



Management's Discussion and Analysis (MDA) For the Nine Months Ended March 31, 2019 and 2018

This section is intended to present management's analysis of Ballad Health's financial condition and activities as of and for the quarters ended March 31, 2019 and 2018. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to the Ballad Health financial statements and should be used in conjunction with the unaudited financial statements, utilization statistics, and performance ratios that follow this section. All dollar amounts, unless otherwise noted, are expressed in thousands of dollars.

The information in the MDA is presented under the following sections:

- Organization and Operations
- Overview of Financial Statements
- Financial Analysis
- Debt Compliance
- COPA & CA Compliance
- Request for Information

Organization and Operations

Ballad Health is a tax-exempt entity and the parent corporation of both Mountain States Health Alliance (MSHA) and Wellmont Health System (WHS). The two healthcare systems came together on February 1, 2018 as a result of a merger approved by the Department of Health in both Tennessee and Virginia. Ballad operates under a Certificate of Public Advantage (COPA) in Tennessee and a Cooperative Agreement (CA) in Virginia. Pursuant to the COPA and CA, MSHA and WHS (the COPA Parties) must fulfill certain obligations, commitments, and covenants agreed to by the states and Ballad Health. Such obligations include certain spending over a ten-year period (beginning July, 2018) on initiatives to ensure access to healthcare services, health research and graduate medical education, population health, and a plan for ensuring patient data is available to providers throughout the region. The full text of the COPA may be found on the Tennessee Department of Health website. The full text of the Cooperative Agreement may be found on the Virginia Department of Health website.

Ballad Health is a healthcare delivery system serving 29 counties in Northeast Tennessee, Southwest Virginia, Northwest North Carolina, and Southeast Kentucky. Ballad operates 3,246 licensed beds in 21 hospitals, including a dedicated children's hospital, community hospitals, three critical access hospitals, a behavioral health hospital, an addiction treatment facility, long-term care facilities, home care and hospice services, retail pharmacies, outpatient services and a comprehensive medical management corporation.

The accompanying unaudited consolidated financial statements include all assets, liabilities, revenues, and expenses, and changes in net assets attributable to non-controlling interests in the following subsidiaries:

- Smyth County Community Hospital and Subsidiary – Ballard Health holds an 80.0% interest
- Norton Community Hospital and Subsidiaries – Ballard Health holds a 50.1% interest
- Johnston Memorial Hospital, Inc. and Subsidiaries – Ballard Health holds a 50.1% interest

Ballad Health is the primary beneficiary of fundraising and development activities of the Ballad Health Foundation.

Overview of Financial Statements

Ballad Health's unaudited financial statements include the following:

Balance Sheet presents information on Ballad Health's assets, liabilities, and net assets as of the period ended March 31, 2019.

Consolidated Statement of Operations presents the results of Ballad Health's operations over the course of the third quarter of fiscal year 2019 compared to the same period in the previous fiscal year and the same for the nine months year to date.

The financial statements are prepared using the accrual basis of accounting and in conformity with generally accepted accounting principles (GAAP).

Financial Analysis

Financial Highlights for the Quarter ended March 31, 2019.

- Ballad Health reports financial improvements over the prior year for the third consecutive quarter since the healthcare systems merged.

Financial Position

Please see accompanying Balance Sheet as of March 31, 2019.

- As of quarter ended March 31, 2019, Ballad Health's assets exceeded liabilities by \$1.630 billion. Total Net Assets increased by 1.7% from year ended June 30, 2018.
- Significant capital investment continued in the third quarter with over \$28 million in expenditures mainly related to information technology infrastructure and a common electronic health record, outpatient service renovations, and other diagnostic and treatment equipment.

Results from Operations

Please see accompanying Statement of Revenue over Expenses for the quarter and nine months ended March 31, 2019 and the same period ended in 2018.

- Ballard Health continues to experience a decline in overall volumes, with acute discharges in the quarter declining by 5.5 percent. The discharge decline is being driven by a reduction in lower acuity admissions, a result of focused efforts by Ballard Health and primary care physician groups to reduce unnecessary admissions and utilize lower cost outpatient services where possible. While overall inpatient volume was down, adjusted discharges were up slightly by 0.7 percent due to improved length of stay management and a shift to outpatient services. Total surgeries decreased by 3.9 percent to 17,547 cases. Inpatient surgeries decreased by 5.4 percent, while outpatient surgeries decreased by 3.3 percent. Emergency Department visits declined by 1.0 percent.
- During the quarter as compared to the same period last year
 - Operating cash flow (Operating EBITDA) improved to \$55.5 million from \$46.7 million in the same quarter prior year, an 18.7 percent increase.
 - Total cash flow (EBITDA) improved to \$44.1 million versus \$40.3 million in the same quarter prior year, a 9.3 percent increase.
 - Revenue for the quarter increased by 1.4 percent, while expenses decreased by 0.2 percent - leading to an improvement in the operating margins for the health system.
 - Ballard Health's financial performance improved through exceptional expense management, including a 31.3 percent reduction in the use of contract – or temporary – labor, improvements in productivity and focused supply cost management. Ballard Health invested \$266.3 million into the region's labor force.
 - Operating Margin improved significantly to 1.3 percent compared to (0.2) percent for the same quarter last year. EBITDA margin improved from 7.9 percent in the prior year quarter to 8.6 percent in the current year quarter.
- For the nine months ended March 31, 2019 as compared to the same period last year
 - Operating cash flow (Operating EBITDA) improved to \$158.7 million from \$141.4 million, a 12.2 percent improvement.
 - Total cash flow (EBITDA) improved to \$169.4 million versus \$145.0 million for the same nine-month period prior year, a 16.8 percent increase.
 - EBITDA margin improved from 9.6 percent in the prior year nine-month period to 11.1 percent in the current year nine-month period.
 - Revenue for the period grew 1.3 percent, while expenses increased 0.4 percent, leading to operating margin improvement to 0.9 percent from 0.0 percent in the prior period.
 - Operating Income for the period grew from \$(.405) million to \$13.7 million.

Debt Compliance

As of March 31, 2019, Ballard Health had \$1.346 billion in debt outstanding, a decrease of \$9.7 million over the prior year end. Total debt outstanding consisted of (1) fixed-rate serial, term, capital appreciation, and revenue bonds, (2) variable rate term bonds (3) variable rate equipment leasing and (4) capital lease obligations.

Credit Ratings

Ballad Health carries underlying ratings of (1) Fitch Ratings: "A" (2) Standard & Poor's: "A-", and (3) Moody's Investor Service: "Baa1".

Days Cash on Hand

Pursuant to the Master Trust Indenture (MTI), Ballad Health is required to maintain **100 days** cash on hand. For the quarter ended March 31, 2019, Ballad Health's **days cash on hand was 259**, more than sufficient to meet the covenant requirements under the MTI.

Debt Service Coverage

Revenues were sufficient to pay debt service. Based on a pro forma annualized quarterly income, debt service coverage was 3.77. Based on rolling twelve months of income, debt service coverage was 4.01.

Certificate of Public Advantage and Cooperative Agreement Compliance

Ballad Health is in compliance with the terms of both the COPA and CA.

Request for Information

This report is intended to provide or investors and creditors an overview of Ballad Health's financials. Questions regarding any of the information provided in this report should be addressed to Ballad Health, Chief Financial Officer, 300 Med Tech Parkway, Suite 300, Johnson City, Tennessee 37604.

Ballad Health
Comparative Balance Sheet

	March 31 2019	June 30 2018
<u>ASSETS</u>		
<u>CURRENT ASSETS</u>		
Cash and Cash Equivalents	146,986,103	86,843,707
Current Portion AWUIL	6,517,252	8,526,640
Accounts Receivable (Net)	293,398,117	288,090,230
Other Receivables	42,051,758	34,470,415
Due From Affiliates	2,977,372	1,322,174
Due From Third Party Payors	4,009,103	(3,892,928)
Inventories	50,211,729	48,439,110
Prepaid Expense	18,553,106	17,359,164
	<u>564,704,539</u>	<u>481,158,511</u>
<u>ASSETS WHOSE USE IS LIMITED</u>	<u>58,197,198</u>	<u>59,143,475</u>
<u>OTHER INVESTMENTS</u>	<u>1,215,564,284</u>	<u>1,203,943,419</u>
<u>PROPERTY, PLANT AND EQUIPMENT</u>		
Land, Buildings and Equipment	3,152,538,859	3,080,374,780
Less Allowances for Depreciation	1,892,480,162	1,801,223,387
	<u>1,260,058,696</u>	<u>1,279,151,393</u>
<u>OTHER ASSETS</u>		
Pledges Receivable	572,320	824,392
Long Term Compensation Investment	31,762,256	32,211,612
Investments in Unconsolidated Subsidiaries	19,316,957	17,562,549
Land / Equipment Held for Resale	3,028,830	6,646,369
Assets Held for Expansion	11,268,702	11,361,384
Investments in Subsidiaries	0	(0)
Goodwill	209,381,219	209,602,215
Deferred Charges and Other	9,273,111	12,329,037
	<u>284,603,395</u>	<u>290,537,558</u>
<u>TOTAL ASSETS</u>	<u>3,383,128,113</u>	<u>3,313,934,356</u>
<u>LIABILITIES AND NET ASSETS</u>		
<u>CURRENT LIABILITIES</u>		
Accounts Payable and Accrued Expense	163,647,544	132,757,940
Accrued Salaries, Benefits, and PTO	118,510,029	122,451,089
Claims Payable	1,272,761	1,953,448
Accrued Interest	9,539,551	9,486,141
Due to Affiliates	0	0
Due to Third Party Payors	17,447,531	10,220,351
Call Option Liability	0	0
Current Portion of Long Term Debt	27,255,904	14,036,863
	<u>337,673,318</u>	<u>290,905,831</u>
<u>OTHER NON CURRENT LIABILITIES</u>		
Long Term Compensation Payable	15,763,251	16,318,189
Long Term Debt	1,318,828,080	1,341,728,650
Estimated Fair Value of Interest Rate Swaps	5,553,865	8,949,730
Deferred Income	24,884,727	7,240,227
Professional Liability Self-Insurance and Other	50,044,847	45,305,098
	<u>1,415,074,770</u>	<u>1,419,541,895</u>
<u>TOTAL LIABILITIES</u>	<u>1,752,748,089</u>	<u>1,710,447,726</u>
<u>NET ASSETS</u>		
Restricted Net Assets	24,182,751	20,612,107
Unrestricted Net Assets	1,351,200,124	1,341,069,857
Noncontrolling Interests in Subsidiaries	254,997,150	241,804,666
	<u>1,630,380,024</u>	<u>1,603,486,630</u>
<u>TOTAL LIABILITIES AND NET ASSETS</u>	<u>3,383,128,113</u>	<u>3,313,934,356</u>

Ballad Health
Statement of Revenue and Expense
For The Period Ended March 31, 2019 and March 31, 2018

	Quarter 3 Mar 2019	Quarter 3 Mar 2018	Year to Date Mar 2019	Year to Date Mar 2018
Revenue, Gains and Support				
Patient service revenue, net of contractual allowances and discounts	543,987,920	556,877,144	1,626,243,194	1,647,055,591
Provision for bad debts	(29,307,369)	(48,414,314)	(100,229,399)	(136,889,638)
Net patient service revenue	514,680,552	508,462,830	1,526,013,796	1,510,165,953
Other operating revenue	14,104,905	13,248,948	42,269,453	38,354,426
TOTAL REVENUE, GAINS AND SUPPORT	528,785,457	521,711,779	1,568,283,249	1,548,520,378
Expenses:				
Salaries and wages	172,042,131	176,456,798	513,992,932	518,551,779
Physician salaries and wages	46,361,934	45,638,233	139,867,764	134,779,991
Contract Labor	8,428,803	12,274,091	24,137,786	36,020,900
Employee Benefits	39,447,001	41,153,635	107,047,934	117,060,247
Fees	54,137,333	52,225,540	165,141,490	160,213,663
Supplies	106,148,411	101,170,428	317,467,846	299,815,875
Utilities	7,734,437	8,029,774	24,035,181	24,182,879
Other Expense	38,963,781	38,002,938	117,916,942	116,523,462
Depreciation	35,151,667	34,401,613	104,558,899	102,709,802
Amortization	(98,134)	492,302	1,902,540	1,413,240
Interest & Taxes	13,336,352	12,908,632	38,509,903	37,653,397
TOTAL EXPENSES	521,653,718	522,753,983	1,554,579,218	1,548,925,234
OPERATING INCOME	7,131,739	(1,042,204)	13,704,031	(404,855)
Nonoperating gains (losses):				
Interest and dividend income	4,698,839	4,179,656	17,677,365	17,993,519
Net realized gains (losses) on the sale of securities	(47,601)	2,532,597	7,117,833	14,905,330
Change in net unrealized gains on securities	70,010,895	(7,258,754)	(13,945,183)	27,000,802
Derivative related income	500,452	743,373	2,137,265	2,045,878
Loss on extinguishment of LTD / derivatives	0	(1,379,728)	0	(1,809,712)
Change in estimated fair value of derivatives	947,723	(9,963,580)	2,947,686	(7,974,263)
Gain (loss) on discontinued operations	(251,503)	(851)	(252,072)	2,235
Other nonoperating gains (losses)	(1,187,828)	(11,080,641)	(2,884,277)	(17,500,747)
Noncontrolling interests in subsidiaries	(15,182,290)	(2,824,847)	(13,024,052)	(13,791,521)
NET NONOPERATING GAINS	59,488,688	(25,052,774)	(225,433)	20,871,520
EXCESS OF REVENUE, GAINS AND SUPPORT OVER EXPENSES AND LOSSES	66,620,427	(26,094,979)	13,478,597	20,466,665
EBITDA	44,051,694	40,309,629	169,447,437	145,026,277

Utilization Statistics

	Fiscal Year Ended June 30					Q3		Nine Months Ended	
	2014	2015	2016	2017	2018	Mar-19	Mar-18	Mar-19	Mar-18
Acute Licensed Beds	2,293	2,293	2,293	2,366	2,506	2,434	2,490	2,434	2,490
Acute Patient Days	361,325	377,150	371,429	382,504	391,458	94,309	101,596	278,156	296,824
Acute Discharges	83,953	87,437	86,358	91,274	94,456	22,688	24,008	67,237	71,192
Observations	38,997	40,100	41,402	36,092	37,656	8,451	9,625	26,302	28,487
Patients in a Bed	122,950	127,537	127,760	127,366	132,112	31,139	33,633	93,539	99,679
Acute Average Daily Census including Observations	1,097	1,143	1,128	1,147	1,176	1,142	1,236	1,111	1,187
Acute Occupancy Rate including Observations (licensed)	48%	50%	49%	48%	47%	47%	50%	46%	48%
Acute Average Length of Stay (Days)	4.30	4.31	4.30	4.19	4.14	4.16	4.23	4.14	4.17
ER Visits	409,937	434,181	443,292	442,025	449,412	110,947	112,121	326,970	339,897
Surgical Cases	69,441	69,589	70,524	70,365	73,973	17,547	18,266	54,340	55,250
Births	6,423	6,558	6,405	6,422	6,435	1,568	1,559	5,069	4,941
Newborn Days	11,997	11,872	12,110	12,016	12,275	2,976	2,911	9,123	9,280
Physician Outpatient Visits (includes Urgent Care)	1,044,097	1,169,966	1,267,204	1,356,033	1,489,429	385,673	385,458	1,100,596	1,110,910
Urgent Care (included in above)	128,873	163,067	193,400	243,723	258,372	80,726	76,403	196,617	204,139

Payor Mix %

	Fiscal Year Ended June 30					Q3		Nine Months Ended	
	2014	2015	2016	2017	2018	Mar-19	Mar-18	Mar-19	Mar-18
Medicare	31.2	29.2	28.1	28.0	26.9	25.9	26.8	26.1	27.2
Medicare Managed Care	21.1	23.0	23.9	24.3	26.2	28.0	26.7	27.2	25.4
Medicaid & Managed Medicaid	13.3	13.1	13.8	14.0	13.7	13.9	13.5	13.3	13.8
Managed Care/Other	27.1	28.1	28.1	27.8	27.0	22.5	23.1	23.4	23.7
Self-Pay and Charity	7.3	6.6	6.1	5.9	6.2	9.7	9.9	10.0	9.9
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Financial Ratios

	Fiscal Year Ended June 30					Nine Months Ended	
	2014	2015	2016	2017	2018	Mar-19	Mar-18
Days Cash on Hand							
Cash and Cash Equivalents (000s)	\$ 89,859	\$ 128,580	\$ 179,373	\$ 165,984	\$ 86,844	\$ 146,986	\$ 139,862
Unrestricted Investments (000s)	1,006,067	1,073,752	1,014,018	1,139,009	1,203,943	1,215,564	1,172,465
Unrestricted Cash & Investments (000s)	\$ 1,095,926	\$ 1,202,332	\$ 1,193,391	\$ 1,304,993	\$ 1,290,787	\$ 1,362,550	\$ 1,312,327
Days Cash on Hand	252	264	256	266	245	259	245
Total Direct Debt	1,614,145	1,570,760	1,450,683	1,397,756	1,355,766	1,346,084	1,328,875
Cash to Direct Debt	68%	77%	82%	93%	95%	101%	99%
Annual Debt Service Coverage							
Net Income Available for Debt Service	\$ 238,099	\$ 249,168	\$ 229,176	\$ 323,046	\$ 248,619	\$ 242,692	\$ 189,063
Maximum Annual Debt Service	113,601	110,263	85,500	85,500	67,208	64,374	85,500
Maximum Annual Debt Service Coverage ¹ (MADS)	2.10	2.26	2.68	3.78	3.70 ¹	3.77 ¹	2.21
<small>¹Effective June 6, 2018, a new Master Trust Indenture (MTI) was adopted by Ballad Health. Due to the MTI change, the calculation of maximum annual debt service and MADS is not consistent with previous years.</small>							
Quarterly Debt Service Coverage							
Pro Forma Net Income Available for Debt Service (Based on Quarter to Date Net Income)						3.77	2.21
Pro Forma Net Income Available for Debt Service (Based on Rolling 12 month Net Income)						4.01	2.57