UNAUDITED

Management Discussion and Analysis

For the Three Months Ended March 31, 2015
Henry Ford Health System’s Management’s Discussion and Analysis (MD&A) is intended to provide a high level overview of the financial performance for the three months ended March 31, 2015 with comparable prior year information, including operational highlights. This document includes certain forward looking comments based on management’s beliefs; actual results could differ materially. This document should be read in conjunction with the unaudited consolidated financial statements for the three months ended March 31, 2015.

It is management’s intention to provide an MD&A in conjunction with the public release of unaudited quarterly and annual audited financial statements. The intent is to provide current and prospective bond holders and other interested parties with a better understanding of Henry Ford Health System’s consolidated financial and operational performance. It is also management’s intention to schedule periodic investor calls.

**Organizational Overview**

Henry Ford Health System (the System) is a Baldrige award-winning, integrated, academic health system that includes both extensive provider assets and insurance operations. The System offers differentiated capabilities, as well as strong focus on population health and disease management.

The System is celebrating its 100th year with an integrated hospital and employed physician model. The System has an extensive integrated provider network, including:

- Five hospitals in three counties, including Henry Ford Hospital, an internationally known academic referral center and an inpatient psychiatric hospital
- Over 1,200 employed physicians, primarily through the Henry Ford Medical Group
- A pluralistic physician model at the System’s suburban hospitals, leveraged through the System’s clinically integrated network
- An extensive distributed ambulatory network with 32 medical centers, behavioral health facilities, home-based care, pharmacy, and retail services
- Strong market share, brand and differentiation within Southeastern Michigan, as well as a statewide, national, and international reputation resulting in substantial referral volume
- A substantial role in teaching the health professionals of tomorrow, complemented by a significant research and discovery function

In addition to extensive provider assets, the System also has three decades of experience managing pre-payment arrangements through Health Alliance Plan (HAP) and its subsidiaries. HAP has products for every market segment and serves more than 694,000 members through six distinct lines of business: group insured commercial, individual, Medicare Advantage (the oldest plan in southeast Michigan), Medicaid, self-funded, and network leasing. HAP participates in public and private exchanges, high-performing networks, and has substantial Administrative Services Only (ASO) capabilities.

Given its history and assets, the System is uniquely positioned to succeed in a pay-for-value environment.
Summary of Operating Results

The System reported excess of revenue over expenses of $22 million for the three months ended March 31, 2015, on revenues of $1.2 billion. This reflected significant improvement over the deficiency of revenue over expense of $15 million reported in the prior year and was favorable to the budget. Performance reflected positive top-side revenue growth for both provider and insurance plan segments. The balance sheet remained stable for the first quarter of 2015.

The System completed the System-wide installation of a new integrated clinical and revenue software application (EPIC) with go-lives at its final two hospitals early in 2014. This implementation had a significant impact on most operational areas of the System including substantial one-time expense as well as some short-term adverse revenue implications. The implementation was completed on time and within budget. The EPIC system is now stable and is being optimized. Days in accounts receivable have returned to below pre-go-live levels and are expected to trend lower in the future. In July 2013 the System also completed implementation of a new information system (TriZetto Facets) within HAP.

A significant transformational initiative, the Strength & Sustainability Plan (the Plan), was launched in 2014 to improve the financial and operational positioning of the System as the health care business environment continues to evolve. The Plan provides the framework for coordinated ongoing System-wide efforts to create value through reduced costs, profitable growth, improved revenue cycle, operational and clinical redesign, enhanced quality and safety, and increased satisfaction of patients, employees and physicians. Overall cost per case mix adjusted equivalent discharge was reduced by 9.4% between 2014 and 2015.

Revenue Growth

As a fully integrated system, total unrestricted revenue grew to $1.2 billion during the three months ended March 31, 2015, up $80 million or 7% from the three months ended March 31, 2014. The System had net patient service revenue of $546 million and healthcare premium revenue of $586 million for the three months ended March 31, 2015. Revenues associated with healthcare services provided by the System to members of its capitated insurance products are included in premium revenue. Net patient service revenue reflects amounts recognized from all other payers and patients.

Net patient service revenue increased $36 million or 7% during the three months ended March 31, 2015 compared to the three months ended March 31, 2014 due to inpatient volume growth (admissions were 722 or 3% favorable to prior year levels), outpatient volume growth (outpatient facility visits were 24,301 or 3% over prior year levels) and growth in ancillary areas (e.g. pharmacy).

Health care premiums increased $37 million or 7% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, due to an increase in premium rates partially offset by a product mix change and overall increase in fully insured membership of 2%. Specifically, HAP saw a decline in membership in the commercial fully insured products of 3% while the self-insured products increased by 12%, consistent with expectations under the Affordable Care Act. In addition, the Medicaid product line experienced a significant increase in membership of 23% due to Medicaid Expansion (“Healthy Michigan”) that became effective in the State of Michigan on April 1, 2014. Medicare Advantage membership remained unchanged between years.

Other income increased $7 million or 13% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, due to expansion of third-party service arrangements associated with HAP’s Administrative Services Only (ASO) products, revenue growth in specialty pharmacy arrangements, and increased meaningful use revenue earned from the EPIC installation
**Expense Trends**

Total expenses increased by $43 million or 4% from 2014 levels, well behind the growth in revenue. Salaries, wages, and employee benefits increased by only $16 million or 4% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014. This moderate growth rate reflects Strength & Sustainability initiatives including expanded management change of control, shifting staffing mix, reduced pension expense following plan redesign, and other labor expense initiatives. This increase also includes a shift from health care provider expense of $11 million due to the conversion from HAP fully insured to self-insured employee health insurance (amount relates to foreign claims paid for employee benefits), the conversion of information technology resources of $3 million from contracted services to employed staff, and other increases due to increased volume.

Health care provider expense decreased $12 million or 3% for the three months ended March 31, 2015 compared to three months ended March 31, 2014, due primarily to the above mentioned shift of $11 million to salaries, wages, and employee benefits due to the conversion from HAP fully insured to self-insured employee health insurance.

Supplies expense increased $29 million or 20% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, primarily due to pharmacy expense related to expanded ambulatory and specialty pharmacy activities and other increases in volume. Significant savings were achieved in hospital supply costs due to aggressive product standardization and contracting initiatives.

Depreciation and amortization expense decreased $3 million or 8% for the three months ended March 31, 2015 compared to prior year, primarily due to prior year write-down of the legacy electronic medical record system.

General and other administrative expense increased $13 million or 15% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, primarily due to increased commissions, fees, and premium tax expenses related to the Affordable Care Act; the reinstatement of the state use tax to fund the Medicaid program in Michigan; and increased income tax on Midwest Health Plan, a wholly owned subsidiary of HAP, due to increased membership.

Other contracted services expense decreased $3 million or 5% for the three months ended March 31, 2015 compared to the three months ended March 31, 2014, primarily due to the conversion of information technology contracted services to employed staff.

**Community Benefits**

The System provided $81 million of uncompensated care at cost for the three months ended March 31, 2015, up from $72 million in the prior year. Consistent with expectations resulting from the Affordable Care Act, there were fewer patients without health insurance coverage due to expanded coverage through the subsidized health insurance exchanges and Michigan Medicaid expansion. However, there remains a large number of uninsured individuals, and many patients are finding that they now have insurance coverage with deductibles and copayments that are beyond their ability to pay. The System’s loss on Medicaid grew during the three months ended March 31, 2015 due to the expanded number of covered individuals. Given its mission, the System also had substantial unreimbursed costs for health professional education, research and other community services.
**Balance Sheet**

The System maintains a solid balance sheet. Total System days cash (inclusive of insurance operations) at March 31, 2015 totaled 100.3 versus 97.7 at the same time last year and 104.3 at 12/31/2014. The decrease from December 31, 2014 is primarily due to the annual funding of the supplemental retirement savings account. Total System days cash is lower than some health systems due to the substantial size of the insurance segment and the amount of capitation revenue and operating expenses for medical services. If days cash was calculated only using expenses of the provider segment for the denominator, days cash would be a much stronger 141 days at March 31, 2015. The System’s financial assets are conservatively invested, with a significant portion invested in short-term and high-grade debt securities.

The System has a modest debt load, with total debt of $922 million and a cash-to-debt ratio of 144% at March 31, 2015.

**Health System Leadership**

The System continues to have very long-term tenure among its executives and has further strengthened its leadership ranks by bringing in the following highly regarded leader who joined the System executive team during the first quarter of 2015:

- John Deledda, M.D. was named the chair of Emergency Medicine for the Henry Ford Medical Group. Dr. Deledda, formerly of the University of Cincinnati College of Medicine, is a board-certified emergency medicine physician.

**Awards**

Henry Ford Health System is nationally and internationally recognized for its innovation and excellence. The following are several highlights from the first quarter of 2015:

- HAP has the “Highest Member Satisfaction among Commercial Health Plans in Michigan, Eight Years in a Row”***.

- Henry Ford Wyandotte Hospital has been rated as one of America’s Best 100 Hospitals by Healthgrades. America’s 100 Best Hospitals are those hospitals who fall within the top 2 percent of hospitals in the country, with the lowest mortality and complication rates across a range of 33 of the most common procedures and diagnoses. Only 100 of the nation’s more than 4,400 hospitals received this distinction for clinical quality. Not only is Henry Ford Wyandotte Hospital one of America’s Best 100 Hospitals, it is the only hospital to achieve this designation in the surrounding counties of Wayne, Monroe, and Washtenaw.

- In its 2015 rankings of the Top 5 Hospitals and Health Systems, DiversityInc has named Henry Ford Health System #1. DiversityInc bases its rankings on diversity as demonstrated through the talent pipeline and equitable talent development; CEO/leadership commitment and accountability; and supplier diversity spend with and support of underrepresented groups.

- The Healthy Workplace Award program of the Governor’s Council on Physical Fitness, Health and Sports has been honoring Michigan companies and organizations who have made worksite wellness a priority. The Diamond level, achieved by Henry Ford Health System in 2015, is the highest award and represents an organization that has sustained and comprehensive programs for employees that are strategic and integral parts of the organization. The program must
provide some incentives to employees to participate and have had at least 40% employee participation in at least two wellness categories during the year to even qualify.

- William Conway, M.D., CEO of the Henry Ford Medical Group, has been selected as one of the “50 Most Influential Physician Executives and Leaders” by *Modern Healthcare* magazine. Ranked No. 23, this is the third year in a row that Dr. Conway has been selected by the readers and the editors of the magazine.

- Kimberly Brown, MD, division head, Gastroenterology, Henry Ford Medical Group, has been selected for the Castle Connolly National Physician of the Year Award for Clinical Excellence.

- Nancy Schlichting, CEO of Henry Ford Health System, has been named one of the Top 25 Women in Healthcare by the editors of *Modern Healthcare* magazine. The magazine honors executives in all fields of health care who are “an influential and powerful group of women who have gone above and beyond in leading their organization and employees to great heights.” This is the fourth time that Schlichting has received this recognition from the magazine and she is the only woman from Michigan.

**Strategic Developments and Additional Highlights**

- BBC News and the *Guardian*, along with many other international news outlets highlighted Henry Ford Behavioral Health Service’s successful work to reduce suicide among its patients, a strategy which has now been adopted by the United Kingdom to dramatically reduce its rising suicide rates.

- *ABC News* covered news of a Henry Ford Hospital study that found breastfeeding helps stimulate the immune system. The series of studies, led by Christine Cole Johnson, Ph.D., MPH, chair of the Department of Public Health Sciences, were reported in more than 70 national media outlets.

- The *Washington Post* interviewed Henry Ford pediatric otolaryngologist Ilaaf Darrat, M.D., about a new device that may help clear babies’ stuffy noses.

- *Health Day* wrote a story about a new study led by Jason Davis, M.D., a joint replacement surgeon at Henry Ford West Bloomfield Hospital, which found the painful recovery process following knee replacement surgery is a persistent problem.

- *Fox News* reported on a study led by Henry Ford neurologist Vibhangini S. Wasade, M.D., that revealed most patients who undergo brain surgery for epilepsy are satisfied with their choice to undergo the procedure.

- News of the first transcaval aortic valve replacement performed in Europe was covered by *Diagnostic and Interventional Cardiology*. Adam Greenbaum, M.D., co-director of the Henry Ford Center for Structural Heart Disease, helped perform the procedure.

- MedPage Today featured a story about how the perceived costs of Parkinson’s disease drugs might affect patient outcomes, which included an interview with Peter A. LeWitt, M.D.

**Health Alliance Plan of Michigan received the highest numerical score among commercial health plans in Michigan in the proprietary J.D. Power 2008-2015 U.S. Member Health Plan Studies.**

*2015 study based on 34,315 total member responses, measuring four plans in Michigan (excludes Medicare and Medicaid). Proprietary study results are based on experiences and perceptions of members surveyed December 2013 – January 2015. Your experiences may vary. Visit jdpower.com.*