

ALLEGHENY HEALTH NETWORK

Unaudited Financial Information and Management's Discussion and Analysis
For the Periods Ended September 30, 2022 and 2021



November 29, 2022

ALLEGHENY HEALTH NETWORK

Index

For the Periods Ended September 30, 2022 and 2021

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BASIS OF PRESENTATION; FORWARD-LOOKING STATEMENTS

Allegheny Health Network is the Credit Group Representative of an obligated group (the “Obligated Group”) formed pursuant to a Master Trust indenture dated as of December 1, 2017, as amended (the “Master Trust Indenture”). The Allegheny County Hospital Development Authority Revenue Bonds (Allegheny Health Network Obligated Group Issue), Series 2018A (the “Series 2018A Bonds”) are secured pursuant to the Master Trust Indenture. The information contained herein is being filed by Allegheny Health Network for the purpose of complying with the Obligated Group’s obligations under the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 2018A Bonds. Allegheny Health Network and its consolidated subsidiaries are referred to collectively herein as “AHN.”

AHN presumes that users of this financial information have read or have access to AHN’s audited financial statements and that the adequacy of additional disclosure needed for a fair presentation may be determined in that context. The audited financial statements of AHN for the fiscal years ended December 31, 2021 and 2020 are on file at www.emma.msrb.org.

Except as otherwise specified, information contained in this report includes the unaudited financial performance of AHN on a consolidated basis, and thus includes entities that are not members of the Obligated Group. The unaudited consolidated financial information contained herein include all required adjustments that management believes are necessary for a fair presentation of AHN’s financial position and the results of operations for these quarters. All financial and statistical information is derived from internal records of AHN.

References herein to Highmark Health (“Highmark Health”), which is the parent of AHN and of Highmark Inc. (“Highmark”), mean those entities affiliated with AHN by virtue of common corporate control. **NEITHER HIGHMARK HEALTH NOR HIGHMARK IS OBLIGATED WITH RESPECT TO THE SERIES 2018A BONDS, AND NONE OF THEIR RESPECTIVE ASSETS OR REVENUES ARE AVAILABLE TO PAY DEBT SERVICE ON THE SERIES 2018A BONDS.**

This report contains information which constitutes “forward-looking statements.” Forward-looking statements include all statements that do not relate solely to historical or current facts, and can be identified by the use of words like “may,” “believe,” “will,” “expect,” “project,” “estimate,” “anticipate,” “plan,” “initiative” or “continue.” These forward-looking statements are based on the current plans and expectations of AHN and are subject to a number of known and unknown uncertainties and risks, many of which are beyond AHN’s control and could significantly affect current plans and expectations and AHN’s future financial position and results of operations. These factors include, but are not limited to, (i) the highly competitive nature of the health care industry, (ii) the efforts of insurers, health care providers and others to contain health care costs, (iii) possible changes in the Medicare and Medicaid programs that may impact reimbursements to health care providers and insurers, (iv) the ability to achieve expected levels of patient volumes and control the costs of providing services, (v) changes in federal, state or local regulations affecting the health care industry, (vi) the ability to attract and retain qualified management and personnel, including affiliated physicians, nurses and medical support personnel, (vii) liabilities and other claims asserted against AHN, (viii) changes in accounting practices, (ix) changes in general economic conditions including growing numbers of uninsured and unemployed patients, (x) changes in revenue mix and the ability to enter into and renew managed care provider arrangements on acceptable terms and (xi) the collectability of uninsured accounts and deductible and co-pay amounts. As a consequence, current plans, anticipated actions and future financial position and results of operations may differ from those expressed in any forward-looking statements made by or on behalf of AHN. Users of this report are cautioned not to rely on such forward-looking statements when evaluating the information presented in this report, including “Management’s Discussion and Analysis.”

It should be noted that earnings before interest, taxes, depreciation and amortization (“EBITDA”), days cash on hand and certain other financial metrics included in this filing are not measures of operating performance, liquidity or financial leverage defined by generally accepted accounting principles and may not be comparable to similarly titled measures presented by other companies.

ALLEGHENY HEALTH NETWORK

Introduction and Overview

Allegheny Health Network is the parent organization of a system of acute care hospitals and affiliated providers in western Pennsylvania that constitutes the clinical delivery component of an integrated delivery and financing system (“IDFS”), with Highmark Health as its parent company. Highmark Health is also the parent of Highmark Inc. (“Highmark”). AHN is the clinical delivery system affiliate of Highmark for enrollees in Highmark’s various health plans in the region, as well as enrollees covered by other insurers and Medicaid and Medicare programs. While AHN is integrated with Highmark Health and its affiliates for strategic planning, budgetary, and other purposes and shares certain common management personnel, directors, and committees, neither Highmark Health nor Highmark is part of the Obligated Group (as defined in the Master Trust Indenture). Neither Highmark Health nor Highmark is obligated with respect to the Series 2018A Bonds, and none of their assets or revenues are pledged to pay debt service on such bonds.

ALLEGHENY HEALTH NETWORK

Consolidated Balance Sheets – Unaudited*

September 30, 2022 and 2021 and December 31, 2021

(Dollars in thousands)

	2022	2021	
	September	September	December
Assets			
Current assets			
Cash and cash equivalents	\$ 162,742	\$ 420,289	\$ 259,127
Patient accounts receivable	500,631	447,923	453,827
Other current assets	239,069	230,708	217,402
Total current assets	902,442	1,098,920	930,356
Investments	458,506	574,331	667,282
Assets whose use is limited	82,053	84,144	85,133
Restricted investments	317,001	383,062	400,303
Equity investments/other	42,566	42,036	42,650
Property and equipment, net	1,839,154	1,809,037	1,862,066
Right to use assets	309,489	326,151	304,077
Other assets	173,809	194,153	204,450
Total assets	\$ 4,125,020	\$ 4,511,834	\$ 4,496,317
Liabilities and net assets			
Current liabilities	\$ 567,512	\$ 598,941	\$ 612,050
Current portion of lease liabilities	41,630	42,451	39,087
Current portion of CMS advances	817	169,992	135,124
Current portion of long-term debt	26,559	26,769	25,911
Total current liabilities	636,518	838,153	812,172
Accrued pension obligation	136,240	221,700	152,740
Long-term debt	935,942	981,716	960,502
Lease liabilities	284,014	302,845	282,954
Other liabilities	193,833	229,149	216,065
Total liabilities	2,186,547	2,573,563	2,424,433
Net assets:			
Without donor restrictions	1,621,033	1,547,699	1,663,342
With donor restrictions	317,440	390,572	408,542
Total net assets	1,938,473	1,938,271	2,071,884
Total liabilities and net assets	\$ 4,125,020	\$ 4,511,834	\$ 4,496,317

* Includes entities that are not members of the Obligated Group

ALLEGHENY HEALTH NETWORK

Consolidated Statements of Operations – Unaudited* For the Periods Ended September 30, 2022 and 2021

(Dollars in thousands)

	QTD		YTD	
	2022	2021	2022	2021
Revenue				
Net patient service revenue	\$ 989,771	\$ 942,238	\$ 2,911,534	\$ 2,785,891
Other operating revenue	176,246	67,096	339,649	203,857
Total revenue	1,166,017	1,009,334	3,251,183	2,989,748
Expenses				
Salaries, wages, and fringe benefits	632,236	552,188	1,864,521	1,623,490
Patient care supplies	239,959	228,009	692,407	665,353
Other operating expenses	216,324	196,338	641,658	594,961
Depreciation and amortization	55,846	49,399	168,814	147,636
Total operating expenses	1,144,365	1,025,934	3,367,400	3,031,440
Operating income (loss)	21,652	(16,600)	(116,217)	(41,692)
Investment income	5,502	6,793	35,340	21,873
Net unrealized (losses) gains	(18,743)	(7,413)	(109,693)	6,445
Interest expense	(8,540)	(5,406)	(24,400)	(17,321)
Other components of net periodic benefit credit	7,625	8,050	22,875	24,150
Other non-operating expense, net	(1,709)	(1,271)	(2,474)	(4,771)
Excess (deficit) of revenue over expenses, before income taxes	5,787	(15,847)	(194,569)	(11,316)
Income tax expense	(878)	(1,329)	(3,674)	(2,354)
Excess (deficit) of revenue over expenses	\$ 4,909	\$ (17,176)	\$ (198,243)	\$ (13,670)
Operating margin %	1.9%	-1.6%	-3.6%	-1.4%
Net margin %	0.4%	-1.7%	-6.1%	-0.5%
Operating EBITDA	\$ 77,498	\$ 32,799	\$ 52,597	\$ 105,944
Operating EBITDA %	6.6%	3.2%	1.6%	3.5%
Net EBITDA	\$ 70,173	\$ 38,958	\$ (1,355)	\$ 153,641
Net EBITDA %	6.0%	3.9%	0.0%	5.1%
Total current and long-term debt**	\$ 962,501	\$ 1,008,485	\$ 962,501	\$ 1,008,485
Total current and long-term debt** to net EBITDA	3.4	6.5	(532.7)	4.9

* Includes entities that are not members of the Obligated Group

** Excluding lease liabilities

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Utilization Statistics*

For the Periods Ended September 30, 2022 and 2021

	QTD		YTD	
	2022	2021	2022	2021
Discharges	19,253	18,694	55,830	56,505
Observation cases	11,448	11,220	32,580	32,470
Total discharges and observation cases	30,701	29,914	88,410	88,975
Patient days	110,445	107,661	320,943	317,497
Average length of stay (medical acute days only)	5.39	5.29	5.48	5.28
Case-mix index (all payor)	1.98	2.03	2.01	2.00
Outpatient registrations	429,106	402,343	1,248,237	1,384,047
Emergency department visits	88,366	83,835	248,290	224,883
Inpatient surgeries	5,937	5,945	17,254	18,220
Outpatient surgeries	13,973	14,357	42,614	43,413
Ambulatory surgical cases	6,312	6,819	19,483	20,750
Total surgical cases	26,222	27,121	79,351	82,383
Physician visits	898,482	894,883	2,646,295	2,586,219
Full time equivalents	21,418	20,989	21,208	20,693
Days in patient accounts receivable**	46.5	43.7	46.5	43.7

* Includes entities that are not members of the Obligated Group

** Calculated using 90 days rolling net patient revenue

Note: Certain PY amounts have been updated to provide consistency with 2022

ALLEGHENY HEALTH NETWORK

Management's Discussion and Analysis of Recent Financial Performance

Consolidated Statements of Operations

Year to date September 30, 2022 compared to year to date September 30, 2021

For the nine months ended September 30, 2022, loss from operations was \$116.2 million compared to loss from operations of \$41.7 million for the comparable 2021 period, a year over year decline of \$74.5 million. AHN has experienced an increase in labor costs driven by staffing shortages and higher wage rates resulting from the usage of agency staffing, needs-based bonuses and overtime. Contracted labor costs have increased \$105.4 million from \$40.6 million for the nine months ended September 30, 2021 to \$146.0 million for the nine months ended September 30, 2022. Hospital and post-acute staffing shortages have put pressure on both volumes and length of stay.

Patient care supplies expense also increased over prior year driven by higher infusion therapy drug costs (also driving higher revenue), price inflation on patient care supply commodities, and longer length of stay for inpatient cases.

For the nine months ended September 30, 2022, AHN recorded a deficit of revenue over expenses of \$198.2 million compared to a deficit of revenue over expenses of \$13.7 million for the same period in the prior year, a decline of \$184.5 million. This is primarily due to the increase in operating loss, noted above, as well as a decline in investment results due to market volatility. AHN had a total investment loss (net unrealized losses and investment income) of \$74.4 million for the nine months ended September 30, 2022 compared to investment earnings of \$28.3 million for the nine months ended September 30, 2021, a year over year decline of \$102.7 million.

Operating EBITDA was \$52.6 million for the nine months ended September 30, 2022 versus operating EBITDA of \$105.9 million for the same period in the prior year, a decrease of \$53.3 million. Net EBITDA decreased to (\$1.4) million for the nine months ended September 30, 2022 versus net EBITDA of \$153.6 million during the same period in the prior year. This decrease was driven by operating losses and a decline in investment results as described above.

Volumes, as measured by the combined total of discharges and observation cases, decreased 0.6% (565 cases) from 88,975 cases for the nine months ended September 30, 2021 to 88,410 cases for the same period during 2022. Total surgical cases decreased 3.7% (3,032 cases) from 82,383 cases for the nine months ended September 30, 2021 to 79,351 cases for the nine months ended September 30, 2022. Outpatient registrations, when excluding COVID-19 vaccine registrations, increased 10.6% (119,219 registrations) from 1,125,991 cases for the nine months ended September 30, 2021 to 1,245,210 cases for the same period during 2022. Physician visits grew 2.3% (60,076 visits) from 2,586,219 visits for the nine months ended September 30, 2021 to 2,646,295 visits for the same period during 2022.

Wexford Hospital opened in the fourth quarter of 2021 and accounted for 6.4% of the inpatient volume and 6.6% of the outpatient volume, contributing \$104.5 million of patient revenue for the nine months ended September 30, 2022.

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Management's Discussion and Analysis of Recent Financial Performance

Consolidated Balance Sheets

September 30, 2022 compared to September 30, 2021

Cash and unrestricted investments totaled \$703.3 million and \$1,078.8 million at September 30, 2022 and September 30, 2021, respectively. Days cash on hand decreased by 42 days from 102 days at September 30, 2021 to 60 days at September 30, 2022. This decrease was driven by the scheduled repayments of Centers for Medicare and Medicaid Services (CMS) advances (\$169.2 million) and AHN's first principal payment on the Series 2018A Bonds, partially offset by the receipt of payor quality incentives and funding of strategic investments from Highmark. Additionally, days cash on hand was negatively impacted by declining investment values, driven by overall poor market performance.

Property and equipment increased \$30.2 million from \$1,809.0 million as of September 30, 2021 to \$1,839.2 million as of September 30, 2022. The increase reflects investments in strategic capital projects including Wexford Hospital and Information Technology infrastructure.

Long-term debt (including the current portion) decreased \$46.0 million from \$1,008.5 million as of September 30, 2021 to \$962.5 million as of September 30, 2022. The consolidated joint venture, Erie Medical Complex, LLC ("EMC") held an outstanding mortgage loan of \$19.9 million at September 30, 2021, related to a medical office building. In December 2021, EMC was merged with and into a third party real estate investment trust. As a result of the merger, AHN's interest in EMC was cancelled in exchange for cash consideration, and EMC was removed from the consolidated financial statements. The additional decrease in debt was due to the required principal payments, including the first bond payment of \$18.7 million for the Series 2018A Bonds, and the amortization of bond premiums.

As of September 30, 2022, AHN had a three-year line of credit facility for \$50.0 million that was established in July 2020. \$20.0 million of this amount was set aside for letters of credit, of which \$12.8 million has been utilized for strategic real estate projects, but not drawn upon. No amounts were outstanding at September 30, 2022.

AHN's recorded unfunded pension obligations, related to its defined benefit plans, declined during the first nine months of 2022. Certain defined benefit pension plans are frozen with no new participation permitted. As of September 30, 2022, AHN's recorded unfunded pension obligations totaled \$136.2 million, which was a decrease of \$85.5 million from \$221.7 million at September 30, 2021. The decrease was due to a net periodic benefit credit and unrealized gain activity.

CMS advances decreased \$169.2 million from \$170.0 million as of September 30, 2021 to \$0.8 million as of September 30, 2022. The decrease was attributable to the scheduled repayment of advances provided in 2020 in connection to the Accelerated and Advance Payment Programs. The remaining \$0.8 million was repaid to CMS in October 2022.

Net assets without donor restrictions as of September 30, 2022 totaled \$1,621.0 million. This was an increase of \$73.3 million over the balance of \$1,547.7 million as of September 30, 2021. The increase was a result of the net asset transfers made to AHN by Highmark pursuant to the clinical affiliation agreement and certain pension plan liability changes, partially offset by AHN's deficit of revenue over expenses during the period.

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Management's Discussion and Analysis of Recent Financial Performance

Investments in AHN by Highmark

Highmark has continued to make investments in AHN to enhance AHN's position as the provider core to the Highmark Health IDFS. Highmark is not an obligor or guarantor of the Series 2018A Bonds and none of its assets or revenues are pledged as collateral.

For the nine months ended September 30, 2022, Highmark made investments in AHN pursuant to a clinical affiliation agreement between the parties to support strategic capital investments made by AHN. These capital investments totaled \$148.0 million and were reflected as net asset transfers in the AHN financial statements. In addition, Highmark deposited \$21.3 million in trust for the purpose of paying interest on the Series 2018A Bonds, also reflected as a net asset transfer on the consolidated balance sheets.

State and Federal COVID-19 Funding

In April 2022, AHN received \$11.0 million from the Commonwealth of Pennsylvania pursuant to Act 2 of 2022 enacted under the American Rescue Plan Act, which provided Pennsylvania hospitals with dedicated funding to support nursing recruitment and retention efforts. In July 2022, AHN distributed these funds to eligible employees and recognized the revenue within other operating revenue on the consolidated statements of operations.

In the second quarter of 2022, AHN recognized \$25.5 million from the federal government for Phase 4 General and Rural American Rescue Plan payments. These amounts were reported in other operating revenue.

In the third quarter of 2022, AHN recognized \$91.0 million for Phase 3 American Rescue Plan payments after having made a request for a Phase 3 Reconsideration. These amounts were reported in other operating revenue.

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Appendix

Series 2018A Revenue Bonds Due Dates and CUSIPs

Serial Bonds:

<u>Due Date</u>	<u>Amount</u>	<u>CUSIP</u>
4/1/2023	19,655,000	01728A3H7
4/1/2024	20,665,000	01728A3J3
4/1/2025	21,720,000	01728A3K0
4/1/2026	22,835,000	01728A3L8
4/1/2027	24,005,000	01728A3M6
4/1/2028	25,240,000	01728A3N4
4/1/2029	26,535,000	01728A3P9
4/1/2030	27,895,000	01728A3Q7
4/1/2031	29,325,000	01728A3R5
4/1/2032	30,825,000	01728A3S3
4/1/2033	32,410,000	01728A3T1
4/1/2034	34,070,000	01728A3U8
4/1/2035	35,815,000	01728A3V6
4/1/2036	37,655,000	01728A3W4
4/1/2037	39,385,000	01728A3X2
4/1/2038	40,990,000	01728A3Y0
	<u>\$ 469,025,000</u>	Total Serial Bonds

Term Bonds

<u>Due Date</u>	<u>Amount</u>	<u>CUSIP</u>
4/1/2044	\$ 283,575,000	01728A3Z7
4/1/2047	172,070,000	01728A4A1
	<u>\$ 455,645,000</u>	Total Term Bonds

\$ 924,670,000 Total Series 2018A Revenue Bonds Outstanding