



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

**For the Year Ended December 31, 2022**

**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 of America 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, 2022. 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 Year Ended December 31, 2022**

#### **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 Banner Health Network ("BHN"), Banner – University Health Plans ("BUHP"), Banner Medicare Advantage ("MAPD") plans, and Banner|Aetna commercial health plan (under a joint-venture). 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 operates a broad range of healthcare services, including thirty-two (32) hospitals concentrated in three geographic areas: the greater Phoenix metropolitan area; the greater Tucson metropolitan area; and western state 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, Chandler and Mesa, Arizona.

For internal management and reporting purposes, Banner has organized itself into two operating divisions, Care Delivery and Insurance Operations: (1) Care Delivery includes all provider operations, including academic medical centers, community hospitals, academic and non-academic employed physicians, and all ambulatory care services, including certain (clinical) joint ventures; (2) Insurance Operations includes Banner's accountable care organization and provider network (BHN) including CMS MSSP operations and delegated risk contracts from third party MAPD plans, its commercial insurance joint venture (Banner—Aetna), its wholly-owned Medicaid/AHCCCS contractor plans and special needs Medicare Advantage plan operating under BUHP, and its wholly-owned MAPD plans.

## Financial Reporting Summary

Banner posted \$17M of operating income in 2022, resulting in operating and operating EBIDA margins of 0.1% and 5.6%, respectively. After five consecutive quarters of operating losses, the fourth quarter of 2022 represented a sharp improvement in performance driven by increases in several key volume indicators as well as progress being made to rebuild core nursing staff.

Total surgical volume, including ASC outpatient surgeries, increased over the prior year by 3.7%. The medical/surgical mix climbed to 21.6% compared to 21.1% in 2021. Acute length of stay declined 10.8% year-over-year as the incremental burden created by the pandemic, largely subsided in 2022. Coinciding with the decline in length of stay, the overall case mix index ended the year at 1.80 versus the prior year's 1.83. Outpatient emergency department registrations, physical therapy visits, and imaging procedures all had modest increases in 2022.

Total revenue for the year was \$12.7B, a \$0.3B increase over 2021. Contract labor cost was reduced by \$210M, or 26.2%, through a combination of reduced rate and lower utilization. Supply expense as a percentage of patient revenue increased approximately a full percentage point, primarily driven by inflationary pressures.

Banner's Insurance division continued its pattern of profitable growth as evidenced by a third consecutive year of positive operating income. The division posted an operating income of \$44M, on \$3.1B of revenue, resulting in an operating margin of 1.4%. Total revenue increased 11.2% over 2021 driven by a 9.8% increase in full-risk members and the highest amount of value-based shared savings realized to date. The division's combined medical loss ratio has improved year-over-year from 90.4% to 89.4%; medical loss ratios for most lines of business declined (improved) as management continues to mature its overall care management and utilization review capabilities. The Insurance division has served as a natural hedge to the pandemic-driven disruption of Care Delivery financial performance as Banner continues to mature its insurance strategy across commercial, Medicare, and Medicaid products. Insurance premium revenue now represents 24% of Banner's overall operating revenue stream.

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

	<b>FY 2020</b>	<b>FY 2021</b>	<b>FY 2022</b>
Revenue	\$10,397	\$12,359	\$12,656
Operating expenses	10,086	12,232	12,639
Operating EBIDA	957	830	712
Interest, depreciation and amortization	646	703	695
<b>Net operating income</b>	<b>311</b>	<b>127</b>	<b>17</b>
Nonoperating income (loss)	320	701	(398)
Excess of revenues over expenses attributable to non-controlling interests	44	78	66
Excess (deficiency) of revenues over expenses attributable to Banner Health	\$587	\$750	\$(447)
Operating Margin	3.0%	1.0%	0.1%
Operating EBIDA Margin	9.2%	6.7%	5.6%

Net operating income (loss) for the year ended December 31, 2022 and 2021 are reflected in the tables below, by reporting division:

**For the Twelve Months Ended December 31, 2022**

<i>(\$ in thousands)</i>	Care Delivery	Insurance Operations	Eliminations/ Other	<b>Sub-total Recurring Operations</b>	Cares Act Stimulus	<b>Consolidated</b>
Operating Revenue	\$ 10,270,022	\$ 3,053,120	\$ (727,654)	<b>\$ 12,595,488</b>	\$ 60,462	<b>\$ 12,655,950</b>
Operating Expense	10,377,166	3,009,393	(747,246)	<b>12,639,313</b>	0	<b>12,639,313</b>
Operating (Loss) Income	<u>\$ (107,144)</u>	<u>\$ 43,727</u>	<u>\$ 19,592</u>	<u><b>\$ (43,825)</b></u>	<u>\$ 60,462</u>	<u><b>\$ 16,637</b></u>

**For the Twelve Months Ended December 31, 2021**

<i>(\$ in thousands)</i>	Care Delivery	Insurance Operations	Eliminations/ Other	<b>Sub-total Recurring Operations</b>	Cares Act Stimulus	<b>Consolidated</b>
Operating Revenue	\$ 10,199,319	\$ 2,746,585	\$ (723,434)	<b>\$ 12,222,470</b>	\$ 136,401	<b>\$ 12,358,871</b>
Operating Expense	10,179,224	2,701,383	(648,415)	<b>12,232,192</b>	0	<b>12,232,192</b>
Operating Income	<u>\$ 20,095</u>	<u>\$ 45,202</u>	<u>\$ (75,019)</u>	<u><b>\$ (9,722)</b></u>	<u>\$ 136,401</u>	<u><b>\$ 126,679</b></u>

Performance results for Banner's Care Delivery and Insurance Operations Divisions for the year ended December 31, 2022 include the following highlights:

**Care Delivery** recognized an operating loss of \$47M in 2022 (including \$60M CARES Act funding). Banner's hospitals continue to recover from the impact of crisis-level stress on clinical workers over two plus years that contributed to the 'great resignation' experienced broadly across the U.S. healthcare landscape, requiring unprecedented utilization of ECL at hyper-inflated rates. Banner's commercial lab joint venture - Sonora Quest Laboratories (SQL) achieved a year-to-date operating income of \$113M, trailing 2021 by 30.8%. COVID (PCR) testing demand peaked in January 2022, more than 25% higher than any previous month, and since has stabilized close to historical norms.

Year-to-date net healthcare revenue of \$9B (before eliminations) was essentially equal to 2021 with declines in hospital revenue being offset with increases in free-standing surgery center revenue, increased clinical productivity from employed clinic providers, and modest growth across several other ambulatory business lines.

The shortage of core labor contributed to constrained hospital capacity throughout mid-2022 however, the fourth quarter brought increases in core nurse staff balanced with contract labor to allow for increased volume. Management remains vigorously focused on recovery of its core business and realignment of staffing practices and labor costs.

The **Insurance Division** produced a \$44M operating gain in 2022, compared to \$45M gain in the prior year. Insurance Operations are organized in three sub-divisions: commercial insurance plan joint venture (Banner|Aetna); Banner Health Network (BHN) plans; and Banner University Health Plans (BUHP).

1. **Banner|Aetna (joint venture)** recognized a \$5M year-to-date operating gain, rebounding from a \$3M operating loss in 2021. Full risk membership has increased 11.7% over the prior year. Banner|Aetna covers roughly 380,000 commercial member lives in Arizona with roughly 85% of those members covered under self-funded (ASO) contracts. Note — Banner records full financial consolidation for the Banner|Aetna joint venture.
2. **BHN plans (primarily Medicare Advantage risk contracts and Banner's new stand-alone MAPD)** contributed a \$2M operating gain in 2022; a \$23M improvement over the prior year. The improvement was driven by 2021 MSSP shared savings that were bolstered by a quality score of 98.93, highest in the Arizona market. Banner Medicare Advantage Plans have experienced significant membership growth in their second year of operations.
3. The **BUHP (Medicaid) plans** posted an operating gain of \$37M versus the prior year gain of \$70M. Membership has grown 9.0% year-over-year while the medical loss ratio improved from 88.1% to 87.4%. Higher administrative investments have resulted in improving care coordination activities to reduce avoidable utilization which has produced sustained profitability. BUHP combined is the 3<sup>rd</sup> largest Medicaid plan in Arizona.

### **Non-Operating Performance**

After two-plus years of strong investment performance, resulting in annual investment income of \$653M and \$448M in 2021 and 2020, respectively, an investment loss of \$576M was experienced in 2022 – as economic inflation, muted economic growth, and the Federal Reserve’s actions caused an unfavorable reaction across the investment markets. Interest rate swaps yielded a \$202M unrealized gain as interest rates moved higher but remained low from a long-term historical perspective. Banner remains committed to a long-term investment and financing strategy that anticipates short-term volatility managed under defined risk tolerance guidelines.

### **Balance Sheet Ratios**

Banner’s elongated business recovery and muted operating performance, CMS recoupment of Medicare Advanced Payments, and downward pressures on investment markets resulting in primarily unrealized losses have had modest impact on the indicators in 2022 as shown below:

	<u>2020</u>	<u>2021</u>	<u>2022</u>
Long-Term Debt to Capitalization	37.7%	35.5%	36.0%
Days Cash on Hand	284	256	218
Cash to Long-Term Debt	174%	190%	173%
Historical Annual Debt Service Coverage	4.8	5.9	3.7