



# **Management Discussion and Analysis of Results from Operations and Financial Position**

**For the Nine Months Ended September 30, 2019**

**For Public Posting to:  
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**Banner Health**  
**Management's Discussion and Analysis of Results of Operations**  
**and Financial Position**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make assumptions and estimates that affect the amounts reported in the financial statements, including the notes thereto, and related disclosures of commitments and contingencies, if any. Management relies on historical experience and other assumptions believed to be reasonable under the circumstances in making its judgments and estimates. Actual results could differ materially from those estimates.

We recommend that you read this discussion together with the audited consolidated financial statements and related notes of Banner Health ("Banner") for the year ended December 31, 2018. The audited consolidated financial statements are available from the Municipal Securities Rulemaking Board (the "MSRB") on its Electronic Municipal Market Access ("EMMA") system, found at <http://emma.msrb.org>.

# **Banner Health**

## **Management's Discussion and Analysis**

### **For the Nine Months Ended September 30, 2019**

#### **Overview**

Banner Health ("Banner") is one of the nation's largest secular nonprofit healthcare systems, combining a portfolio of hospitals, ambulatory care centers, medical clinics, a comprehensive academic medicine division in partnership with the University of Arizona, and an insurance division operating both Banner Health Network and Banner – University Health Plans. Banner's stated mission is "making health care easier, so life can be better" and is achieving that mission for the members and patients it serves through the integration of payer and provider solutions with a customer-obsessed focus. Headquartered in Phoenix, Arizona, Banner provides a broad range of healthcare services, including twenty-eight (28) hospitals concentrated in three geographic areas: the greater Phoenix metropolitan area; the greater Tucson metropolitan area; and its Western States markets including northern and northeastern Colorado, with the remaining facilities located in mainly rural communities in Wyoming, Nebraska, Arizona, Nevada, and California. Centralized services supporting these operations are provided from Banner's corporate offices in Phoenix and Mesa, Arizona.

Effective October 9, 2019, Banner purchased the hospital and related assets of North Colorado Medical Center (NCMC) as well as certain off-campus properties. The transaction terminated the long-term lease between Banner and NCMC Inc and conveyed lien-free title of NCMC assets to Banner Health.

#### **Financial Performance for the Nine Months Ended September 30, 2019**

Banner generated \$116.5 million in operating income and \$393.4 million in net income for the nine months ending September 30, 2019. These results equate to operating and total margins of 1.7% and 5.4%, respectively, on total operating revenue of \$7.0 billion. Operating revenue increased 12.2% over the prior year driven by growth in premium revenues from additional covered lives in the Insurance Operations, mainly from enrollment growth in Banner—University Health Plans (Medicaid contracts), coupled with modest increases in patient volumes and commercial reimbursement rates. Year-to-date operating and EBIDA margins, of 1.7% and 8.0% respectively, are below 2018 results as Banner has made significant short-term investments in academic medicine, ambulatory care facilities, and certain consumer engagement platforms that will provide for future growth.

Operating margins continue to be supported by strong performance in overall Care Delivery operations. Surgical volume and adjusted admissions (inclusive of outpatient activity) have increased 6.7% and 3.7%, respectively, over the prior year. Strong patient volumes in the first quarter during the busy winter season have yielded to challenging second and third quarters, as (elective) volumes have softened during the summer months. The opening of new patient towers at Banner—University Medicine medical centers in both Phoenix and Tucson in the past twelve months, at a value of nearly \$1 billion, has added an increased cost burden in the form of depreciation, interest, and (temporary) startup costs. Growth in Banner's ambulatory care operations (imaging, ambulatory surgery, physical rehab, and urgent care), expansion of Banner—

University Health Plans (Medicaid), and investments in our employed physician base also required startup costs as Banner's care delivery footprint continues to grow. Banner expects to mature these investments and new assets in the coming year.

Banner's comprehensive investment program (CIP) yielded \$430.9 million of investment income on a year to date basis, bringing the fair value of Banner's cash and investment portfolio over \$5.2 billion. Fixed interest rate swaps generated a mark-to-market loss of \$128.0 million year to date, as bond yields have declined due to money supply flowing into the 'safe-haven' of US markets. As a result, the required collateral posting of unrestricted cash and securities has increased \$83.4 million since the end of 2018.

***Financial Highlights***  
***(\$000's in millions)***

	<b><u>2019 YTD</u></b>	<b><u>2018 YTD</u></b>	<b><u>FY 2018</u></b>	<b><u>FY 2017</u></b>
Revenue	\$7,016.5	\$6,255.5	\$8,519.8	\$7,835.3
Operating Expenses	6,900.0	6,133.4	8,333.4	7,564.6
Operating EBIDA	556.1	523.0	727.6	795.4
Interest, Depreciation and Amortization	439.6	400.9	541.3	524.8
Operating Income	116.5	122.1	186.3	270.7
Nonoperating Income	276.9	156.2	(142.4)	438.7
Revenue over Expenses	393.4	278.3	44.0	709.4
Operating Margin	1.7%	2.0%	2.2%	3.5%
Operating EBIDA Margin	8.0%	8.4%	8.5%	10.2%
Total Margin	5.4%	4.3%	0.5%	8.6%

## For the Nine Months Ended September 2019

<i>(\$ in thousands)</i>	<b>Care Delivery Operations</b>	<b>Insurance Operations</b>	<b>Elims/Other</b>	<b>Consolidated</b>
Operating Revenue	\$6,027,336	\$1,507,740	\$(518,605)	\$7,016,471
Operating Expense	5,894,242	1,560,687	(554,917)	6,900,013
Operating Income	\$ 133,094	\$ (52,947)	\$ 36,312	\$ 116,459

## For the Nine Months Ended September 2018

<i>(\$ in thousands)</i>	<b>Care Delivery Operations</b>	<b>Insurance Operations</b>	<b>Elims/Other</b>	<b>Consolidated</b>
Operating Revenue	\$5,623,004	\$1,133,850	\$(501,338)	\$6,255,517
Operating Expense	5,493,613	1,201,870	(562,104)	6,133,379
Operating Income	\$ 129,392	\$ (68,020)	\$ 60,766	\$ 122,138

Performance results for Banner's two primary operating divisions for the nine months ended September 30, 2019 include the following highlights:

### Delivery Operations

- Adjusted admissions and total surgical volume increased 3.7% and 6.7%, respectively, as patient volumes continue to exhibit growth in Banner's core markets
- Net healthcare revenue per adjusted admission was 3.1% higher, reflecting modest increases in reimbursement rates
- SWB as a percentage of total net healthcare revenue declined 0.5% while supply expense per the same metric increased 2.7% -- indicative of more complex cases in Banner hospitals involving expensive supplies and pharmaceuticals not fully compensated in (government) reimbursement programs
- Urgent care visits have increased 9.5%, while Emergency Department visits remained relatively flat, supporting lower cost points of care for our insurance strategy
- Employed physicians have increased 4.9% year over year, while clinic encounters increased 7.0%, as Banner continues to invest in new (employed) providers to expand its care delivery footprint
- Outpatient registrations increased 15.2% as a result of new outpatient rehabilitation business following the commencement of the Banner Health\Select Medical joint venture in mid-2018, and the 2019 acquisition of a portfolio of imaging center centers in the Phoenix metro area

### Insurance Operations

- Insurance premium revenue now represents over 21.0% of total system revenue, as premium revenues increased 33.8% year over year
- Combined medical loss ratio improved from 98.9% to 96.2%, as Banner continues to improve on managing risk within Medicare Advantage and Medicaid programs
- Significant growth in Banner—University Health Plans (Medicaid) membership, driven by expansion to Maricopa County
- Membership in Banner|Aetna commercial insurance plans continues to exhibit rapid growth in Arizona (16.9% in last nine months), now with nearly 325,000 members after only 2-years of operation
- Banner is now approaching 1 million lives covered by value-based payment models
- Management has continued to develop risk-scoring and quality (Star-ratings) data procedures to drive corresponding premium revenue and margin opportunities

	<b>2019 YTD</b>	<b>2018 YTD</b>
BHN – Full Risk	55,904	62,931
Banner Employee – Full Risk	82,417	84,666
Medicaid Contractor Plans	223,321	158,350
<b>Total Full Risk Lives</b>	<b>361,642</b>	<b>305,947</b>
BHN/Banner-Aetna - Shared Risk	551,799	497,630
<b>Total Lives</b>	<b>913,441</b>	<b>803,577</b>

**Banner's balance sheet indicators remain solid in 2019, as shown below:**

	<b>Q3 2019</b>	<b>YE 2018</b>	<b>YE 2017</b>
Long-Term Debt to Capitalization	34.7%	35.3%	35.0%
Days Cash on Hand	220	214	246
Cash to Long-Term Debt	162%	151%	161%
Maximum Annual Debt Service Coverage	4.2	4.7	4.9