



Management Discussion and Analysis

As of and for the Three Months Ended March 31, 2019 and 2018



**UNAUDITED
MANAGEMENT DISCUSSION AND ANALYSIS
AS OF AND FOR THE THREE MONTHS ENDED MARCH 31, 2019 AND 2018**

Henry Ford Health System and its affiliates' (the System) Management's Discussion and Analysis (MD&A) is intended to provide a high-level overview of the consolidated financial performance for the three months ended March 31, 2019, 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 as of and for the three months ended March 31, 2019 and 2018.

It is management's intention to regularly provide an MD&A in conjunction with the public release of unaudited quarterly and audited annual statements. The intent is to provide current and prospective bondholders and other interested parties with a better understanding of the System's consolidated financial and operational performance. It is also management's intention to maintain robust communications including investor calls or posting investor presentations.

Organizational Overview

The System is a regional vertically integrated health care network made up of:

- Five acute care hospitals, two psychiatric hospitals, and one specialty hospital.
- Henry Ford Medical Group, one of the nation's largest and longest existing physician group practices, with approximately 1,900 employed physicians and scientists, practicing in over 40 specialties.
- Health Alliance Plan of Michigan (HAP) and its subsidiaries insurance plans with more than three decades of integrated insurance operations, with approximately 540,000 covered lives and products in nearly every market segment.
- Comprehensive provider assets including an extensive ambulatory network with medical and health centers, a substance abuse facility, behavioral health clinics, home-based care, pharmacy, eye care, and other retail-oriented services. In aggregate, the System has more than 200 care delivery locations, serving patients in southeast and south-central Michigan

Summary of Operating Results

The System reported consolidated excess of revenues over expenses of \$120.4 million for the three months ended March 31, 2019, on consolidated revenues of \$1.6 billion, providing a margin of 7.4% (1.6% without investment return). This was favorable to consolidated excess of revenues over expenses of \$20.0 million on consolidated revenues of \$1.5 billion, providing a margin of 1.4% (1.3% without investment return), reported for the three months ended March 31, 2018. Although System performance was positively impacted by investment return, consolidated net patient service revenue and other revenue experienced strong growth.

The System continued with its “System Redesign & Transformation” program, which was launched in 2017, with the goal of achieving increased value by deploying projects targeting population health, greater integration across the care continuum, improved access for customers, and enhanced corporate and support services.

Revenue Trends

Total consolidated revenue without donor restrictions was \$1.6 billion for the three months ended March 31, 2019, up \$174.7 million or 12.1% from the three months ended March 31, 2018. The System recognized consolidated net patient service revenue of \$948.2 million and consolidated healthcare premium revenue of \$483.7 million for the three months ended March 31, 2019. Consolidated revenues associated with healthcare services provided by the System to members of its capitated insurance products are included in health care premium revenue. Consolidated net patient service revenue reflects amounts recognized from all other payers and patients.

Consolidated net patient service revenue increased \$74.9 million or 8.6% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. This was primarily due to increased rates, expanded specialty and ambulatory pharmacy activities, and an increased all payor case mix index.

Health care premium revenue was consistent with prior year levels. Despite the decline in membership as a result of the elimination of certain HAP contracts, the CMS star rating payment to HAP was regained for 2019 which contributed to the stability of the revenue.

Other income increased \$5.6 million or 6.4% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. This was primarily due to increased contract pharmacy revenue and income from net assets released from restrictions. The contract pharmacy revenue increase is due to additional contracts as well as increased volume on existing contracts. The income from net assets released from restrictions includes funding from the National Institute of Health for the All of Us research program which has the goal of advancing precision medicine.

Expense Trends

Consolidated total expenses increased by \$74.3 million or 5.2%, for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. Following are explanations for the most significant variances.

Consolidated salaries, wages, and employee benefits increased by \$39.3 million or 6.3% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. This was primarily due to the salary increases implemented during 2018 and the impact of increased patient service acuity.

Consolidated health care provider expense increased by \$23.8 million or 9.0% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018, primarily due to increased Medicare members with higher risk scores.

Consolidated supplies expense increased \$18.6 million or 7.6% for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 driven by pharmacy expense related to expanded ambulatory and specialty pharmacy activities and increased patient service acuity.

Uncompensated Care and Community Benefits

The System expended \$95.7 million on uncompensated care for the three months ended March 31, 2019, compared to \$112.2 million in the prior year. The primary factors contributing to the decrease in the cost of uncompensated care for the quarter ended March 31, 2019, as compared to the comparable period in 2018, include favorable 2019 trends in Medicaid supplemental payments and Medicare Advantage risk scores, higher collection rates on patient pay obligations, as well as the impact of refinements in the cost accounting model implemented in late 2018.

Given its mission, the System also had substantial unreimbursed costs for health professional education, research and other community services, which are also important components of overall Community Benefit expenditures.

Balance Sheet

Total System days cash (inclusive of insurance operations) at March 31, 2019, totaled 123.6 compared to 122.2 days at December 31, 2018. Total System days cash is lower than some health systems due to the substantial size of the insurance operations and the amount of health care provider expenses. If days cash was calculated only using expenses of the provider segment for the denominator, days cash would be a much stronger 165.0 days at March 31, 2019 and 163.9 days at December 31, 2018.

Investment Performance

The System maintains significant operating investments including cash and cash equivalents, short-term investments, and long-term investments. Consolidated investment return, net recognized during the three months ended March 31, 2019 was \$95.4 million compared to investment return, net of \$1.8 million recognized during the three months ended March 31, 2018. The increase in consolidated investment return is consistent with market returns on the underlying securities in these funds.

System Highlights for First Quarter

The System is nationally and internationally recognized for excellence, leadership and innovation. The following are some of the awards, honors and clinical achievements from first quarter:

Recognized for Excellence

- The System was ranked among the 50 best health care supply chains in North America by the Global Health Exchange for using e-commerce to improve operational performance and drive down costs. More than 4,100 hospitals and health systems were evaluated in the United States and Canada.
- Henry Ford Allegiance Health was recognized as a Pioneers in Quality™ Solution Contributor for embracing new technology for reporting newborn hearing screenings. Henry Ford Allegiance Health was among 25 hospitals to receive the Joint Commission honor.
- Henry Ford Hospital was a recipient of the Baldwin Award from the Accreditation Council of Graduate Medical Education and the Arnold P. Gold Foundation DeWitt C. Baldwin, Jr. Sponsoring Institution Award. The award recognizes institutions that foster a respectful, supportive environment for medical education and training and the delivery of patient care which leads to the professional and personal development of learners. The hospital was among a select few recipients of more than 800 eligible institutions.

Recognized for Leadership

- Joneigh Khaldun, M.D., was appointed Chief Deputy Health Director of the State of Michigan by Gov. Gretchen Whitmer and the Michigan Department of Health and Human Services Director Robert Gordon.
- Interventional cardiologist Akshay Khandelwal, M.D., was named chair of the American College of Cardiology Board of Governors and secretary of the Board of Trustees, the main governing body of the ACC.
- Susan Hawkins, Henry Ford Health System Senior Vice President of Population Health, was named one of Becker's 32 chief population health officers to know. The individuals featured lead initiatives for their organizations focused on improving the health and wellness in their communities.

Recognized for Innovation

- The Henry Ford Cancer Institute is using advanced technology on several fronts in the fight against multiple forms of cancer, including:
 - For brain cancer, was part of the clinical trial that led to FDA approval of a wearable cap device that emits low-intensity, electric currents to the scalp in hopes of slowing or stopping the growth of cancer cells in patients who are newly diagnosed with glioblastoma, the most common brain cancer in adults and one of the most difficult to treat.
 - For breast cancer patients who undergo chemotherapy as part of their treatment plan, offered a wearable cap device that has shown effectiveness for preventing or reducing hair loss which can be a demoralizing side effect. It works by circulating a cooling fluid on the head that reduces the flow of chemotherapy to the scalp, sparing the hair follicles from having contact with the chemotherapy medicine.

- For women undergoing breast reconstruction after mastectomy, were the first in Michigan to offer a new needle-free tissue expander option that eliminates the need for weekly saline injections. This is the first major advancement in breast tissue expansion in more than 40 years.
- For pancreatic cancer, treated the first patient in a new clinical trial to test the effectiveness of using precise, higher dose MRI-guided radiation therapy.
- The Henry Ford Comprehensive Epilepsy Center was the first in Michigan to treat a patient with thalamic deep brain stimulation for epilepsy. The treatment has shown effectiveness for significantly improving a patient's symptoms and reducing damage caused by seizures.

Additional Recognition

- Henry Ford Macomb Hospitals earned full recognition for its diabetes prevention program from the Centers for Disease Control and Prevention – the first hospital in Macomb County to receive such a designation. Organizations that deliver “quality, evidence-based” programs are recognized. It is among 14 statewide organizations and 250 national organizations that were recognized.
- The American College of Surgeons’ National Accreditation Program for Breast Centers awarded a three-year accreditation to all Henry Ford Health System breast center locations. Henry Ford was recognized for prevention programs, patient participation in clinical trials, a sophisticated genetics program, diversity of patients in southeast and central Michigan, among other areas of excellence.
- Henry Ford Macomb Hospitals was awarded full accreditation during its Joint Commission triennial survey in March 2019. Joint Commission accreditation is recognized nationwide as a symbol of quality that reflects an organization's commitment to meet certain performance standards.

Subsequent Event

On May 2, 2019 the System closed on the issuance of \$227,910,000 in Series 2019A fixed rate hospital revenue bonds (“Series 2019A”). The Series 2019A bonds were issued at a premium of \$22,094,000. The proceeds will be used for the purposes of financing or refinancing the construction, renovation and equipping of the System’s facilities.