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March 31, 2020

VIA ELECTRONIC FILING

Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

Re: *Order No. ID-RC-13-06/Condition 14*

Dear Deputy Commissioner DiMemmo:

Pursuant to Condition 14 of the above-captioned Order, Highmark Health is filing with the Department the attached non-confidential Allegheny Health Network report for the period ending September 30, 2019. This report was previously deferred by the Department pending resolution of a Request for Modification of Condition 14. I have copied Mr. Beaser and Mr. DeLacey with the filing.

Very truly yours,

Jack M. Stover

JMS/jls
Attachment
cc: Lawrence J. Beaser, Esquire (via email)
Patrick T. DeLacey (via email)

ALLEGHENY HEALTH NETWORK

Unaudited Financial Information and Management's Discussion and Analysis

For the Periods Ended September 30, 2019 and 2018

AHN

November 26, 2019

ALLEGHENY HEALTH NETWORK

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For the Periods Ended September 30, 2019 and 2018

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BASIS OF PRESENTATION; FORWARD-LOOKING STATEMENTS

Allegheny Health Network is the Credit Group Representative of an obligated group (the "Obligated Group") formed pursuant to a Master Trust indenture dated as of December 1, 2017, as amended (the "Master Trust Indenture"). The Allegheny County Hospital Development Authority Revenue Bonds (Allegheny Health Network Obligated Group Issue), Series 2018A (the "Series 2018A Bonds") are secured pursuant to the Master Trust Indenture. The information contained herein is being filed by Allegheny Health Network for the purpose of complying with the Obligated Group's obligations under the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 2018A Bonds. Allegheny Health Network and its consolidated subsidiaries are referred to collectively herein as "AHN."

AHN presumes that users of this interim financial information have read or have access to AHN's audited financial statements and that the adequacy of additional disclosure needed for a fair presentation may be determined in that context. The audited financial statements of AHN for the fiscal year ended December 31, 2018 and 2017 are on file at www.emma.msrb.org.

Except as otherwise specified, information contained in this report includes the unaudited financial performance of AHN on a consolidated basis, and thus includes entities that are not members of the Obligated Group. The unaudited consolidated financial information contained herein, as of and for the periods ended September 30, 2019 and 2018, include all required adjustments that management believes are necessary for a fair presentation of AHN's financial position and the results of operations for these periods. All financial and statistical information is derived from internal records of AHN.

References herein to Highmark Health ("Highmark Health"), which is the parent of AHN and of Highmark Inc. ("Highmark"), mean those entities affiliated with AHN by virtue of common corporate control. **NEITHER HIGHMARK HEALTH NOR HIGHMARK IS OBLIGATED WITH RESPECT TO THE SERIES 2018A BONDS, AND NONE OF THEIR RESPECTIVE ASSETS OR REVENUES IS AVAILABLE TO PAY DEBT SERVICE ON THE SERIES 2018A BONDS.**

This report contains information which constitutes "forward-looking statements." Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words like "may," "believe," "will," "expect," "project," "estimate," "anticipate," "plan," "initiative" or "continue." These forward-looking statements are based on the current plans and expectations of AHN and are subject to a number of known and unknown uncertainties and risks, many of which are beyond AHN's control and could significantly affect current plans and expectations and AHN's future financial position and results of operations. These factors include, but are not limited to, (i) the highly competitive nature of the health care industry, (ii) the efforts of insurers, health care providers and others to contain health care costs, (iii) possible changes in the Medicare and Medicaid programs that may impact reimbursements to health care providers and insurers, (iv) the ability to achieve expected levels of patient volumes and control the costs of providing services, (v) changes in federal, state or local regulations affecting the health care industry, (vi) the ability to attract and retain qualified management and personnel, including affiliated physicians, nurses and medical support personnel, (vii) liabilities and other claims asserted against AHN, (viii) changes in accounting practices, (ix) changes in general economic conditions including growing numbers of uninsured and unemployed patients, (x) changes in revenue mix and the ability to enter into and renew managed care provider arrangements on acceptable terms and (xi) the collectability of uninsured accounts and deductible and co-pay amounts. As a consequence, current plans, anticipated actions and future financial position and results of operations may differ from those expressed in any forward-looking statements made by or on behalf of AHN. Users of this report are cautioned not to rely on such forward-looking statements when evaluating the information presented in this report, including "Management's Discussion and Analysis."

It should be noted that earnings before interest, taxes, depreciation and amortization ("EBITDA"), days cash on hand and certain other financial metrics included in this filing are not measures of operating performance, liquidity or financial leverage defined by generally accepted accounting principles and may not be comparable to similarly titled measures presented by other companies.

ALLEGHENY HEALTH NETWORK

Introduction and Overview

Allegheny Health Network is the parent organization of a system of acute care hospitals and affiliated providers in western Pennsylvania that constitutes the clinical delivery component of an integrated delivery and financing system ("IDFS"), with Highmark Health as its parent company. Highmark Health is also the parent of Highmark Inc. ("Highmark"), which together with its subsidiaries and controlled affiliates constitute the nation's fourth largest Blue Cross Blue Shield insurance plan (based on Q2 2019 capital). While AHN is integrated with Highmark Health and its affiliates for strategic planning, budgetary, and other purposes and shares certain common management personnel, directors, and committees, neither Highmark Health nor Highmark is part of the Obligated Group (as defined in the Master Trust Indenture). Neither Highmark Health nor Highmark is obligated with respect to the Series 2018A Bonds and none of their assets or revenues are pledged to pay debt service on such bonds.

AHN is the clinical delivery system affiliate of Highmark in western Pennsylvania for enrollees in Highmark's various health plans in the region, as well as enrollees covered by other insurers and Medicaid and Medicare programs.

Headquartered in Pittsburgh, AHN's operations are concentrated primarily in the Pennsylvania cities of Pittsburgh and Erie and their surrounding communities. AHN is a patient-centered and clinician-led academic healthcare system that provides comprehensive healthcare services to patients in western Pennsylvania and the adjacent regions of Ohio, West Virginia, New York and Maryland. With more than 20,000 total employees and 1,500 volunteers, AHN operates eight acute care hospitals with 2,200+ beds in quaternary, tertiary and community facilities, eight ambulatory surgical centers, six urgent care centers, and five Health + Wellness Pavilions. AHN employs more than 1,400 physicians who provide a variety of primary and specialty care at more than 250 healthcare sites throughout the region. AHN is affiliated with three medical schools and currently educates more than 500 residents and fellows each year in 46 accredited residency programs. AHN also controls a research institute and four charitable foundations and a trust that support certain hospitals within AHN. AHN provides an array of post-acute care services, primarily under joint venture arrangements, including durable medical equipment, home infusion services and home health and hospice services. AHN also owns and operates a group purchasing organization that supports close to 100 members (which include AHN entities) in the region, a captive insurance company, and a clinically integrated network, among other businesses.

In addition, AHN-affiliated physicians provide services to or on behalf of 29 other hospitals throughout the western Pennsylvania region. For example, AHN's hospital emergency rooms are staffed by physicians provided through an AHN joint venture that also currently provides emergency room physician services to four other non-AHN affiliated hospitals in the region. Many other clinical services, including specialty coverage services, are provided by AHN affiliates in nearby hospitals and geographies.

ALLEGHENY HEALTH NETWORK

Consolidated Balance Sheets – Unaudited*

September 30, 2019 and 2018 and December 31, 2018

(Dollars in thousands)

	2019	2018	
	September	September	December
Assets			
Current assets			
Cash and cash equivalents	$ 182,400	$ 173,022	$ 162,504
Patient accounts receivable	398,048	370,509	373,930
Other current assets	171,002	155,407	166,298
Total current assets	751,450	698,938	702,732
Investments	468,934	418,622	412,767
Assets whose use is limited	61,363	71,068	62,606
Bond project funds	77,485	191,143	167,752
Restricted investments	312,920	318,554	282,057
Equity investments/other	45,066	44,837	44,424
Property and equipment, net	1,467,066	1,216,055	1,365,932
Other assets	421,240	222,973	188,979
Total assets	**$ 3,605,524**	**$ 3,182,190**	**$ 3,227,249**
Liabilities and net assets			
Current liabilities	$ 514,887	$ 489,666	$ 529,450
Current portion of long-term debt	8,763	4,335	8,026
Total current liabilities	523,650	494,001	537,476
Accrued pension obligation	285,256	245,293	331,018
Long-term debt	1,005,661	1,017,393	1,011,122
Other liabilities	367,194	265,365	168,401
Total liabilities	2,181,761	2,022,052	2,048,017
Net assets:			
Without donor restrictions	1,104,394	842,040	891,665
With donor restrictions	319,369	318,098	287,567
Total net assets	1,423,763	1,160,138	1,179,232
Total liabilities and net assets	**$ 3,605,524**	**$ 3,182,190**	**$ 3,227,249**

* Includes entities that are not members of the Obligated Group

Note: Certain prior year amounts have been reclassified to conform with current year presentation

ALLEGHENY HEALTH NETWORK

Consolidated Statements of Operations – Unaudited*
For the Periods Ended September 30, 2019 and 2018

(Dollars in thousands)

	QTD		YTD	
	2019	2018	2019	2018
Revenue				
Net patient service revenue	$ 846,264	$ 776,569	$ 2,500,087	$ 2,304,991
Other operating revenue	51,145	41,128	149,526	125,251
Total revenue	897,409	817,697	2,649,613	2,430,242
Expenses				
Salaries, wages, and fringe benefits	491,614	445,698	1,440,739	1,316,530
Patient care supplies	186,958	167,252	548,547	488,858
Other operating expenses	168,791	163,946	514,570	488,195
Depreciation and amortization	40,332	35,396	116,877	107,450
Total operating expenses	887,695	812,292	2,620,733	2,401,033
Operating income	**9,714**	**5,405**	**28,880**	**29,209**
Investment income	7,929	6,812	21,955	25,248
Unrealized (losses) gains	(1,063)	3,334	28,425	(3,594)
Interest expense	(6,269)	(8,685)	(20,379)	(25,512)
Loss on debt refinancing	-	(7,495)	-	(7,495)
Other non-operating (expense) income, net	(1,479)	394	(3,262)	(335)
Excess (deficit) of revenue over expenses, before income taxes	**8,832**	**(235)**	**55,619**	**17,521**
Income tax (expense) benefit	(458)	225	(135)	521
Excess (deficit) of revenue over expenses	**$ 8,374**	**$ (10)**	**$ 55,484**	**$ 18,042**
Operating margin %	1.1%	0.7%	1.1%	1.2%
Net margin %	0.9%	0.0%	2.1%	0.7%
Operating EBITDA	$ 50,046	$ 40,801	$ 145,757	$ 136,659
Operating EBITDA %	5.6%	5.0%	5.5%	5.6%
Net EBITDA	$ 55,433	$ 43,846	$ 192,875	$ 150,483
Net EBITDA %	6.2%	5.4%	7.3%	6.2%
Total current and long-term debt (excluding lease liabilities)	$ 1,014,424	$ 1,021,728	$ 1,014,424	$ 1,021,728
Total current and long-term debt (excluding lease liabilities) to net EBITDA	4.6	5.8	3.9	5.1

* Includes entities that are not members of the Obligated Group

Note: Certain prior year amounts have been reclassified to conform with current year presentation

ALLEGHENY HEALTH NETWORK

Utilization Statistics*

For the Periods Ended September 30, 2019 and 2018

	QTD		YTD	
	2019	2018	2019	2018
Discharges	20,401	21,194	62,564	64,884
Observation cases	10,543	8,804	30,702	25,062
Total discharges and observation cases	30,944	29,998	93,266	89,946
Patient days	107,058	110,072	328,307	332,103
Average length of stay (medical acute days only)	4.85	4.82	4.88	4.81
Case-mix index (all payor)	1.92	1.88	1.92	1.86
Outpatient registrations	343,808	330,901	1,008,763	990,875
Emergency department visits	70,840	70,889	209,819	210,364
Inpatient surgeries	7,287	7,170	21,658	22,046
Outpatient surgeries	14,066	13,382	41,811	40,633
Ambulatory surgical cases	6,216	5,577	18,731	16,931
Total surgical cases	27,569	26,129	82,200	79,610
Physician visits	825,264	742,440	2,453,251	2,212,134
Full time equivalents	20,324	19,076	19,972	18,828
Days in patient accounts receivable**	43.3	43.9	43.3	43.9

* Includes entities that are not members of the Obligated Group

** Calculated using 90 days rolling net patient revenue

Year to date September 30, 2019 compared to year to date September 30, 2018

For the nine months ended September 30, 2019, income from operations was $28.9 million compared to operating income of $29.2 million for the comparable 2018 period, a year over year decrease of $0.3 million. Year over year net patient service revenue grew $195.1 million. This increase is primarily attributable to higher case mix of patients, increases in contracted rates with payors, higher combined volumes from inpatient discharges plus observations and related quality and value based payments.

For the nine months ended September 30, 2019, AHN recorded an excess of revenue over expenses of $55.5 million compared to $18.0 million for the same period in the prior year, an increase of $37.5 million. This increase is due to improved investment earnings and performance in the midst of stronger investment markets. AHN achieved total investment earnings (unrealized gains and investment income) of $50.4 million for the nine months ended September 30, 2019 compared to $21.7 million for the nine months ended September 30, 2018. Additionally, there was a $7.5 million non-cash charge in third quarter 2018 related to the early extinguishment of debt due to the issuance of the Series 2018A Bonds.

Operating EBITDA was $145.8 million for the nine months ended September 30, 2019 versus operating EBITDA of $136.7 million for the same period in the prior year, an increase of $9.1 million. Net EBITDA improved to $192.9 million for the nine months ended September 30, 2019 versus net EBITDA of $150.5 million during the same period in the prior year due primarily to the investment results and the prior year non-cash charge related to the early extinguishment of previously existing debt described above.

Volumes, as measured by the combined total of discharges and observation cases, increased 3,320 (3.7%) from 89,946 for the nine months ended September 30, 2018 to 93,266 for the same period during 2019. AHN continues to experience growth in observation cases that exceed the decline in inpatient discharges, resulting in a net positive increase in this metric. The transition to greater levels of observation cases and lower levels of inpatient discharges has had a negative effect on AHN's patient service revenue because of lower reimbursement attributable to observation cases. However, a portion of the revenue decline is offset through various mechanisms in AHN's value-based payor contracts. AHN also experienced an increase in documented inpatient acuity as measured by its case mix index, which increased to 1.92 from 1.86 or an increase of approximately 3.2% for the nine months ended September 30, 2019 as compared to the same period in the prior year. Total surgical cases increased 3.3% (2,590 cases) for the nine months ended September 30, 2019, with the increase driven primarily by growth at AHN's ambulatory surgery centers ("ASC"). ASC surgical cases increased 10.6% (1,800 cases), reflecting the continuing growth trend in the ASC environment. Physician visits continue to grow as well, as AHN continues implementation of its value based model and continues to increase their physician complement. For the nine months ended September 30, 2019, physician visits totaled 2,453,251, an increase of 241,117 (or 10.9%) from 2,212,134 in the comparable prior period.

Investments in AHN by Highmark

Highmark has continued to make investments in AHN to enhance AHN's position as the provider core of the Highmark Health IDFS, although Highmark is not an obligor or guarantor of the Series 2018A Bonds and none of its assets or revenues are pledged as collateral.

For the nine months ended September 30, 2019, Highmark made investments in AHN pursuant to a clinical affiliation agreement between the parties to support strategic capital investments made by AHN. These investments totaled $153.4 million and were reflected as equity transfers in the AHN financial statements.

Cash, Liquidity, Long-Term Debt and Unfunded Pension Obligations

Cash and unrestricted investments totaled $790.2 million at September 30, 2019, which was a decrease of $63.7 million over the September 30, 2018 total of $853.9 million. Days cash on hand decreased from 101 days at September 30, 2018 to 85 days at September 30, 2019. The overall decrease in liquidity was attributable primarily to planned strategic capital investments and payments made during the period, including expenditures of $113.7M of bond project funds which equates to 12.3 days of cash on hand.

Long-term debt (including the current portion) declined $7.3 million from $1,021.7 million as of September 30, 2018 to $1,014.4 million as of September 30, 2019. The reduction was primarily due to required principal payments and the amortization of bond premiums.

In August 2018, the Series 2018A Bonds were issued with a par value of $943.4 million and with proceeds of $1.0 billion. The proceeds were used to refund the Series 2017 Bonds. The Series 2018A Bonds consist of both serial and term bonds, with the final maturity 29 years from the original issuance date at fixed rates of interest. AHN is required to pay interest only on the Series 2018A Bonds for the first three years with level debt service thereafter consisting of principal and interest. The Series 2018A Bonds were assigned an "A" rating with a stable outlook by S&P Global Ratings, which was reaffirmed in March 2019.

AHN's recorded unfunded pension obligations related to its defined benefit plans declined during the first nine months of 2019. Certain defined benefit pension plans are frozen with no new participation permitted. As of September 30, 2019, AHN's recorded unfunded pension obligations totaled $285.3 million, which was a decrease of $45.7 million from $331.0 million at December 31, 2018. The decrease was primarily due to additional employer contributions made during 2019 and pension credits recognized.

Net assets without donor restrictions increased to $1,104.4 million as of September 30, 2019, an increase of $262.4 million over the balance of $842.0 million as of September 30, 2018. The increase was primarily a result of the clinical affiliation payments made to AHN by Highmark and AHN earnings during the period, offset by certain pension plan liability adjustments recorded in December 2018.

Adoption of new accounting literature

Implemented

In February 2016, FASB issued ASU 2016-02, *Leases* (ASC 842), in order to increase transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing arrangements. AHN adopted ASC 842 on January 1, 2019 using the modified retrospective transition approach and recognized an increase of $255.5 million in assets and liabilities to the consolidated balance sheet on January 1, 2019, with no material change to the consolidated statements of operations or cash flows. The adoption of ASC 842 did not have an impact on AHN's compliance with debt covenants.

Under Evaluation

In March 2017, FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefits Cost*, requiring an entity to disaggregate the service cost component from the other components of net benefit cost. The service cost component is to be reported in the same line item on the consolidated statements of operations as other compensation costs arising from services rendered by the employees. The other components are to be presented in the consolidated statements of operations outside of operating income. The impact of this adoption is expected to increase salaries, wages and fringe benefits in 2019 by $20 million to $25 million and decrease operating income by the same amount. There will also be a corresponding decrease in non-operating expense. There will not be any impact on the excess of revenue over expenses. AHN is required to adopt this new guidance for the year ending December 31, 2019 and interim periods effective January 1, 2020.

If such presentation were required to be adopted for quarterly reporting in 2019, September 30, 2019 would have been presented as follows:

	Quarter Ended September 30, 2019		
	As Reported	ProForma	Difference
Operating income	$ **9,714**	$ **4,142**	$ **5,572**
Non-operating activity	(1,340)	4,232	(5,572)
Excess of revenue over expenses	$ **8,374**	$ **8,374**	$ -

	Year to Date September 30, 2019		
	As Reported	ProForma	Difference
Operating income	$ **28,880**	$ **12,158**	$ **16,722**
Non-operating activity	26,604	43,326	(16,722)
Excess of revenue over expenses	$ **55,484**	$ **55,484**	$ -

Other Matters

Beginning in 2014, the University of Pittsburgh Medical Center ("UPMC") and Highmark were each party to parallel Consent Decrees facilitated by the Pennsylvania Governor's Office and the Pennsylvania Office of the Attorney General (the "Consent Decrees"). The Consent Decrees provided for continued access for Highmark members to UPMC hospitals on an in-network basis in a number of circumstances specified therein.

The Consent Decrees were to terminate on June 30, 2019, thereby terminating in-network access for Highmark indemnity and managed care members (non-Medicare Advantage) at most UPMC hospitals in Allegheny County and UPMC Hamot Hospital in Erie, Pennsylvania. In addition, UPMC had notified Highmark that it was terminating its Medicare Advantage facility contracts with Highmark with respect to the same UPMC hospitals in Allegheny County and Erie, effective December 31, 2018 (with a six-month run-out for care until June 30, 2019).

In February 2019, the Office of the Attorney General brought an action against UPMC and Highmark seeking continuation of the Consent Decrees under a modified format. While the litigation was progressing, on June 24, 2019, the Pennsylvania Attorney General announced that he had facilitated an agreement between Highmark and UPMC pursuant to which the organizations had agreed to a 10 year contract offering full in-network access to Highmark members in certain Highmark health products, including Medicare Advantage. Beginning July 1, 2019, all Highmark members had full in-network access to UPMC hospitals if their health plan included UPMC in the provider network (pursuant to the Consent Decrees).

While AHN will continue to assess the overall impact of the contract, its current strategies remain the same and it has no current intention to change any of its ongoing or planned investments.

Series 2018A Revenue Bonds Due Dates and CUSIPs

Serial Bonds:

Due Date	Amount	CUSIP
4/1/2022	$ 18,695,000	01728A3G9
4/1/2023	19,655,000	01728A3H7
4/1/2024	20,665,000	01728A3J3
4/1/2025	21,720,000	01728A3K0
4/1/2026	22,835,000	01728A3L8
4/1/2027	24,005,000	01728A3M6
4/1/2028	25,240,000	01728A3N4
4/1/2029	26,535,000	01728A3P9
4/1/2030	27,895,000	01728A3Q7
4/1/2031	29,325,000	01728A3R5
4/1/2032	30,825,000	01728A3S3
4/1/2033	32,410,000	01728A3T1
4/1/2034	34,070,000	01728A3U8
4/1/2035	35,815,000	01728A3V6
4/1/2036	37,655,000	01728A3W4
4/1/2037	39,385,000	01728A3X2
4/1/2038	40,990,000	01728A3Y0
	$ 487,720,000	Total Serial Bonds

Term Bonds:

Due Date	Amount	CUSIP
4/1/2044	$ 283,575,000	01728A3Z7
4/1/2047	172,070,000	01728A4A1
	$ 455,645,000	Total Term Bonds
	$ 943,365,000	**Total Series 2018A Revenue Bonds**