |         |         |         |         |
| Due to (from) Affiliates, Net                                    |                         |         |         |         |         |
| <b>Total Current Liabs (excl CP's of LT Liabs)</b>               |                         |         |         |         |         |
| Long-term Debt   |                         |         |         |         |         |
| Deferred Revenue   |                         |         |         |         |         |
| Self Insurance Liabilities                                       |                         |         |         |         |         |
| Accrued Pension Obligation                                       |                         |         |         |         |         |
| Other Noncurrent Liabilities                                     |                         |         |         |         |         |
| <b>Total Liabilities</b>   | \$1,541                 | \$1,645 | \$1,698 | \$1,628 | \$1,624 |
| <b>Total Net Assets (Deficit)</b>                                | (\$243)                 | (\$268) | (\$197) | (\$16)  | \$95    |
| <b>Total Liabilities and &amp; Net Assets</b>                    | \$1,298                 | \$1,376 | \$1,502 | \$1,613 | \$1,719 |
| <b>Selected Operational Metrics</b>                              |                         |         |         |         |         |
| Accounts Receivable (Days)                                       | 32.8                    | 26.5    | 27.7    | 26.7    | 26.6    |
| Average Payment Period (Days)                                    | 26.4                    | 26.6    | 29.2    | 28.9    | 29.2    |
| Cushion Ratio <sup>(2)(3)</sup>                                  | 5.2x                    | 5.4x    | 6.1x    | 5.6x    | 7.9x    |
| Cash-to-Debt   | 30.1%                   | 26.8%   | 34.4%   | 41.1%   | 51.2%   |
| Debt-to-Capitalization   | 132.9%                  | 132.2%  | 121.3%  | 101.6%  | 91.5%   |
| Debt-to-Total Revenue  | 63.3%                   | 63.5%   | 55.6%   | 46.6%   | 44.3%   |

Source: Highmark projections for WPAHS as of 1/16/2013.

- (1) Includes "Short Term Investments," while "Cash and Cash Equivalents" on pages 68, 70 and 82 do not include "Short Term Investments."
- (2) "Cushion Ratio" is defined by Moody's as "Unrestricted Cash and Investments as a % of Estimated Future Peak Debt Service."
- (3) "Future Peak Debt Service" assumed to be equal to annual debt service requirements per Highmark's projections.



### C. Projected Financial Impact on WPAHS

#### Highmark Base Case Impact on WPAHS' Credit Metrics

**Moody's and S&P publish operating and financial median metrics for not-for-profit hospital systems; these metrics provide an indication of the potential impact the Transaction may have on WPAHS' credit profile, on the basis of Highmark's Base Case financial projections for WPAHS.**

#### Comparison of WPAHS to Moody's and S&P Guidelines

| Category   | Moody's Median<br>for Baa-rated Not-<br>for-Profit<br>Hospitals <sup>(1)(3)</sup> | S&P's Median for<br>A-rated Not-for-<br>Profit Healthcare<br>Systems <sup>(2)(3)</sup> | WPAHS: FY2013E - FY2017E |         |         |         |         |
|--|---|--|--------------------------|---------|---------|---------|---------|
|  |   |  | FY2013E                  | FY2014E | FY2015E | FY2016E | FY2017E |
| Operating Margin   | 1.0%  | 2.5%   | (7.0%)                   | (2.2%)  | 2.9%    | 4.7%    | 4.0%    |
| Excess Margin  | 3.3%  | 3.7%   | (6.3%)                   | (1.5%)  | 3.6%    | 8.1%    | 4.8%    |
| Operating Cash Flow Margin / EBITDA Margin                 | 7.5%  | 10.7%  | 0.2%                     | 4.8%    | 9.5%    | 11.9%   | 11.8%   |
| Bad Debt Expense as a % of Net Patient Revenue             | 6.1%  | 5.4%   | 5.5%                     | 5.5%    | 5.5%    | 5.4%    | 5.4%    |
| Salaries & Benefits as a % of Net Patient Revenue          | NA  | 53.3%  | 60.0%                    | 56.6%   | 52.1%   | 49.7%   | 49.1%   |
| Capital Expenditures as a % of Depreciation & Amortization | 90.0%   | 128.3%   | 126.9%                   | 204.5%  | 100.0%  | 100.0%  | 100.0%  |
| Cushion Ratio <sup>(4)(5)</sup>                            | 9.6x  | 14.1x  | 5.2x                     | 5.4x    | 6.1x    | 5.6x    | 7.9x    |
| Long Term Debt to Total Capitalization                     | 51.4%   | 43.4%  | 132.9%                   | 132.2%  | 121.3%  | 101.6%  | 91.5%   |
| Debt to Total Revenue                                      | 40.6%   | NA   | 63.3%                    | 63.5%   | 55.6%   | 46.6%   | 44.3%   |
| Maximum Annual Debt Service Coverage                       | 3.1x  | 3.6x   | 0.3x                     | 1.7x    | 3.2x    | 4.5x    | 4.3x    |
| Days Cash on Hand  | 116.6   | 157.8  | 81.6                     | 76.4    | 85.7    | 86.2    | 99.1    |

■ = Metric is worse than the lower of Moody's and S&P's medians

■ = Metric is better than one or both of Moody's and S&P's medians

► **Note: WPAHS metrics are compared to the median metrics for Highmark's current ratings**

Source: Highmark projections for WPAHS as of 1/16/2013; Moody's Report on U.S. Not-for-Profit Hospitals, August 30, 2011; and S&P's Report on U.S. Not-for-Profit Health Care Systems, August 2, 2011.

(1) Per Moody's Report on U.S. Not-for-Profit Hospitals, August 30, 2011.

(2) Per S&P's Report on U.S. Not-for-Profit Health Care Systems, August 2, 2011.

(3) Moody's and S&P median ratings selected for comparison to show WPAHS discrepancy relative to Highmark's credit rating.

(4) "Cushion Ratio" is defined by Moody's as "Unrestricted Cash and Investments as a % of Estimated Future Peak Debt Service" and is defined by S&P as "Cash as a % of Annual Debt Service."

(5) "Future Peak Debt Service" assumed to be equal to annual debt service requirements per Highmark's projections for WPAHS.



C. Projected Financial Impact on WPAHS

**Highmark Base Case Volume Projections for WPAHS**

**Patient volume is the key driver of WPAHS' projected financial performance. Highmark's Base Case patient volume projections for WPAHS, based on Highmark volume initiatives, are described below.**

- 1 Physician Alignment:** Highmark projects to affiliate with approximately  incremental physicians by June 30, 2015, each of whom is expected to generate an average of  discharges per year
- 2 Employed Physician Out-of-System Referral Practices:** WPAHS allows its employed physicians to admit patients to non-WPAHS facilities. As WPAHS' operations stabilize, Highmark projects aligned physicians to increase in-system referrals
- 3 Physician Organization:** The PO hired  (net) additional physicians since June 30, 2012. The number of physicians is assumed to remain constant thereafter. Highmark also projects opportunity for improvements in the volume of patients seen by physicians
- 4 Expiration of UPMC Provider Contract:** Projections assume the contract between Highmark and UPMC will expire on December 31, 2014. As a result, current Highmark members will no longer have in-network access to UPMC facilities and UPMC-employed physicians from January 2015 onward, leading to an increase in WPAHS utilization

**WPAHS Projected Volume by Category**

| Category  | FY            |               |               |               |               |               |               | 2015E % of Incremental Volume Above Baseline |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--|
|   | FY2011A       | FY2012A       | FY2013E       | FY2014E       | FY2015E       | FY2016E       | FY2017E       |  |
| Baseline Volume                                   | 61,486        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        |  |
| Adjustment to Actual                              | -             | -             | (1,032)       | -             | -             | -             | -             |  |
| Revised Baseline Volume                           | 61,486        | 56,644        | 55,611        | 56,644        | 56,644        | 56,644        | 56,644        |  |
| 1 Physician Alignment                             |               |               |               |               |               |               |               |  |
| 2 Employed Phys. Out-of-System Referral Practices |               |               |               |               |               |               |               |  |
| 3 Physician Organization                          |               |               |               |               |               |               |               |  |
| 4 Expiration of UPMC Provider Contract            |               |               |               |               |               |               |               |  |
| 5 New Highmark Products                           |               |               |               |               |               |               |               |  |
| 6 IDN Impact and Declining Population             |               |               |               |               |               |               |               |  |
| 7 UPMC East Hospital Opening                      |               |               |               |               |               |               |               |  |
| 8 West Penn Hospital Reopening                    |               |               |               |               |               |               |               |  |
| <b>Total WPAHS Volume (Post-Physician Impact)</b> | <b>61,486</b> | <b>57,455</b> | <b>58,928</b> | <b>68,274</b> | <b>80,297</b> | <b>88,304</b> | <b>89,624</b> | <b>100.0%</b>                                |

Source: Highmark projections for WPAHS as of 1/16/2013.



C. Projected Financial Impact on WPAHS

**Highmark Base Case Volume Projections for WPAHS (cont'd.)**

**5 New Highmark Products:** Highmark has created new products in an effort to reduce healthcare costs borne by its members. The Highmark Accountable Care Organization (“ACO”) and Community Blue Products were launched in 2012

**6 IDN Impact and Declining Population:** If the proposed Affiliation is approved, WPAHS and Highmark intend to strengthen initiatives to integrate the delivery of care. As a result, Highmark projects that there will be a reduction in inpatient admissions based on improved standards of practice. Further, Highmark projects a small decline in the market population

**7 UPMC East Hospital Opening:** On July 2, 2012, UPMC opened a new acute care hospital in close proximity to WPAHS’ Forbes Regional Hospital, a member of the WPAHS system

**8 West Penn Hospital Reopening:** In February of 2012, West Penn Hospital reopened its Emergency Department and plans to reopen its Cardiology services in 2013. Highmark forecasts that WPH’s volume levels will return to historical levels by

**WPAHS Projected Volume by Category**

| Category  | FY            |               |               |               |               |               |               | 2015E % of Incremental Volume Above Baseline |
|---|---------------|---------------|---------------|---------------|---------------|---------------|---------------|--|
|   | FY2011A       | FY2012A       | FY2013E       | FY2014E       | FY2015E       | FY2016E       | FY2017E       |  |
| Baseline Volume                                   | 61,486        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        |  |
| Adjustment to Actual                              | -             | -             | (1,032)       | -             | -             | -             | -             |  |
| Revised Baseline Volume                           | 61,486        | 56,644        | 55,611        | 56,644        | 56,644        | 56,644        | 56,644        |  |
| 1 Physician Alignment                             |               |               |               |               |               |               |               |  |
| 2 Employed Phys. Out-of-System Referral Practices |               |               |               |               |               |               |               |  |
| 3 Physician Organization                          |               |               |               |               |               |               |               |  |
| 4 Expiration of UPMC Provider Contract            |               |               |               |               |               |               |               |  |
| 5 New Highmark Products                           |               |               |               |               |               |               |               |  |
| 6 IDN Impact and Declining Population             |               |               |               |               |               |               |               |  |
| 7 UPMC East Hospital Opening                      |               |               |               |               |               |               |               |  |
| 8 West Penn Hospital Reopening                    |               |               |               |               |               |               |               |  |
| <b>Total WPAHS Volume (Post-Physician Impact)</b> | <b>61,486</b> | <b>57,455</b> | <b>58,928</b> | <b>68,274</b> | <b>80,297</b> | <b>88,304</b> | <b>89,624</b> | <b>100.0%</b>                                |

Source: Highmark projections for WPAHS as of 1/16/2013.



C. Projected Financial Impact on WPAHS

**Highmark Base Case WPAHS Volume Projection Vulnerabilities**

**Blackstone notes the following vulnerabilities with respect to Highmark's Base Case volume projections for WPAHS.**

**Volume Vulnerabilities by Category**

- 1 Physician Alignment:** The cost of achieving alignment with physicians may be greater than anticipated, and the number of discharges generated by each newly-employed physician may be less than anticipated
- 2 Employed Physician Out-of-System Referral Practices:** Mechanisms for altering referral patterns of WPAHS-aligned physicians lack specificity and may be hindered by cultural resistance within WPAHS
- 3 Physician Organization:** Plans for physician productivity improvement initiatives lack specificity and may encounter cultural resistance within WPAHS
- 4 Expiration of UPMC Provider Contract:** Highmark plans to continue seeking a contract extension with UPMC beyond 2014, which may result in materially reduced volumes at WPAHS
- 5 New Highmark Products:** Community Blue and ACO participation may fall below projections; Community Blue was previously marketed by Highmark without favorable results
- 6 IDN Impact and Declining Population:** The impact of declining population in the Western Pennsylvania region and the success of Highmark's plans to shift care to lower cost outpatient settings may be greater than Highmark anticipates
- 7 UPMC East Hospital Opening:** Limited data exists upon which to gauge the impact from the opening of UPMC East
- 8 West Penn Hospital Reopening:** Increased discharges from WPH may be uncertain given the numerous changes to service levels at the facility in recent years

**WPAHS Projected Volume by Category**

| Category   | FY2011A       | FY2012A       | FY2013E       | FY2014E       | FY2015E       | FY2016E       | FY2017E       |
|--|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Baseline Volume  | 61,486        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        | 56,644        |
| Adjustment to Actual                                     | -             | -             | (1,032)       | -             | -             | -             | -             |
| Revised Baseline Volume                                  | 61,486        | 56,644        | 55,611        | 56,644        | 56,644        | 56,644        | 56,644        |
| <b>1 Physician Alignment</b>                             |               |               |               |               |               |               |               |
| <b>2 Employed Phys. Out-of-System Referral Practices</b> |               |               |               |               |               |               |               |
| <b>3 Physician Organization</b>                          |               |               |               |               |               |               |               |
| <b>4 Expiration of UPMC Provider Contract</b>            |               |               |               |               |               |               |               |
| <b>5 New Highmark Products</b>                           |               |               |               |               |               |               |               |
| <b>6 IDN Impact and Declining Population</b>             |               |               |               |               |               |               |               |
| <b>7 UPMC East Hospital Opening</b>                      |               |               |               |               |               |               |               |
| <b>8 West Penn Hospital Reopening</b>                    |               |               |               |               |               |               |               |
| <b>Total WPAHS Volume (Post-Physician Impact)</b>        | <b>61,486</b> | <b>57,455</b> | <b>58,928</b> | <b>68,274</b> | <b>80,297</b> | <b>88,304</b> | <b>89,624</b> |

**In addition to the vulnerabilities noted at left, the following should also be considered:**

- ▶ Providers across the Western Pennsylvania region have noted declines in discharge volumes in late 2012 and early 2013 attributed to a potentially sustained shift from admissions to observation cases
- ▶ Cultural barriers to changes in physician behavior may be encountered at WPAHS, particularly given that the system has historically been viewed as having restrictions on referral practices
- ▶ WPAHS market share ceded to competitors may be difficult to regain, particularly in light of potential dynamic responses from competitors

Source: Highmark projections for WPAHS as of 1/16/2013.



### C. Projected Financial Impact on WPAHS

#### Ms. Guerin-Calvert's View of Highmark Base Case WPAHS Volume Assumptions

##### **Blackstone notes the below commentary from Ms. Guerin-Calvert of Compass Lexecon with respect to projected WPAHS patient volume.**

"With regard to volume projections and cost savings, the success of Highmark's affiliation with WPAHS depends critically on the ability of the IDN to attract large numbers of inpatients away from UPMC to WPAHS. I have reviewed the foundation and bases for the shifting of inpatient volume to WPAHS projected by Grant Thornton, with key inputs provided by Highmark. I find there is a great deal of uncertainty underlying many of the key assumptions supporting these projections and some appear to be unreasonable or lacking in credibility given market conditions. I point these out here because they materially affect the overall assessment:

- A critical factor in the IDN's success is the ability to develop incentive-based mechanisms that align physicians, hospitals, and the insurer to provide more efficient care locations for treating patients, and to guide patients to make better healthcare choices. Highmark has provided details of its Community Blue product (a limited network) that it markets as a lower cost plan to consumers. In my view, Highmark's Community Blue and ACA products have characteristics necessary to appeal to consumers. Whether consumers will switch in large numbers to adopt these more attractively priced, but narrower-choice products remains to be seen, and therefore, remain a source of great uncertainty in Highmark achieving its IDN savings.
- Highmark and its consultant, Grant Thornton, do not incorporate any dynamic response by competing hospitals to the projected loss of volume likely at their respective hospitals from UPE's IDN/WPAHS strategy. This materially affects the robustness and credibility of the WPAHS volume and financial projections. The projections also assume that any Highmark contract with UPMC would not include any prohibitions or limitations on consumer choice initiatives, such as anti-tiering and anti-steering provisions. This assumption is the driving force behind attaining incremental discharges as in the Without UPMC Affiliation scenario.
- If UPMC is out-of-network, Highmark assumes that 90% of utilization of UPMC by Highmark's remaining enrollees will shift to WPAHS or other hospitals in certain of its IDN initiatives, and on the whole, about % across all initiatives. Should Highmark fall short in achieving these projections, this would represent an overstatement of cost savings such as Highmark's oncology shift and utilization shift IDN savings from UPMC out-of-network."

**Given the vulnerabilities listed on the previous page and the vulnerabilities noted by Ms. Guerin-Calvert of Compass Lexecon above, with which Blackstone concurs, the PID requested that Highmark run a scenario, referred to herein as the "Downside Case," to reflect a 50% decrease in projected incremental patient volume at WPAHS.**

## **D. WPAHS Downside Scenario**



## D. WPAHS Downside Scenario

### WPAHS Downside Case Projections

The PID requested a set of projections for WPAHS demonstrating the financial impact to WPAHS if incremental gains in discharge volume per the Base Case are reduced by 50%.

#### Key Assumptions of the WPAHS Downside Case, as Requested by Blackstone and Prepared by Highmark

- ▶ Highmark's provider contract with UPMC is extended, which causes the projected increase in volume associated with the expiration of Highmark's UPMC provider contract to be removed
- ▶ The projected decline in patient volumes at Forbes is fully retained
- ▶ Projected increases in patient volumes related to all other initiatives are reduced by 50%
- ▶ No refinancing of Highmark's WPAHS bond holdings in 2015
- ▶ Debt service coverage remains below 3.0x, resulting in cancellation of interest to Highmark on its loans to WPAHS
- ▶ Days cash on hand falls below 35 during FY2017, necessitating additional funding from Highmark in the amount of \$38.6 million

**Note: The Downside Case projections do not reflect any actions or response that WPAHS management would take to mitigate the reduced incremental patient volumes in the theoretical scenario in which these specific volume levels are achieved**

#### WPAHS Downside Case (\$ in millions)

| Income Statement                           | FY2013E        | FY2014E        | FY2015E        | FY2016E        | FY2017E        |
|--|----------------|----------------|----------------|----------------|----------------|
| Total Net Patient Revenue                  | \$1,532        | \$1,634        | \$1,773        | \$1,870        | \$1,929        |
| Provision for Bad Debts                    |                |                |                |                |                |
| Other Operating Revenue                    |                |                |                |                |                |
| Net Assets Released from Restrictions      |                |                |                |                |                |
| <b>Total Revenue and Gains</b>             | <b>\$1,522</b> | <b>\$1,620</b> | <b>\$1,753</b> | <b>\$1,848</b> | <b>\$1,905</b> |
| Total Operating Expense                    | (\$1,645)      | (\$1,718)      | (\$1,829)      | (\$1,922)      | (\$2,002)      |
| Operating Income / (Loss)                  |                |                |                |                |                |
| (+) Depreciation & Amortization            |                |                |                |                |                |
| (+) Interest Expense                       |                |                |                |                |                |
| <b>EBIDA</b>                               | <b>(\$10)</b>  | <b>\$23</b>    | <b>\$58</b>    | <b>\$74</b>    | <b>\$73</b>    |
| <b>Net Income</b>                          | <b>(\$111)</b> | <b>(\$87)</b>  | <b>(\$65)</b>  | <b>(\$64)</b>  | <b>(\$87)</b>  |
| <b>Balance Sheet</b>                       |                |                |                |                |                |
| Cash and Cash Equivalents                  |                |                |                |                |                |
| Other Current Assets                       |                |                |                |                |                |
| Assets Restricted As to Use PPE            |                |                |                |                |                |
| Other Long-Term Assets                     |                |                |                |                |                |
| <b>Total Assets</b>                        | <b>\$1,282</b> | <b>\$1,292</b> | <b>\$1,263</b> | <b>\$1,231</b> | <b>\$1,213</b> |
| Total Current Liab (excl. CP of LT Liab)   |                |                |                |                |                |
| Long-Term Debt                             |                |                |                |                |                |
| Accrued Pension Obligation                 |                |                |                |                |                |
| Other Non-Current Liabilities              |                |                |                |                |                |
| <b>Total Liabilities</b>                   | <b>\$1,538</b> | <b>\$1,635</b> | <b>\$1,671</b> | <b>\$1,702</b> | <b>\$1,772</b> |
| <b>Total Net Assets (Deficit)</b>          | <b>(\$256)</b> | <b>(\$343)</b> | <b>(\$407)</b> | <b>(\$471)</b> | <b>(\$559)</b> |
| <b>Total Liabilities &amp; Net Assets</b>  | <b>\$1,282</b> | <b>\$1,292</b> | <b>\$1,263</b> | <b>\$1,231</b> | <b>\$1,213</b> |
| <b>Selected Operational Metrics</b>        |                |                |                |                |                |
| EBIDA Margin                               | (0.7%)         | 1.4%           | 3.3%           | 4.0%           | 3.8%           |
| Operating Margin                           | (8.1%)         | (6.1%)         | (4.3%)         | (4.0%)         | (5.1%)         |
| Net Income Margin                          | (7.3%)         | (5.4%)         | (3.7%)         | (3.5%)         | (4.6%)         |
| Bad Debt as % of Net Patient Revenue       | 5.5%           | 5.5%           | 5.4%           | 5.4%           | 5.4%           |
| Salaries/Benefits as % of Net Patient Rev. | 60.7%          | 59.2%          | 56.7%          | 55.4%          | 54.9%          |
| Cash-to-Debt                               | 29.0%          | 20.3%          | 16.1%          | 12.2%          | 9.5%           |
| Debt-to-Capitalization                     | 135.4%         | 145.1%         | 157.0%         | 170.1%         | 186.5%         |
| Debt-to-Total Revenue                      | 64.3%          | 68.1%          | 64.0%          | 61.9%          | 63.2%          |
| Days Cash on Hand                          | 80             | 64             | 52             | 42             | 36             |
| Debt Service Coverage                      | 0.0x           | 0.6x           | 1.1x           | 1.3x           | 1.4x           |

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Source: Highmark financial projections for WPAHS as of 3/7/2013.



#### D. WPAHS Downside Scenario

#### WPAHS Downside Case vs. Base Case

The WPAHS Downside Case, relative to Highmark's Base Case Transaction scenario that assumes UPMC is out-of-network beyond 2014, results in considerably less patient volume and diminished financial performance at WPAHS.

#### WPAHS Income Statement: Base Case vs. Downside

(\$ in millions)

| Base Case UPMC-Out of Network Post-2015 |               |               |               |               |               |                |
|---|---------------|---------------|---------------|---------------|---------------|----------------|
|   | FY2013E       | FY2014E       | FY2015E       | FY2016E       | FY2017E       | Cum. '13 - '17 |
| Total Revenue and Gains                 | \$1,548       | \$1,736       | \$2,015       | \$2,227       | \$2,309       | \$9,835        |
| Total Operating Expense                 | (1,657)       | (1,774)       | (1,957)       | (2,123)       | (2,216)       | (9,727)        |
| Operating Income / (Loss)               | (\$109)       | (\$38)        | \$58          | \$104         | \$93          | \$108          |
| EBIDA                                   | \$3           | \$83          | \$192         | \$265         | \$271         | \$814          |
| Net Income                              | (\$97)        | (\$26)        | \$72          | \$181         | \$111         | \$241          |
| <i>Memo:</i>                            |               |               |               |               |               |                |
| <b>Total Volume</b>                     | <b>58,928</b> | <b>68,274</b> | <b>80,297</b> | <b>88,304</b> | <b>89,624</b> | <b>NA</b>      |

| Downside Case             |         |         |         |         |         |                |
|---------------------------|---------|---------|---------|---------|---------|----------------|
|                           | FY2013E | FY2014E | FY2015E | FY2016E | FY2017E | Cum. '13 - '17 |
| Total Revenue and Gains   | \$1,522 | \$1,620 | \$1,753 | \$1,848 | \$1,905 | \$8,648        |
| Total Operating Expense   | (1,645) | (1,718) | (1,829) | (1,922) | (2,002) | (9,115)        |
| Operating Income / (Loss) | (\$123) | (\$98)  | (\$76)  | (\$74)  | (\$96)  | (\$467)        |
| EBIDA                     | (\$10)  | \$23    | \$58    | \$74    | \$73    | \$217          |
| Net Income                | (\$111) | (\$87)  | (\$65)  | (\$64)  | (\$87)  | (\$413)        |
| <i>Memo:</i>              |         |         |         |         |         |                |
| <b>Total Volume</b>       |         |         |         |         |         |                |

| Downside Case vs. Base Case UPMC-Out of Network Post-2015: Surplus / (Deficit) |         |         |         |         |         |                |
|--|---------|---------|---------|---------|---------|----------------|
|  | FY2013E | FY2014E | FY2015E | FY2016E | FY2017E | Cum. '13 - '17 |
| Total Revenue and Gains  | (\$26)  | (\$116) | (\$262) | (\$380) | (\$403) | (\$1,188)      |
| Total Operating Expense  | 12      | 56      | 128     | 202     | 214     | 612            |
| Operating Income / (Loss)  | (\$14)  | (\$60)  | (\$134) | (\$178) | (\$190) | (\$576)        |
| EBIDA  | (\$13)  | (\$60)  | (\$134) | (\$190) | (\$199) | (\$597)        |
| Net Income   | (\$14)  | (\$61)  | (\$136) | (\$245) | (\$198) | (\$654)        |
| <i>Memo:</i>   |         |         |         |         |         |                |
| <b>Total Volume</b>  |         |         |         |         |         |                |

#### WPAHS Balance Sheet: Base Case vs. Downside

(\$ in millions)

| Base Case UPMC-Out of Network Post-2015 |         |         |         |         |         |
|---|---------|---------|---------|---------|---------|
|   | FY2013E | FY2014E | FY2015E | FY2016E | FY2017E |
| Cash & Cash Equivalents                 | \$295   | \$296   | \$385   | \$426   | \$524   |
| Total Assets                            | 1,298   | 1,376   | 1,502   | 1,613   | 1,719   |
| Long-term Debt                          | \$979   | \$1,103 | \$1,121 | \$1,037 | \$1,023 |
| Accrued Pension Obligation              | 252     | 216     | 216     | 216     | 216     |
| Total Liabilities                       | 1,541   | 1,645   | 1,698   | 1,628   | 1,624   |
| Total Net Assets (Deficit)              | (243)   | (268)   | (197)   | (16)    | 95      |

| Downside Case              |         |         |         |         |         |
|----------------------------|---------|---------|---------|---------|---------|
|                            | FY2013E | FY2014E | FY2015E | FY2016E | FY2017E |
| Cash & Cash Equivalents    | \$284   | \$224   | \$181   | \$139   | \$115   |
| Total Assets               | 1,282   | 1,292   | 1,263   | 1,231   | 1,213   |
| Long-term Debt             | \$980   | \$1,103 | \$1,121 | \$1,143 | \$1,204 |
| Accrued Pension Obligation | 252     | 215     | 215     | 215     | 215     |
| Total Liabilities          | 1,538   | 1,635   | 1,671   | 1,702   | 1,772   |
| Total Net Assets (Deficit) | (256)   | (343)   | (407)   | (471)   | (559)   |

| Downside Case vs. Base Case UPMC-Out of Network Post-2015: Surplus / (Deficit) |         |         |         |         |         |
|--|---------|---------|---------|---------|---------|
|  | FY2013E | FY2014E | FY2015E | FY2016E | FY2017E |
| Cash & Cash Equivalents  | (\$11)  | (\$72)  | (\$204) | (\$287) | (\$409) |
| Total Assets   | (16)    | (84)    | (239)   | (382)   | (506)   |
| Long-term Debt   | \$0     | (\$0)   | \$0     | \$106   | \$182   |
| Accrued Pension Obligation   | (0)     | (1)     | (1)     | (1)     | (1)     |
| Total Liabilities  | (3)     | (10)    | (28)    | 73      | 147     |
| Total Net Assets (Deficit)   | (13)    | (74)    | (211)   | (455)   | (654)   |

Source: Highmark financial projections for WPAHS as of 1/16/2013 and 3/7/2013.

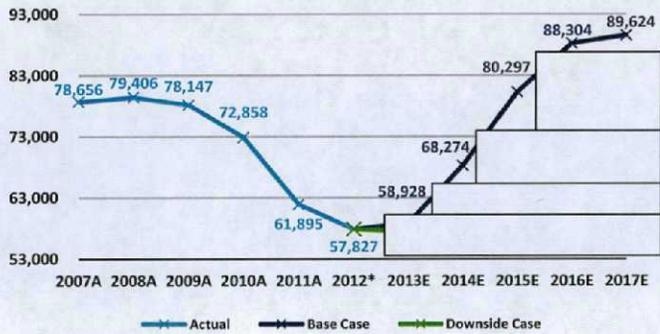


D. WPAHS Downside Scenario

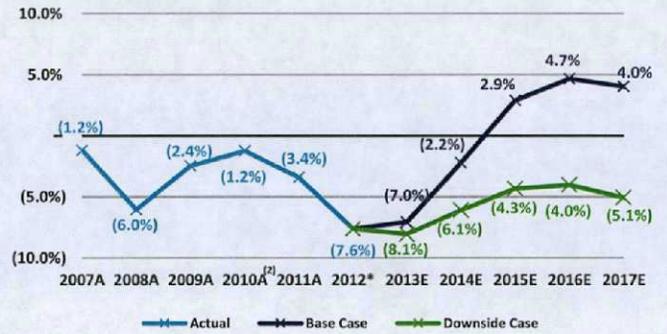
WPAHS Downside Case vs. Base Case (cont'd.)

Below is a comparison of 2007 – 2012 actual results for select WPAHS financial metrics compared to the Base Case and Downside Case projections for 2013 – 2017.

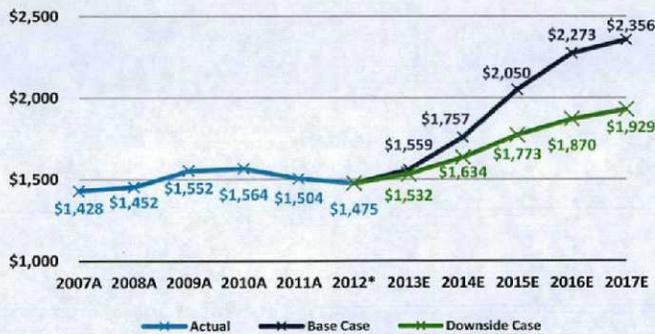
Inpatient Discharges



Operating Margin<sup>(1)</sup>



Total Net Patient Revenue  
(\$ in millions)



Net Income  
(\$ in millions)



Source: WPAHS 2007 – 2011 Audited Financial Statements; WPAHS 2012 Unaudited Financial Statements; Highmark financial projections as of 1/16/2013 and 3/7/2013.

\*Per WPAHS 2012 Unaudited Financial Statements, which can be found at: [http://www.wpahs.org/sites/default/files/file/EY2012\\_annual.pdf](http://www.wpahs.org/sites/default/files/file/EY2012_annual.pdf).

(1) Historical operating margins are calculated using "Total Revenue and Gains" net of "Provision for Bad Debts" in order to conform with the presentation of Highmark's 2013 – 2017 projected Operating Margins.

(2) Operating Income used for Operating Margin calculation excludes Impairment Loss of \$71 million in 2010.

(3) Removes the effect of Highmark's unrestricted grants to WPAHS of \$50 million in 2011A and \$58 million in 2012\*. Does not adjust for Highmark's 2011A advance of \$25 million to WPAHS, since it was not accounted for as revenue to WPAHS.



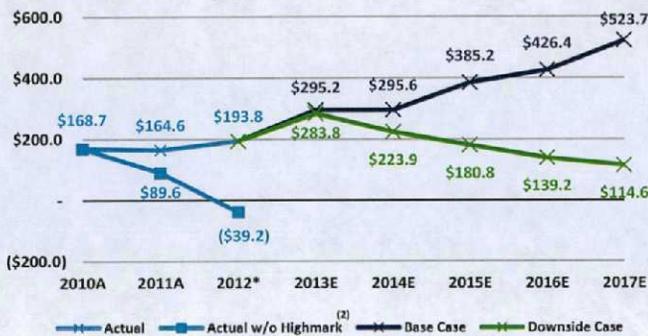
D. WPAHS Downside Scenario

WPAHS Downside Case vs. Base Case (cont'd.)

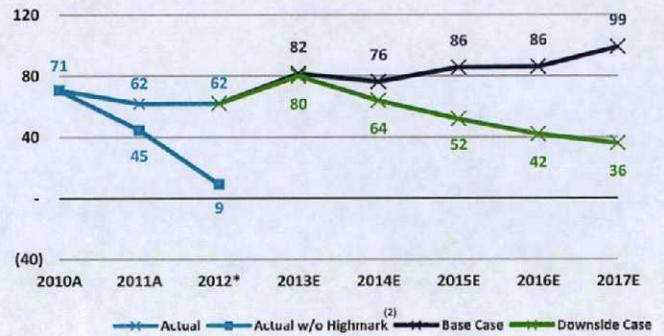
Below is a comparison of 2007 – 2012 actual results for select WPAHS financial metrics compared to the Base Case and Downside Case projections for 2013 – 2017.

Cash and Cash Equivalents

(\$ in millions)

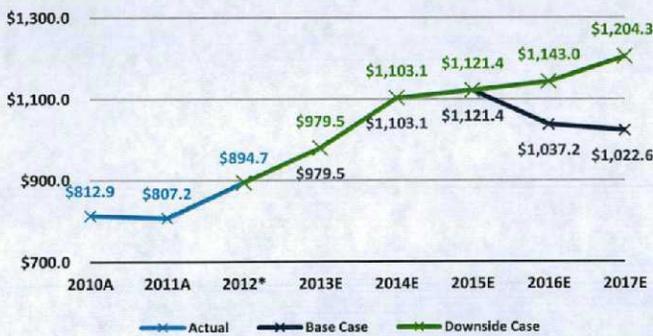


Days Cash on Hand<sup>(1)</sup>

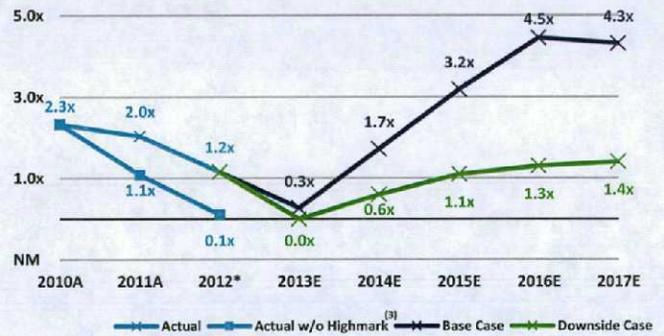


Total Debt

(\$ in millions)



Debt Service Coverage



Source: WPAHS 2007 – 2011 Audited Financial Statements; WPAHS 2012 Unaudited Financial Statements; Highmark financial projections as of 1/16/2013 and 3/7/2013.

\*Per WPAHS 2012 Unaudited Financial Statements, which can be found at: [http://www.wpahs.org/sites/default/files/file/FY2012\\_annual.pdf](http://www.wpahs.org/sites/default/files/file/FY2012_annual.pdf).

(1) Total Cash Available for Days Cash on Hand Calculation includes Cash and Cash Equivalents, Short Term Investments, Board Designated Funds and any Additional Funding Requirements.

(2) Removes the cumulative effect of Highmark's unrestricted grants and loans to WPAHS of \$75 million by 2011A and \$233 million by 2012\*.

(3) Removes the effect of Highmark's unrestricted grants to WPAHS of \$50 million in 2011A and \$58 million in 2012\*. Does not adjust for Highmark's 2011A advance of \$25 million to WPAHS, since it was not accounted for as revenue to WPAHS.



#### D. WPAHS Downside Scenario

### Potential Highmark Downside Contingency Actions for WPAHS

Highmark has developed potential contingency actions in the event of a WPAHS Downside Case scenario. Any revenue increases, cost decreases or sale proceeds associated with these contingency actions were excluded from the Downside Case financial projections for purposes of conservatism.

- ▶ Highmark management believes a scenario that assumes a 50% reduction in the growth of discharges at WPAHS is highly unlikely, but in the event of such an outcome, Highmark has described the following contingency actions that could be enacted at WPAHS:
  - **Efficiency improvements and revenue opportunities**, which Highmark estimates can improve EBIDA by an estimated ~\$ [ ] million per year (less than [ ]% of WPAHS' operating expenses)
  - **Right-size the cost structure of Physician Organization** [ ] which Highmark believes can save approximately [ ] million per year, net of lost revenue
  - **Defer or reduce capital expenditures**; Highmark anticipates that management could conserve an estimated \$ [ ] million and \$ [ ] million of CapEx in [ ] and [ ], respectively
  - **Reduce / eliminate unfunded research** that currently costs ~\$ [ ] million per year
  - **Sell non-core assets** that are associated with, but not critical to, WPAHS' hospital operations, [ ] for estimated proceeds ranging from [ ] million
  - **Restructure compensation and benefits** [ ]
  - **Outsource selected departments**, [ ] to improve financial performance by an estimated \$ [ ] - \$ [ ] million per year
- ▶ If the above contingency actions were insufficient to turn around an ailing WPAHS, Highmark could elect to **increase its reimbursement rates to WPAHS**; Highmark estimates that it could increase reimbursement rates to WPAHS by up to \$ [ ] million annually, beginning in [ ], which may partially be passed through to Highmark policyholders



#### D. WPAHS Downside Scenario

### WPAHS Downside Case Impact on Highmark

Highmark's projected income statement and balance sheet, assuming the WPAHS Downside Case projections, are shown below.

▶ Highmark estimates the following impact to its financial projections resulting from a WPAHS Downside Case scenario compared to the Transaction / "UPMC-Out" Case

- Revenue:** Beginning in 2014, revenue improves as a result of increased enrollment and a reversion of the health margins to the historical norm associated with stability in the insurance and provider markets. This impact is more pronounced in 2015 when UPMC would have been out-of-network in the Base Case
- Operating Expense:** Similar to revenue, operating expenses are higher as a result of increased enrollment partially offset by the ability to leverage fixed costs
- Cash and Investments:** Cash and Investments are lower in the WPAHS Downside scenario in 2014 driven by the write-down of WPAHS investments (\$193m); in 2015 and 2016, Cash and Investments are higher driven by Highmark continuing to secure financing to hold the WPAHS bonds beyond July 1, 2015
- Debt:** Debt is \$600 million higher in the WPAHS Downside scenario as Highmark would need to continue to secure financing to continue holding the WPAHS bonds beyond July 1, 2015, which is the base case assumption
- Reserves:** Reserves are lower in the WPAHS Downside scenario in 2014 and 2015, driven by the write-down of WPAHS investments (\$193m) partially offset by the improvement in operating results when UPMC remains in-network. By 2016, the improvement in operating results offsets the write-off of WPAHS investments

#### Highmark Projections in WPAHS Base Case (UPMC Out-of-Network Post 2015)

| (\$ in millions)                       | 2012E        | 2013E        | 2014E        | 2015E        | 2016E        |
|--|--------------|--------------|--------------|--------------|--------------|
| <b>Income Statement</b>                |              |              |              |              |              |
| Total Operating Revenue <sup>(1)</sup> | \$14,867     | \$15,614     | \$16,663     | \$16,563     | \$17,538     |
| Total Operating Expense                | (14,405)     | (15,300)     | (16,233)     | (16,136)     | (17,044)     |
| <b>Operating Income</b>                | <b>\$462</b> | <b>\$314</b> | <b>\$430</b> | <b>\$427</b> | <b>\$493</b> |
| <b>Net Income</b>                      | <b>\$413</b> | <b>\$106</b> | <b>\$334</b> | <b>\$336</b> | <b>\$390</b> |
| <b>Balance Sheet</b>                   |              |              |              |              |              |
| Cash and Investments                   | \$6,854      | \$7,226      | \$7,458      | \$7,252      | \$7,659      |
| Debt                                   | 1,118        | 1,322        | 1,254        | 599          | 599          |
| Reserves                               | 5,444        | 5,444        | 5,763        | 6,090        | 6,464        |
| RBC                                    |              |              |              |              |              |

#### Highmark Projections in WPAHS Downside Case (UPMC In-Network Post 2015)

| (\$ in millions)                       | 2012E        | 2013E        | 2014E        | 2015E        | 2016E        |
|--|--------------|--------------|--------------|--------------|--------------|
| <b>Income Statement</b>                |              |              |              |              |              |
| Total Operating Revenue <sup>(1)</sup> | \$14,865     | \$15,614     | \$16,833     | \$17,970     | \$18,736     |
| Total Operating Expense                | (14,405)     | (15,300)     | (16,385)     | (17,389)     | (18,103)     |
| <b>Operating Income</b>                | <b>\$460</b> | <b>\$314</b> | <b>\$448</b> | <b>\$582</b> | <b>\$633</b> |
| <b>Net Income</b>                      | <b>\$413</b> | <b>\$106</b> | <b>\$222</b> | <b>\$443</b> | <b>\$486</b> |
| <b>Balance Sheet</b>                   |              |              |              |              |              |
| Cash and Investments                   | \$6,854      | \$7,226      | \$7,364      | \$7,876      | \$8,451      |
| Debt                                   | 1,118        | 1,322        | 1,254        | 1,199        | 1,199        |
| Reserves                               | 5,444        | 5,444        | 5,651        | 6,085        | 6,555        |
| RBC                                    |              |              |              |              |              |

#### Downside Case (UPMC-In) vs. Base Case (UPMC-Out): Surplus / (Deficit)

| (\$ in millions)        | 2012E        | 2013E    | 2014E          | 2015E        | 2016E        |
|-------------------------|--------------|----------|----------------|--------------|--------------|
| <b>Income Statement</b> |              |          |                |              |              |
| Total Operating Revenue | (\$2)        | -        | \$171          | \$1,407      | \$1,199      |
| Total Operating Expense | -            | -        | (152)          | (1,253)      | (1,059)      |
| <b>Operating Income</b> | <b>(\$2)</b> | <b>-</b> | <b>\$19</b>    | <b>\$155</b> | <b>\$140</b> |
| <b>Net Income</b>       | <b>-</b>     | <b>-</b> | <b>(\$112)</b> | <b>\$108</b> | <b>\$96</b>  |
| <b>Balance Sheet</b>    |              |          |                |              |              |
| Cash and Investments    | -            | -        | (\$95)         | \$624        | \$792        |
| Debt                    | -            | -        | -              | 600          | 600          |
| Reserves                | -            | -        | (113)          | (5)          | 91           |
| RBC                     |              |          |                |              |              |

Source: Highmark financial projections as of 3/7/2013.

(1) Net of Change in Premium Deficiency Reserves.



D. WPAHS Downside Scenario

**WPAHS Downside Impact on Highmark's Credit Profile**

**Highmark's projected impact of a WPAHS Downside scenario on Highmark's credit profile is shown below.**

**Highmark's Credit Profile in "Transaction" Base Case**

(\$ in millions)

| Key Credit Metrics   | Moody's Guidelines <sup>(1)</sup> |           |           | Transaction Case |       |       |       |       |
|--|-----------------------------------|-----------|-----------|------------------|-------|-------|-------|-------|
|  | A                                 | Baa       | Ba        | 2012E            | 2013E | 2014E | 2015E | 2016F |
| Goodwill and Intangible Assets as a % of Equity <sup>(2)</sup> | 25%-35%                           | 35%-50%   | 50%-80%   | 16.6%            | 15.4% | 14.5% | 13.6% | 12.8% |
| EBITDA Margin (3 year weighted average) <sup>(3)(4)</sup>      | 8%-5%                             | 5%-3%     | 3%-1%     | 3.7%             | 3.3%  | 3.3%  | 3.1%  | 3.4%  |
| Adjusted Debt to Capital <sup>(5)</sup>                        | 30%-40%                           | 40%-50%   | 50%-65%   | 17.0%            | 19.5% | 17.9% | 9.0%  | 8.5%  |
| Adjusted Debt to EBITDA <sup>(6)</sup>                         | 1.0x-1.5x                         | 1.5x-2.5x | 2.5x-3.5x | 2.0x             | 3.1x  | 2.3x  | 1.1x  | 1.0x  |

**Highmark's Credit Profile in WPAHS Downside**

(\$ in millions)

| Key Credit Metrics   | Moody's Guidelines <sup>(1)</sup> |           |           | WPAHS Downside Case Impact on Highmark |       |       |       |       |
|--|-----------------------------------|-----------|-----------|--|-------|-------|-------|-------|
|  | A                                 | Baa       | Ba        | 2012E                                  | 2013E | 2014E | 2015E | 2016F |
| Goodwill and Intangible Assets as a % of Equity <sup>(2)</sup> | 25%-35%                           | 35%-50%   | 50%-80%   | 16.6%                                  | 15.4% | 14.7% | 13.6% | 12.6% |
| EBITDA Margin (3 year weighted average) <sup>(3)(4)</sup>      | 8%-5%                             | 5%-3%     | 3%-1%     | 3.7%                                   | 3.3%  | 3.4%  | 3.5%  | 3.9%  |
| Adjusted Debt to Capital <sup>(5)</sup>                        | 30%-40%                           | 40%-50%   | 50%-65%   | 17.0%                                  | 19.5% | 18.2% | 16.5% | 15.5% |
| Adjusted Debt to EBITDA <sup>(6)</sup>                         | 1.0x-1.5x                         | 1.5x-2.5x | 2.5x-3.5x | 2.0x                                   | 3.1x  | 2.2x  | 1.7x  | 1.6x  |

(1) Per Moody's Rating Methodology for U.S. Health Insurance Companies, May 2011.

(2) For Highmark, calculated as (Goodwill and Other Intangibles, Net) / (GAAP Total Reserves), per 2011 GAAP Balance Sheet.

(3) For Highmark, calculated as 3-year average EBITDA margin per 2009 – 2011 GAAP Audit Reports.

(4) Assumes Depreciation & Amortization to be 0.72% of Total Operating Revenue in 2012E – 2016E, consistent with the average ratio for 2010A – 2011A.

(5) For Highmark, calculated as Debt / (Debt plus GAAP Total Reserves).

(6) For Highmark, calculated as Debt / EBITDA per 2011 GAAP Audit Report.

**E. Summary Conclusions: Financial Impact on Highmark**



E. Summary Conclusions: Financial Impact on Highmark  
**Summary Conclusions<sup>(\*)</sup>: Highmark's Financial Stability**

**Blackstone notes the following conclusions with respect to the Transaction's impact on Highmark's financial stability:**

- ▶ Highmark considers the total amount of capital commitments associated with its IDN Plan to be \$1.0 billion. An all-inclusive calculation would value the total amount of capital commitments to be \$1.8 billion, with the potential for up to \$2.4 billion when accounting for WPAHS' unfunded pension liabilities and other unsecured liabilities
- ▶ Of the \$1.8 billion in total IDN capital commitments, approximately \$1.2 billion has been, or will have been, funded regardless of the PID's decision with respect to the Form A, resulting in \$646 million of capital commitments that are contingent upon the Transaction's approval
- ▶ Taken as a whole, Highmark's \$1.8 billion of IDN capital commitments will result in a material change in Highmark's financial profile as a significant portion of Highmark's current balance of net liquid assets will be converted into illiquid, highly concentrated and, in the case of WPAHS, high-risk investments
- ▶ With respect to Highmark's projections for WPAHS, we note the following:
  - Highmark's Base Case projections for WPAHS appear to be optimistic given the financial, reputational and cultural challenges facing WPAHS, the ongoing regional decline in demand for inpatient services and the potential for a significant competitive response from UPMC and other area providers
  - Highmark's Downside Case projections appear reasonable as a potential outcome for patient volumes and financial performance at WPAHS and indicate that Highmark's investments into WPAHS face substantial doubt as to the likelihood of full recovery

Continued on Next Page

(\*) This draft report has been prepared and is being filed to assist the Pennsylvania Insurance Department ("PID") in its ongoing consideration of the Form A Application of UPE, dated November 7, 2011, as amended. This report will not be complete until the public has had appropriate opportunity to review, and Blackstone reserves the right as may be required in its judgment to amend and/or supplement this report based upon additional or new information that may be provided during the public comment period or thereafter or in response to comments by the Applicants, the public or PID officials.



#### E. Summary Conclusions: Financial Impact on Highmark

#### Summary Conclusions<sup>(\*)</sup>: Highmark's Financial Stability (cont'd.)

#### **Blackstone notes the following conclusions with respect to the Transaction's impact on Highmark's financial stability:**

- ▶ Taken as a whole, Highmark's IDN strategy will materially decrease its liquidity and will reduce the quality of its investment portfolio
  - Analysis of Highmark's projected financial position under ordinary circumstances (i.e. moderate growth and maintenance of historical operating margin levels for its insurance franchise) indicate that the Transaction on its own is not likely to jeopardize Highmark's financial stability
  - It remains possible, however, that when combined with possible adverse operational and financial conditions caused by unforeseen external circumstances, the Transaction could materially lessen Highmark's financial flexibility and capacity to respond to such circumstances
  - Given the uncertain nature of potential changes to (a) the overall economy, (b) investment portfolio performance, (c) actions taken by strategic competitors and (d) the state and federal regulatory environment, including implementation of the Affordable Care Act, we cannot conclude that Highmark's total IDN capital commitments will not, in the long term, potentially jeopardize the financial stability of Highmark, absent the imposition of certain safeguards
- ▶ Given the above, the PID may wish to consider the following types of conditions related to Highmark's financial stability:
  - Conditions requiring a remediation plan for WPAHS if the hospital system's financial performance is not turned around by a specified date
  - Conditions limiting distributions from Highmark to UPE based upon certain thresholds, which may include RBC, credit ratings or other triggering metrics
  - Conditions limiting the amount of capital that may be expended by Highmark in the form of unrestricted grants to 501(c)3 organizations
  - Conditions limiting the amount of capital that Highmark may commit in the context of an acquisition, affiliation, asset purchase or other business alliance to entities whose primary business is not health insurance and/or which would not be structured as a subsidiary of Highmark, without providing the PID with consent and/or notification subject to specified standards of review

<sup>(\*)</sup> This draft report has been prepared and is being filed to assist the Pennsylvania Insurance Department ("PID") in its ongoing consideration of the Form A Application of UPE, dated November 7, 2011, as amended. This report will not be complete until the public has had appropriate opportunity to review, and Blackstone reserves the right as may be required in its judgment to amend and/or supplement this report based upon additional or new information that may be provided during the public comment period or thereafter or in response to comments by the Applicants, the public or PID officials.

## **V. Costs and Benefits to Policyholders**

**Blackstone**



## V. Costs and Benefits to Policyholders

### Summary of Risks and Analyses: Cost vs. Benefits to Policyholders

**The Transaction's costs and benefits to policyholders were assessed as follows:**

#### Potential Concerns Noted:

##### **Value of Assets Received by Highmark in Exchange for IDN Investments and Expenditures**

1. The tangible value of financial assets received by Highmark may be significantly less than the \$1.8 billion of capital Highmark has committed to the IDN Plan, primarily due to the speculative nature of investments made into WPAHS

##### **Potential Policyholder Benefits**

1. Savings realized by Highmark and its policyholders in the cost of care generated by the planned WPAHS and IDN investments are based upon plans that have limited precedent and may be less effective and/or more expensive than Highmark anticipates
2. IDN spending may generate "franchise" benefits to Highmark in the form of increased enrollment, market share and revenue compared to a No-Transaction scenario. Declines in the cost of care for Highmark's policyholders, however, may not match the cost of investments made by Highmark in its IDN strategy. This may particularly be the case if Highmark is unable to implement product designs that are likely to incentivize members to choose lower cost care options

#### Analyses Performed:

- ▶ Reviewed Highmark's financial exposure to WPAHS, on both a contingent and non-contingent basis
- ▶ Assessed the total amount of potential value available to repay Highmark's anticipated loan and bond investments in WPAHS under different operating scenarios and at different points in time
- ▶ Compared Highmark's total financial exposure to WPAHS with the amount that Highmark may recover on its investments in WPAHS, resulting in a range of potential implied net losses to Highmark (the "WPAHS Value Gap"), on both a contingent and non-contingent basis
- ▶ Reviewed Highmark's financial exposure to non-WPAHS elements of the IDN Plan
- ▶ Assessed the potential tangible financial value received by Highmark in exchange for its investments into non-WPAHS elements of the IDN Plan
- ▶ Compared Highmark's total financial exposure to non-WPAHS elements of the IDN Plan WPAHS with the potential tangible financial value received by Highmark in exchange for its investments into non-WPAHS elements of its IDN Plan, resulting in a range of potential implied net losses to Highmark ("the IDN Value Gap"), on both a contingent and non-contingent basis
- ▶ Reviewed Highmark's plans to derive financial benefits for policyholders via reduced cost of care and reduced insurance premiums ("IDN Savings")
- ▶ Reviewed the assessment of the potential IDN Savings, including the likelihood of generating such savings given the potential for varying levels of future discharge volume at WPAHS, by Ms. Guerin-Calvert of Compass Lexecon
- ▶ Compared the potential total Transaction-related Value Gap to the potential IDN Savings