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Pennsylvania
Insurance Department

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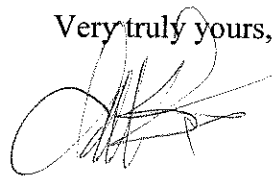
Mr. Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Office of Corporate and Financial Regulation
Pennsylvania Insurance Department
1345 Strawberry Square
Harrisburg, PA 17120

**Re: Order No. ID-RC-13-06 Conditions 15 and 17
June 19, 2015 Approval Letter, Section III (H)**

Dear Deputy Commissioner Johnson:

Pursuant to Conditions 15 and 17 of the above-captioned Order and Section III (H) of the above-captioned Approval Letter, Highmark Health is filing with the Department the attached non-confidential Preliminary AHN Corrective Action Plan.

Very truly yours,



Jack M. Stover

JMS/gmt

Enclosure

cc: Lawrence J. Beaser, Esquire
Brett D. Newman

Highmark Health Preliminary AHN Corrective Action Plan

Executive Summary:

In conjunction with the Pennsylvania Insurance Department's (Department) 2013 Approving Determination and Order (Order) and pursuant to a Letter from the Department on June 19, 2015 related to a proposed Financial Commitment thereunder, Highmark Health has developed the enclosed Preliminary AHN Corrective Action Plan, which outlines a sound strategy that will enable Allegheny Health Network (AHN) to continue its significant progress toward profitability and further enhance its ability to deliver choice and access to the highest quality health care services for the residents of Western Pennsylvania. The health care marketplace has evolved considerably since the formation of Highmark Health and AHN, and this Preliminary AHN Corrective Action Plan supports the ongoing efforts to monitor the progress at AHN.

Elements of this plan include:

- Key accomplishments and advancements since the formation of AHN in 2013, including investments, collaborations and partnerships designed to fill gaps in care, increase efficiency, drive innovation and improve financial performance;
- An overview of the changing regional and national market dynamics that have impacted AHN's strategy and performance;
- Re-projections of AHN's financial performance over the next three years, incorporating the impact of market realities and continued improvement action plans designed to successfully advance the turnaround of the system; and
- A summary of key assumptions as well as risks and opportunities impacting AHN's operating performance over the projection period.

Highmark Health is completing its long term strategic planning process and is continuing to assess the impacts of the highly fluid current market environment noted above and changing demands and expectations of its customers. It is possible that updates to the projections, including adjusted volume projections, alternative strategic growth, capability or technology investments or divestments that AHN determines are necessary for success will result from its ongoing strategic planning processes. The final Highmark Health strategy will be reviewed, approved by its Board and incorporated into the Final AHN Corrective Action Plan that will be submitted by Highmark Health in September 2015.

Background:

In 2011, Highmark requested that the Department approve a series of transactions that were necessary for Highmark to affiliate with West Penn Allegheny Health System (WPAHS). This request was made at a time when UPMC, Western Pennsylvania's dominant provider system, was demanding rate increases from Highmark that would have been extremely detrimental to consumers in Western Pennsylvania, including Highmark's customers. At this same time, the region's second largest provider system, WPAHS, was on the verge of bankruptcy. The convergence of these two factors, combined with urging from area business leaders and other area hospitals, resulted in Highmark seeking an affiliation with WPAHS. The affiliation was grounded in one simple principle – the residents of Western Pennsylvania, including Highmark subscribers and the region's employers, need choice and access to quality providers. Without a vibrant WPAHS, consumers in the Western Pennsylvania region would be subject to the unchecked rate demands of UPMC indefinitely (whether they obtained access to UPMC through Highmark or other insurance companies) and would have available only the amount of insurance competition that UPMC would allow. This was an unacceptable outcome for Highmark and for the people of Western Pennsylvania.

In 2013 the Department approved the change of control of Highmark in favor of the newly formed Highmark Health which allowed the affiliation of Highmark and WPAHS. This affiliation laid the critical foundation for positive change in the Western Pennsylvania health care market by preserving choice, access and competition. The affiliation promoted the development of AHN and established the Highmark Health organization as one of the largest integrated health care delivery and financing systems (IDFS) in the country. The leadership teams at Highmark Health and AHN have successfully established this IDFS while executing a turnaround plan for WPAHS, a hospital system that already has demonstrated considerable progress in improving its financial position. AHN has also begun making significant capital and clinical investments in all of its hospitals to ensure that they are poised to meet the health care needs of the patients and communities they serve. AHN's success to date is a testament to the hard work of its 17,000 employees and its acceptance by patients and employers as a health care provider that offers both high quality and value in the care it provides.

A summary of the key accomplishments at AHN in its two years of operation include:

- Developing a Level II trauma center and state-of-the-art intensive care unit at Forbes Hospital to serve patients in Pittsburgh's eastern suburbs. This investment has already proven its value such as contributing to the saving of lives in area tragedies.
- Opening of a new state-of-the-art 174,000 square foot Wexford Health and Wellness Pavilion offering area residents a variety of healthcare specialists and outpatient diagnostic and ancillary services under one roof. AHN is also expanding and developing similar facilities in Bethel Park and Peters Township.
- Opening of an ambulatory surgery center in Monroeville to serve patients in the Eastern Pittsburgh suburbs, at the Wexford Health and Wellness Pavilion to serve patients in the

Northern suburbs, and the 2015 planned opening in Bethel Park to serve patients in the Southern suburbs.

- Significant investments in women's health and oncology at Jefferson Hospital (JH) located south of Pittsburgh.
- Addition of physicians across various specialties and services lines to grow total physician alignment to over 2,500 physicians (1,100 employed) in over 40 specialties.
- Developing a group purchasing organization (GPO) serving AHN and more than 50 other hospitals, including Johns Hopkins, in supply chain management.
- Installation of the Epic Systems Corporation (Epic) electronic health record technology at Forbes Hospital, Wexford Health and Wellness Pavilion, and various physician offices with further roll-out expected during the second half of 2015. The Epic roll-out represents an important investment in technology to enhance the quality, efficiency and safety of the clinical care AHN provides while reducing costs.
- Establishment of a strategic partnership with Johns Hopkins.

AHN's Strategy is Working:

AHN's key investments and accomplishments have led to significantly improved financial performance and increased patient volumes in the two years since its affiliation with Highmark became effective. For the year ended December 31, 2014, AHN recorded an operating loss of \$37 million, representing a \$365 million improvement over 2013 which included a \$311 million one-time goodwill impairment. Excluding this one-time item, operating results improved by over \$50 million driven primarily by improved net patient service revenue and reduced operating expenses. Had the results for AHN been incorporated for the full year ended December 31, 2013, rather than as of the affiliation date of each hospital, operating results would have shown further improvement of an additional \$80 million year-over-year as a result of turnaround initiatives implemented to restore the provider system.

Volumes have increased incrementally across AHN, particularly at WPAHS and JH, as a result of investments that have expanded AHN's capabilities and improved access to its physicians and programs. Outpatient registrations increased 2% and inpatient discharges increased 1% in 2014 compared to 2013 (assuming AHN results had been incorporated for the full year ended December 31, 2013), even while Highmark and UPMC entered into two separate consent decrees (Consent Decrees) in June 2014 that contained continuity of care provisions which allowed Highmark customers continued in-network access to UPMC hospitals for many services through June 2019.

Changing Market Dynamics:

Improvements in AHN's financial performance over the last two years has taken place against a backdrop of a health care marketplace which – both regionally and nationally – has undergone dramatic change. When Highmark made its initial projections of financial performance and patient volume at

WPAHS, it cautioned that the projections would change as environmental factors in the marketplace evolved. That has proven to be true in several key areas:

- The originally projected affiliation timeline was delayed. This delay and market uncertainty afforded competitors the opportunity to acquire high-performing physician practices. This impacted volumes and increased physician acquisition and retention costs at AHN.
- There has been market confusion regarding the contracting status between Highmark and UPMC following UPMC's decision not to renew its contracts with Highmark, and the resulting Consent Decrees. The Consent Decrees also included "safety net" provisions which allowed Highmark customers who used a UPMC physician in 2014 to continue to see that provider for any services in 2015. In addition, in 2014 the Department interpreted the Consent Decrees in a manner which limited Highmark's ability to offer true narrow network commercial products. As a result, the number of patients previously projected to seek AHN services has been lower than previously projected.
- An overall trend of low market utilization of health care services in Western Pennsylvania impacting the level of volumes at AHN.
- The conditions in the Order placed unanticipated restrictions on AHN's ability to renegotiate payer contracts. When projections were originally prepared, it was assumed that all payer contracts were at market rates with reasonable increases year-over-year to cover inflation. It was also assumed that payer contracts would be able to be negotiated without restriction. The conditions of the Order limited AHN's ability to address the above matters. The continuation of these contracts has caused AHN revenue projections to be lower than originally expected.

Financial Projections

In conjunction with consolidation of the AHN health care delivery system and anticipated changes in Highmark subscriber access to UPMC hospitals, the Highmark Health enterprise underwent a significant capital planning process in 2014 that culminated in Highmark's December 2014 request for approval to invest an additional \$175 million in AHN for capital projects. This request was approved by the Department in June 2015 subject to certain conditions, including the completion of an updated set of three-year financial projections and the submission of (a) this Preliminary AHN Corrective Action Plan; and (b) Final AHN Corrective Action Plan in September 2015.

In response to the conditions in the Department's June 2015 approval, Highmark Health is re-projecting AHN's performance over the next three years, incorporating the impact of the evolving market realities and outlining a set of continued improvement action items. These projections will be updated as part of the submission of the Final AHN Corrective Action Plan. In addition, the Final AHN Corrective Action Plan will elaborate and expand upon those items listed in Appendix B attached hereto.

The updated three-year projections evidence a continued turnaround of AHN, albeit at a slower pace than was originally anticipated. The projections demonstrate continued annual improvement in operating results and cash flow from operations, as well as increased volumes.

A summary of overarching key financial outcomes and assumptions is included below:

\$ in Millions	2014 Actual	2015 Plan	2016 Plan	2017 Plan
TOTAL REVENUES	\$ 2,468	\$ 2,625	\$ 2,735	\$ 2,835
TOTAL OPERATING EXPENSES	2,505	2,661	2,764	2,843
OPERATING LOSS	(37)	(36)	(29)	(8)
NET LOSS	\$ (39)	\$ (34)	\$ (43)	\$ (25)
EBITDA	\$ 69	\$ 90	\$ 107	\$ 131
Operating Margin	(1.5%)	(1.4%)	(1.1%)	(0.3%)
Net Margin	(1.6%)	(1.3%)	(1.6%)	(0.9%)
CASH FLOW FROM OPERATIONS	\$ (55.8)	\$ 42.8	\$ 55.5	\$ 61.7
DAYS CASH ON HAND	87.9	78.4	75.0	62.4
	2014 Actual	2015 Plan	2016 Plan	2017 Plan
Inpatient Discharges (Acute/Psych/Rehab)	83,594	85,817	87,235	88,890
Outpatient Registrations	1,270,270	1,271,509	1,391,942	1,491,922

AHN's operating performance is projected to improve over the projection period from an operating loss in 2014 of \$37 million to an operating loss in 2017 of \$8 million, an improvement of \$29 million. This improvement is driven largely by increased volumes due to the investments made in the system to expand capabilities and services, specific turnaround initiatives including revenue enhancement and cost efficiency actions.

Net results are projected to improve from a loss of \$39 million in 2014 to a loss of \$25 million, an improvement of \$14 million. This reduction is achieved by improved operating performance driven by volumes that are projected to increase, growth in diversified businesses and lower interest expense.

Operating Results Assumptions 2015-2017

A summary of key assumptions which are expected to impact AHN's operating performance over the projection period are summarized below:

Volume: Baseline AHN volume is expected to decline for inpatient services and remain relatively flat for outpatient services based on regional trends and the movement of patients out of hospital facilities to free-standing locations. Highmark product offerings, continued expansion and enhancements of AHN capabilities and the expiration of the safety net provision within the Consent Decrees are expected to contribute additional volume to AHN. The volume estimates are conservative based on UPMC's broad interpretation of the continuity of care provisions of the Consent Decrees. If the definition of continuity of care were to be interpreted differently, AHN's patient volumes would be impacted. Volume has also been adjusted for anticipated changes in Highmark enrollment.

Payer Payments: The 2015 projections incorporate commercial payer payments based on contracts currently in place and include anticipated quality payments, fee schedule reimbursement and community health reinvestment payments. In future years, the projections assume that certain fee schedule payments increase for inflation and contracted terms and, upon expiration, are renewed at competitive market rates. Most of the commercial payer contracts are effective until 2017 and, as a result, AHN has limited ability to improve revenue projections in the short term. Rates for government payers which represent approximately 50% of AHN's volume are expected to remain flat (Medicaid) or grow only 0.5% annually (Medicare).

Expense Inflation: Annual expense inflators include estimated salary and benefit inflation of 2.5% and 3.25% for supplies and drugs. The average rate increase from the commercial and government payers is not sufficient to cover the expense inflators and, as a result, is expected to result in deterioration of the financial results by nearly \$30 million incrementally year-over-year.

Expense reduction through efficiency and revenue improvement initiatives: Improvements in clinical effectiveness, care coordination and other expense reduction initiatives are necessary to improve financial results. A focus on decreasing length of stay is underway to both increase patient satisfaction and decrease expenses. AHN's GPO which was established in the last two years is expected to continue to drive incremental savings via volume purchasing discounts and standardization of products and devices. Enhanced revenue cycle processes, greater workforce efficiencies and improved care alignment processes to keep referrals within the AHN system are expected to drive higher net patient revenues. Additionally, during 2014, outstanding debt at WPAHS was refinanced driving lower annual interest expense.

Investments in the future: Physician acquisitions, expansion of diversified businesses, service line expansion, creation of new outpatient facilities, installation of Epic and increased capital investments in facilities to improve quality and patient experience are expected to pressure results in the near-term prior to volumes associated with these investments ramping up to full capacity. Key investments in access and services such as the Wexford Health and Wellness Pavilion, the Monroeville surgery center and new services at JH are projected to improve operating margin during the projection period.

Please see [Appendix A](#) for the detailed financial statements and related key metrics associated with the projections.

Financial Commitments

No additional financial commitments are included in the Preliminary AHN Corrective Action Plan. As Highmark Health updates its long term strategy, any additional financial commitments will be included as part of the Final AHN Corrective Action Plan.

Projected Capital Expenditures

\$ in Millions	<u>2014 Actual</u>	<u>2015 Plan</u>	<u>2016 Plan</u>	<u>2017 Plan</u>
CAPEX	\$ 179	\$ 213	\$ 155	\$ 139
DEPRECIATION	\$ 106	\$ 126	\$ 137	\$ 139
CAPEX AS A % OF DEPREC.	169%	170%	113%	100%

In addition to the \$175 million earmarked for capital expenditures noted earlier, AHN has a broader capital investment plan based on available cash and focused on quality and safety, customer service, growth and access, financial stability and sustainability. The level of expected capital investment by year as a percentage of depreciation is slightly lower than industry benchmarks in 2017 and excludes the investment in Epic as that technology is funded by Highmark Health and charged to AHN. Given the historically low level of investment prior to the WPAHS affiliation, AHN will continue to evaluate the ability to expedite capital investment in the facilities. Additional strategies are being explored to identify external sources of capital funding via donations or other sources. To the extent that available operating cash flow changes from the current projections, the capital expenditure plan will adjust accordingly. Additionally, if immediate investments are required for critical care issues, days cash on hand (DCOH), as summarized below, may vary from current projections.

The Highmark Health enterprise is committed to offering health care provider choice to the customers and patients it serves and will continue to partner with community hospitals and physicians to enable them to continue to operate independently. As such, the projections do not assume the expansion of hospital assets through acquisition. In addition, the capital projections do not include any expansion or closure of AHN facilities. To the extent that additional capital investment is required, these needs and the source of funding will be identified, and if necessary, submitted to the Department.

Days Cash on Hand

DCOH is directly impacted by the capital funds provided by external sources (i.e., grants, donations, etc.), Highmark Health investments, operating results and AHN capital expenditures. Funds scheduled to come from Highmark as described in the originally filed projections have been incorporated, some of which are reflected as equity transfers per applicable accounting guidance. Based on the aforementioned assumptions, DCOH is projected to be as follows:

	<u>2014 Actual</u>	<u>2015 Plan</u>	<u>2016 Plan</u>	<u>2017 Plan</u>
DAYS CASH ON HAND	87.9	78.4	75.0	62.4

It is important to note that DCOH amounts above include certain funds that are not immediately available for use. These funds include amounts that are restricted by various foundations, for research commitments, required reserves, and other limited uses.

DCOH is projected to decline over the projection period as investments in the system are made and capital is managed to maintain adequate / prescribed levels while AHN's operating results improve. The

projections assume on an annual basis that capital expenditures and operating results approximate identified levels. To the extent that operating cash flow is limited and capital expenditures are required beyond estimated levels, DCOH will be negatively impacted.

Additional key assumptions related to DCOH and cash flow projections include the impact of information technology investments. The projections assume a cash delay related to the Epic conversion in the near term as staff and physicians orient to a new electronic health records system and associated revenue cycle processes. AHN expects those delays to stop following the completion of the conversion process. To date, 65 physician practices and 200 office locations are live on Epic, as is Forbes Hospital, the Wexford Health and Wellness Pavilion and the AHN Urgent Care Center in Braddock. Epic installation and rollout is anticipated at Allegheny General Hospital in 2015 and at West Penn Hospital in early 2016. The cost and timeline for the installation of Epic at Saint Vincent Hospital (SVH) and JH and the other remaining AHN facilities is currently being evaluated and is not included in the projections.

The projections incorporate costs of additional coding resources related to the conversion of the government mandated ICD-10 medical billing coding system in order to manage the potential for cash delays associated with the change. Uncertainty in the governmental requirements and provider / payer preparedness could impact AHN's ability to manage this conversion and its cash impact.

Risks and Opportunities to Financial Performance

AHN is providing a reasonable estimate of its projected financial performance; however, there continues to be uncertainty in the local market and significant market disruption from broader industry impacts such as national healthcare reform. As such, a summary of key risks and opportunities that could impact the projections is reflected below:

Risks:

- Lower utilization trends across all service lines.
- Large scale system implementations which may cause temporary inefficiencies as staff become experienced with new systems and procedures. Cost estimates could vary from what is included in the projections.
- Achievement of improvement initiatives that currently exceed \$100 million across the projection period.
- The projections are subject to various market fluctuations, including changes in interest rates, that could have an impact on various financial statement areas including goodwill, investments and benefit plans. The projections do not assume any material change related to these market fluctuations.

Conversely, there are opportunities that could positively impact the projected results. Such opportunities include:

- Expense initiatives could drive higher profitability in 2016 and 2017.
- The implementation of Epic is expected to drive operating efficiencies including improved care alignment. Those additional efficiencies are not included in these projections.

- Length of stay reduction initiatives are more conservative than operational targets. Additional improvement beyond these projections may occur.
- A favorable result with respect to payer contracting.
- Advertising and branding costs may be reduced in 2016 and 2017 if increased brand recognition and volume is seen.

Access, Quality and Innovation Advancements

While the primary focus of this document is financial improvement, it is critical to understand the advancements AHN has made and continues to drive in the community regarding access to the highest quality care today and for the future.

AHN has aligned with Highmark in its mission to improve access to care in the community whenever medically appropriate. Not only does this enhance the economic viability and quality of life in local communities but studies show that care closer to home leads to better medical outcomes and fewer readmissions and medical complications. AHN continues to support this effort to provide more accessible and affordable care by moving many of its specialists out of its central quaternary facilities and into community settings, including owned facilities and independent community hospitals. AHN also is moving more care, again where medically appropriate, from higher-cost in-patient settings to lower-cost outpatient settings. Importantly, AHN is doing all this even though it receives less revenue from these strategies.

AHN has also worked effectively to recruit leading physicians from inside and outside the market to address areas of need in the community, including physicians in primary care, orthopedic surgery, neurology, cancer, women's health, diabetes and cardiology, among others.

Technology improvements are vital in making the Highmark-AHN integrated delivery model work. The implementation of Epic, the best-in-class of integrated electronic health records, will improve efficiency, quality, cost of care, and the patient experience.

AHN has taken significant steps to further enhance the high quality, comprehensive scope and availability of its clinical, research and academic programs through collaborations with nationally leading organizations. AHN actively engages in various collaborative programs and initiatives with thought-leading and ground-breaking provider organizations and education systems such as Johns Hopkins, Carnegie Mellon and Lake Erie College of Osteopathic Medicine to evolve care to the betterment of our community.

Additionally, physicians and researchers at AHN are advancing quality of care and innovation in many disciplines, including allergy, asthma and autoimmunity; biofilms; cancer; cardiovascular diseases; esophageal diseases; orthopedics; psychiatry; and the neurosciences. AHN has more than 400 active research projects in progress; nearly 150 clinicians are serving as principal investigators. In addition, AHN is offering patients the opportunity to participate in a wide array of clinical trials, giving these patients access to promising new treatments that are not yet available to the general public.

Conclusion

Highmark Health's revised preliminary projections for AHN reflect the goal of improving AHN's financial results, driving quality, access and innovation for patients and further solidifying Highmark Health's integrated healthcare financing and delivery model. This goal is projected to be accomplished and operating results are expected to improve over the projection period, even during a period of heavy investment in infrastructure, strategic care services and innovation.

Highmark Health is completing its long term strategy and is continuing to assess the impacts of the highly fluid current market environment noted above and changing demands and expectations of its customers. It is possible that updates to the preliminary AHN projections, including adjusted volume projections, alternative strategic growth, capability or technology investments or divestments that AHN determines are necessary for success will result from its ongoing strategic planning processes. Changes could also include changes in the proposed footprint for AHN facilities to meet needs to drive care closer to home and potential capital contributions to support the investments needed to provide quality care and access in an expedited manner to patients, including Highmark customers. The final Highmark Health strategy will be reviewed, approved by its Board and incorporated into the Final AHN Corrective Action Plan that will be submitted by Highmark Health in September 2015.

Appendix A – Financial Statements and Key Metrics

Attached are the following financial statements and key metrics being provided in connection with the conditions of the Department's June 2015 approval:

- AHN Consolidated Balance Sheet, Income Statement and Cash Flows for 2015-2017
- AHN Consolidated Days Cash on Hand for 2015-2017
- AHN Consolidated Debt Service Coverage Ratio for 2015-2017
- AHN Consolidated Key Metrics (Volumes, FTEs) for 2015-2017

These projections will be updated as part of the submission of the Final AHN Corrective Action Plan in September 2015.

Allegheny Health Network
Consolidated Balance Sheet
(Dollars in Thousands)

	2015	2016	2017
	DEC	DEC	DEC
<u>ASSETS</u>			
Cash & Cash Equivalents	\$ 114,596	\$ 106,464	\$ 108,790
Net Patient Accounts Receivable	258,683	244,783	247,283
Other Receivables	65,431	66,527	67,223
Inventory, Net	47,700	48,700	49,400
Prepaid Expenses & Other Current Assets	45,110	45,070	45,030
Total Current Assets	<u>531,520</u>	<u>511,544</u>	<u>517,726</u>
Unrestricted - Board Designated Funds	165,620	159,620	153,620
Temporarily Restricted	19,400	19,500	19,600
Permanently Restricted	268,500	268,634	268,768
Total Assets Restricted As To Use	<u>453,520</u>	<u>447,754</u>	<u>441,988</u>
Property, Plant & Equipment - Net	1,071,832	1,090,105	1,089,984
Investments	271,100	280,100	205,100
Goodwill	118,400	118,400	118,400
Other Assets, Net	173,700	175,700	173,700
Total Long-Term Assets	<u>1,635,032</u>	<u>1,664,305</u>	<u>1,587,184</u>
TOTAL ASSETS	<u>\$ 2,620,072</u>	<u>\$ 2,623,603</u>	<u>\$ 2,546,898</u>
<u>LIABILITIES & NET ASSETS</u>			
Accounts Payable	\$ 219,600	\$ 222,100	\$ 224,600
Accrued Expenses	98,800	98,800	99,300
Total Debt	1,427,025	1,420,134	1,414,613
Benefit Plan Liabilities	379,772	333,861	286,949
Other Liabilities	253,300	253,300	250,800
Total Liabilities	<u>2,378,497</u>	<u>2,328,195</u>	<u>2,276,262</u>
Unrestricted Net Assets	(46,325)	7,274	(17,732)
Temporarily Restricted Net Assets	19,400	19,500	19,600
Permanently Restricted Net Assets	268,500	268,634	268,768
Total Net Assets	<u>241,575</u>	<u>295,408</u>	<u>270,636</u>
TOTAL LIABILITIES & NET ASSETS	<u>\$ 2,620,072</u>	<u>\$ 2,623,603</u>	<u>\$ 2,546,898</u>

Allegheny Health Network
Consolidated Statement of Operations
(Dollars in Thousands)

	<u>2015</u>	<u>2016</u>	<u>2017</u>
	<u>YTD DEC</u>	<u>YTD DEC</u>	<u>YTD DEC</u>
Net Patient Revenues	\$ 2,435,782	\$ 2,543,435	\$ 2,669,806
Other Operating Revenues	189,508	191,065	165,483
TOTAL REVENUES	2,625,290	2,734,500	2,835,289
Salaries	1,242,139	1,302,979	1,351,817
Benefits	218,150	229,225	238,473
Professional Fees & Purchased Services	279,701	266,947	266,171
Patient Care Supplies & Drugs	467,205	499,278	527,216
Insurance	33,792	34,150	34,568
Other Operating Expenses	290,556	294,620	285,778
Depreciation and Amortization	125,543	136,627	139,421
Restructuring	3,706	-	-
TOTAL OPERATING EXPENSES	2,660,792	2,763,826	2,843,444
OPERATING INCOME (LOSS)	(35,502)	(29,326)	(8,155)
Interest Expense	(31,342)	(30,856)	(30,505)
Investment Income	19,746	20,770	21,615
Gifts and Donations	1,066	978	978
Other Income (Expense)	10,129	(1,614)	(1,614)
Net Income Attributable to Non-Controlling Interest	(1,084)	(6,388)	(10,660)
Income Tax Benefit	3,150	3,335	3,335
NET (LOSS) INCOME	\$ (33,837)	\$ (43,101)	\$ (25,006)
EBITDA - Using Operating Income	90,041	107,301	131,266
Operating Margin	(1.4%)	(1.1%)	(0.3%)
Net Margin	(1.3%)	(1.6%)	(0.9%)

Allegheny Health Network
Consolidated Statement of Cash Flows
(Dollars in Thousands)

	2015	2016	2017
<u>Cash Flow from Operating Activities</u>			
Increase (Decrease) in Net Assets	\$ 120,864	\$ 53,833	\$ (24,772)
Depreciation & Amortization	125,543	136,627	139,421
Gain on Extinguishment of Debt	(7,500)	-	-
Provision for Doubtful Accounts	83,117	87,086	90,425
CAPEX Equity Transfer from Highmark	(96,000)	(79,000)	-
Other Equity Transfers	(35,700)	(17,700)	-
Other	(4,600)	-	-
Restricted Contributions	(4,734)	(4,733)	(4,723)
(Increase)/Decrease in:			
Net Patient Accounts Receivable	(104,000)	(73,186)	(92,925)
Other Receivables	27,669	(1,096)	(696)
Inventories, Prepaid Expenses & Other Current Assets	(14,210)	(960)	(660)
Other	(13,500)	(2,000)	2,000
Increase/(Decrease) in:			
Accounts Payable & Accrued Expenses	15,300	2,500	3,000
Accrued Pension Liabilities	(41,489)	(45,911)	(46,911)
Other Noncurrent Liabilities	(8,000)	-	(2,500)
Cash Flow from Operating Activities	42,760	55,460	61,659
<u>Cash Flow from Investing Activities</u>			
Capital Expenditures	(213,101)	(154,900)	(139,300)
(Purchases)/sales of investments	7,680	(3,233)	80,765
Cash Flow from Investing Activities	(205,421)	(158,133)	(58,535)
<u>Cash Flow from Financing Activities</u>			
Payment of Debt	(29,341)	(6,892)	(5,521)
CAPEX Equity Transfer from Highmark	96,000	79,000	-
Other Equity Transfers	35,700	17,700	-
Other	4,600	-	-
Restricted Contributions	4,734	4,733	4,723
Additional Financing	32,000	-	-
Cash Flow from Financing Activities	143,693	94,541	(798)
<u>Cash Summary</u>			
Beginning Cash Balance	133,564	114,596	106,464
Net Change in Cash	(18,968)	(8,132)	2,326
Ending Cash Balance	\$ 114,596	\$ 106,464	\$ 108,790

Allegheny Health Network
Consolidated Days Cash on Hand
Year Ended December 31
(Dollars in Thousands)

	2015	2016	2017
Cash and cash equivalents	\$ 114,596	\$ 106,464	\$ 108,790
Investments	271,100	280,100	205,100
Board designated	165,620	159,620	153,620
Total	\$ 551,316	\$ 546,184	\$ 467,510
Total operating expenses	\$ 2,660,792	\$ 2,763,826	\$ 2,843,444
Add: interest expense*	31,342	30,856	30,505
Less: depreciation and amortization	(125,543)	(136,627)	(139,421)
Total	\$ 2,566,591	\$ 2,658,055	\$ 2,734,528
Days in year ending December 31	365	365	365
Operating expense per day	\$ 7,032	\$ 7,282	\$ 7,492
DAYS CASH ON HAND	78.4	75.0	62.4

*Note: Interest expense included in accordance with Master Trust Indenture

Allegheny Health Network
Consolidated Debt Service Coverage Ratio
Year Ended December 31
(Dollars in Thousands)

	<u>2015</u>	<u>2016</u>	<u>2017</u>
Excess of expenses over revenues	\$ (33,837)	\$ (43,101)	\$ (25,006)
Add: depreciation and amortization	125,543	136,627	139,421
Add: interest expense	31,342	30,856	30,505
Total	123,048	124,382	144,920
Debt Service Requirement	\$ 60,683	\$ 37,748	\$ 36,026
DEBT SERVICE COVERAGE RATIO	<u>2.03</u>	<u>3.30</u>	<u>4.02</u>

Note: 2015 debt service includes payments on WPAHS Floating Rate Restructuring Certificates of approximately \$8 million and balloon payments on the WPAHS 2006 Series B debt of approximately \$11 million. The forecast period does not include principal payments on the WPAHS \$700 million term loans with PNC as principal payments for that debt are not required prior to December 31, 2017.

**Allegheny Health Network
Schedule of Statistical Information by System
Year Ended December 31, 2015**

	<u>WPAHS</u>	<u>JRMC</u>	<u>SVH</u>	<u>Other AHN</u>	<u>Total AHN</u>
Inpatient Discharges (Acute/Psych/Rehab)	56,847	14,217	14,753	-	85,817
Outpatient Registrations	810,838	258,324	202,347	-	1,271,509
Occupancy Rates	54.60%	52.10%	48.79%	-	53.20%
FTEs (Exempt)	2,892	258	633	180	3,963
FTEs (Non-Exempt)	8,423	1,260	1,801	63	11,547

**Allegheny Health Network
Schedule of Statistical Information by System
Year Ended December 31, 2016**

	<u>WPAHS</u>	<u>JRMC</u>	<u>SVH</u>	<u>Other AHN</u>	<u>Total AHN</u>
Inpatient Discharges (Acute/Psych/Rehab)	57,859	14,485	14,891	-	87,235
Outpatient Registrations	891,658	295,762	204,522	-	1,391,942
Occupancy Rates	55.36%	52.89%	49.08%	-	53.89%
FTEs (Exempt)	2,943	267	641	189	4,040
FTEs (Non-Exempt)	8,576	1,304	1,823	66	11,769

**Allegheny Health Network
Schedule of Statistical Information by System
Year Ended December 31, 2017**

	<u>WPAHS</u>	<u>JRMC</u>	<u>SVH</u>	<u>Other AHN</u>	<u>Total AHN</u>
Inpatient Discharges (Acute/Psych/Rehab)	59,021	14,761	15,108	-	88,890
Outpatient Registrations	958,817	325,877	207,228	-	1,491,922
Occupancy Rates	56.35%	53.80%	49.70%	-	54.80%
FTEs (Exempt)	2,988	274	646	198	4,106
FTEs (Non-Exempt)	8,716	1,336	1,840	70	11,962

Appendix B – Additional Information to be Provided in Final AHN Corrective Action Plan

Pursuant to Condition H of the June 19, 2015 Letter from the Department approving the grant of \$175 million from Highmark to AHN, Highmark Health is to submit to the Department a final and complete AHN Corrective Action Plan (the “Final AHN Corrective Action Plan”) no later than September 30, 2015. The Final AHN Corrective Action Plan will include, in detail, the following required items:

1. Retrospective review of AHN course of action detailing key initiatives, including period implemented and value realized by year:

(a) A description of the specific steps and investment of funds and changes to AHN and AHN Entities that have already been taken to carry out or implement the IDN Strategy since the close of the Affiliation Agreement; specifically including (A) a description of the category of the IDN program changes, projects or investments that have been incurred or implemented (the “Changes Implemented”); (B) the cost thereof; (C) the specific locations at which the Changes Implemented were made; and (D) the reason(s) why such changes or investments were required or advisable;

(b) The specific results or benefits/costs savings sought to be obtained by the Changes Implemented, including a quantification of value, if available, and comparison of the actual benefits/costs savings obtained to date in comparison to those anticipated as of the date that such Changes Implemented were incurred or implemented;

(c) A description of any steps, initiatives or plans that were proposed, but not implemented, and the reasons for not implementing such plans or proposals; and

(d) The specific objectives or goals of all strategies, plans and actions comprising the AHN Corrective Action Plan, including the timeline for the accomplishment of these objectives.

2. Detailed operating and financial projections on a quarterly basis for the period July 1, 2015 through December 31, 2017 and the following operating and financial projections, together with a description of the assumptions underlying such projections which must be reasonable and likely attainable:

(a) Projected inpatient discharges and outpatient registration volume for each AHN Entity, along with projected occupancy rates and in connection therewith: (A) Written commentary explaining why the Board of Directors of Highmark Health (the “Highmark Health Board”) and the Board of Directors of AHN and their management believe these volumes to be achievable; and (B) A discussion of the impact of the Consent Decrees upon these projections;

(b) Projected income statements, displaying a level of detail consistent with the Base Case Financial Projections for the AHN Entities submitted by Highmark in connection with the Order;

(c) Projected balance sheets, displaying a level of detail consistent with the Base Case Financial Projections for the AHN Entities;

(d) Projected cash flow statements, displaying a level of detail consistent with the Base Case Financial Projections for the AHN Entities; and

(e) A detailed schedule of capital expenditures for all of the AHN Entities' facilities, including a description of any plans to downsize, close or repurpose, in whole or in part, any facility or operation owned or operated by any AHN Entity and a schedule of the timing and cost/ benefit analysis associated with these plans.

3. A description of the due diligence process that the Highmark Health Board pursued in approving the Final AHN Corrective Action Plan, including a description of the following:

(a) The manner in which the Final AHN Corrective Action Plan was prepared and how projections were assessed or made at each facility;

(b) The material issues or concerns that the Highmark Health Board or management expressed with regard to earlier drafts of the Final AHN Corrective Action Plan; and

(c) The changes that were made to the Final AHN Corrective Action Plan in order to ultimately obtain approval by the Highmark Health Board.

4. Identification of any proposed Financial Commitments (including Donations)

5. The AHN Corrective Action Plan shall be reviewed by an independent external financial expert who was not involved with, and who did not otherwise participated in the preparation of or provide any analysis for, the Preliminary AHN Corrective Action Plan or the Final Corrective Action Plan (the Financial Commitment Reviewer"). The Financial Commitment Reviewer shall provide an option as to the reasonableness of the Final ANH Corrective Action Plan, the sufficiency of the Final AHN Corrective Action Plan to accomplish Plan Objectives and the specific level of benefits and costs to be borne by Highmark's policyholders, as distinct from any franchise benefits accruing to Highmark in the form of higher enrollment, revenue, and market share, and an option as to the reasonableness of the value assigned by Highmark Health and/or Highmark to Highmark's investments in AHN.